

Newsletter Senior Housing and Care



Editorial Notes

We've been inquired by senior housing and care investors about the legal issues on land price, admission fees, loans, tax policies, exit possibilities, among others—all trying to reach the ultimate goal of every business: lower cost and higher profit.

In this edition we pick up two typical issues: is collective-owned land use right that at a lower cost suitable for senior housing? And how to, from an operational perspective, establish a justified pricing mechanism in a senior care facility?

As usual, news updates related to the industry are not only from media, but combined with our understanding as well. We welcome your feedback and suggestion.

—*Michael Qu*

News Update

Legend Holding Invests in Senior Care Industry

Legend Holding as media reported has established an operational enterprise for the business of senior care early this August. The company, with a registered capital of RMB 2,000 million, will focus on operation of senior care facilities, senior housing development and fund management in relevant fields. The company will be navigated by Hony Capital, one sector of Legend Holding engages in PE investment, where funds in RMB and US dollar that value for totally more than RMB 30 billion are in management.

We've find recently capital from home and abroad are targeting at the booming market in senior care industry, not only in real estate and senior facilities, but also very ambitiously aiming to capture the whole profitable chain by equity investment in healthcare, medical, nursing training and financing sectors, etc.

Fantasia Holding Pilots on Senior Housing Development

Fantasia Holding, a leading property developer mostly famous in southern China has recently announced its pace to senior housing development. As alleged, Fantasia Holding has targeted and started construction of two pilot communities in Shenzhen and Chengdu, after years of in-depth research in the area. To pursue this, Fantasia Holding is planning to cooperate with experienced service providers from US, Japan or Taiwan.

Apart from housing, developers in senior's communities will provide convenience service, health care or assisted-living and insurance, where unlike traditional business model, value-added products are believed to create more profits. In lack of relevant experience, but with huge resource of real estate on hand to build senior communities, now developers like Fantasia Holding are seeking cooperative partners in western countries, trying to find out a win-win solution in cooperation.

China Citic Bank Tries on a “Semi-Reverse-Mortgage” Service

China Citic Bank announced on October 9th that it is going to provide a new mortgage loan product for the elderly. According to the introduction, borrower, be senior or his legitimate successor, shall mortgage his apartment to the bank in order to obtain a loan to the senior that paid as monthly pension with a maximum term of 10 years. Among other qualifications for borrowers to apply for this financial product, one is the borrowers should own more than one apartment.

Apparently, this is a product similar to “reverse mortgage” in other countries that we’ve introduced in our last edition of newsletter. However, we think instead of being a typical reverse mortgage product, this is more like a loan service targeting to aged costumers. Without participation of insurance companies who can calculate risks by factoring in senior’s age, average life expectancy, value of mortgage assets and pension amount, the bank is unable to take the risks of unexpected life expectancy and devalue of house—therefore the longest term is only 10 years and at the end of the day, borrower will have to find out how to pay back the loan or otherwise loss his property. We believe as a trial for banks to test the market of elderly service, uncertainty of the market response lies ahead.

Beijing Release Local 12th Five Year Plan on Senior Care Industry



Beijing Civil Affair Bureau this October releases its 12th year plan on senior care industry. Compare with the nation-wide plan, Beijing’s is more specific and practical. From an investment and legal

perspective, we think the following points, among others, are worth noting:

--Explore finance products. Lacking of finance innovation to support senior care industry has been a systematic problem in China for years, and it will not be solved over night. Beijing’s plan encourages trials on long-term care insurance, which is proven an essential supplementary of social insurance in many countries, and “house-for-pension scheme” or “reverse mortgage” with insurance companies, banks and Housing Fund Management Centers involve in.

--Regulatory support on in-home care service, including encouraging private investment in in-home care service, tax preferential and subsidiary policies for service providers. Aiming to establish an industry mechanism that regulate entry and exit threshold for service providers and standardize service criteria and charging rates through industry associations, it is anticipated within year self-discipline alliances may be created with government playing a supportive role.

--Explore preferential policies on land providing and prices for utility fees, improve foreign investment environment. High cost to acquire senior facilities has always been a big concern for many foreign investors. It is still not clear how these preferential policies could be, but Beijing’s plan does shed some lights on a loose regulatory trend in land control.

--Strengthen standardized management in senior facilities by promulgating relevant regulations. If a comprehensive system on service level, assessment methods and match-in charging rates are established in the near future, we believe some illegal or unregulated phenomenon in the market will decrease and eventually customs will benefit.

--Positive on cooperation between profitable provider and non-profit facilities. Recent report has shown big cities like Beijing and Tianjin are constructing senior communities under an affordable housing mechanism, creating a big market for service providers that governments are unable to serve without participation of private players. As a result, well-trained providers with experience in Chinese market are more likely to be selected as government’s partners. Moreover, to run a franchise with a famous brand and mature management seems to be a huge market with great opportunities.

How government can fulfill its targets and to what extent their support could be? And what are situations in other cities? We will continue to probe.

A Justified Pricing Mechanism in Senior Care Facilities

A pricing mechanism in senior care facilities may be related to its service, market environment, customer demands and industrial standards. We may find some investors are always complaining about its unprofitability but unable to raise their price, while some others setting up unimaginable high price to target super high-ending market. People can't help asking-- what happens to the pricing mechanism? Is there any regulatory governing this industry?

A typical situation in senior community

A private senior community in Guangzhou is planning to raise its monthly fee for RMB 100 in response to inflation and increase of operational costs. However, only one out of thirty-six agrees the proposal in a community conference attended by resident representatives. As alleged by a resident, presenting an admission agreement entered into in 2007, he is entitled to live in the community until death after paying entry fee of around RMB 70,000, which is for the purpose of room decoration, and continuously paying a fixed amount of monthly fee to enjoy senior care services. According to this agreement, he thought any price alteration without a prior consent is a breach of contract, even though the service provider had a reasonable excuse of increasing cost of labor and materials.

The dispute here arises is very common in practice, where illustrates the importance of a justified and reasonable pricing mechanism in senior communities.

Regulatory environment on pricing in senior community

Pursuant to PRC Price Law, prices of most commodities and services shall be the market-regulated prices and prices of an extremely small number of commodities and services shall be the government-guided prices or the government-set prices. Market-regulated prices mean those prices determined autonomously by the operators and formed through market competition, while government-guided prices and government-set prices are determined by authorities either in the range of price fluctuations based on benchmark or the specific price mandatorily to act.

There are no nation-wide laws or regulations on pricing requirement in senior communities. However cities such as Guangzhou and Tianjin have their own regulations, saying, prices and service items in private nursing facilities are following market-related price mechanism while in public or non-profit facilities are government-guided. Does that mean private-owned senior care facilities can determine the price as high as they wish? Not that simple.

Administration on pricing and its supervision

First of all, as a principle in Price Law, operators shall, in determining prices, abide by the principle of fairness, being in conformity with law, honesty and credibility. Therefore, production and management costs and market supply and demand situation shall be the fundamental basis for the determination of prices by the operators.

Secondly, pricing in senior care facilities is under double supervision from Civil Affair Bureau and Bureau of Commodity Price. Price can be determined by operators with respect to the service quality and market demand, but certain procedures are to be followed—bulletin the price items and levels in noticeable places and then filing it with the Bureau of Commodity Price. Failure to follow the above procedure, the pricing may be deemed as fraud pursuant to the Consumer Protection Law, and as a result the price mechanism may face great challenge, or more seriously, be imposed of administrative penalties—for example fine and business suspension.

Thirdly, freedom to determine the price for their products and services by operators doesn't necessarily mean they can alter—in most cases raise the price-- at will after consumers have purchased the products or services. Operators shall abide by the admission agreement they have reached with the residents, meaning any unilateral price rising is invalid. However, operators can insert some clauses in the admission agreement that, under certain circumstance price can be adjusted only by notification of the operator. In order to make it legally binding, operators shall avoid this clause from being considered as “form clause” that usually are unfair to consumers by wording the clause very carefully.

Last, if practicable, we advise operators to file their form of admission agreement with relevant authorities. This is not a must step, at least not as required in some industries such as property management, public utility service, house purchase and tourist, etc. And failure to the filing will not result in void of agreement either. However we anticipate while authorities realize regulating price in senior care facilities is of great importance for many people's long-term benefit, it will sooner or later find some method to supervise those at-will price mechanism.

Discuss on some practices

In light of the very principle regulatory environment, some practices are worth discussing:

A. Pre-payment: deposit, entrance fee and membership fee

Deposits are usually paid by residents to reserve a right of admission during project construction, whereas for developers are used as assistance to project financing. As required by Contract Law, 20% of the product price is at top for a deposit. However in practice it is hard to apply in the admission deposit because most of the "products" that monthly paid are without a fixed price. Questions are not only on how much can a deposit be, but also on how deposit will be refund, or deducted from entrance or monthly fee.

Considering of entrance fee, there will always be the types of refundable and non-refundable. By nature of long-term care essence of the service, we think both types are acceptable as long as it can survive the test in marketplace. For refundable model, usually refund certain percent of entrance fee upon death of the resident based on a pre-agreed calculation, it is more acceptable especially for Chinese people; and for non-refundable model, as is practice in western countries for decades, is also proven workable since usually residents will be entitled to enjoy higher level of service with less expense after admission. So the importance here is to specify services and rights that can be enjoyed by residents in connection with the entrance fee, for example specify the condition of accommodation facilities, type or coverage of caring service or meal standard, etc. Moreover, the mechanism of "grace period" can be introduced, whether for non-refundable or membership card practice, in order to give residents a complete reflection of what they really want.

On the other hand, membership card—a variation of ownership-style structure—is very popular in the Chinese market. Customers may have opportunity to receive a return on investment through resale or redemption by developers. In practice, membership cards are sold before construction completion of senior facilities, enables developers to finance their project, or in some cases provides developer with capital to fund other unrelated projects. To avoid being considered as illegal financing of real estate development and take control of financial capability, we advise investors to proceed with selling membership cards only when construction is completed or at least main body of buildings are completed, and reserve certain percentage of income for construction and early operation of the senior housing project.

As long as regulatory enforcement on monitoring pre-payment to protect the resident is in lack, and no requirement for developers to establish escrow account, residents may concern about the financial capability of the developer. It is time for developers come up with affordable guarantee instead of pure promises to convince and educate costumers to accept their product. In addition, investors shall be aware of any future restriction or even prohibition of pre-payment obtained by developers if regulators are afraid of massive financial problems result from real property overheat that may lead to losses to senior customers.

B. Monthly fee

Nowadays, monthly fee for the service plus entrance fee is commonly adopted in senior care communities. Instead of lump sum entrance fee or membership card payment, monthly fee is flexible in items freely for residents to choose and reduce risks in inflation and cost increase on a long-term basis, and therefore, some investors choose this as the single pricing model. As a result, monthly charge varied a lot in different facilities. While it is hard from legal to restrict ranging of pricing, given the nature of senior housing neither a landlord-tenant relationship (which can refer to market rental), nor a proprietor-lodger relationship (which will have a industry-regulated price level), we can only advice operators to strictly follow the rules we mentioned above to mitigate regulatory risks.

In the future, ranging of service rates match up with its standards is to be introduced by industry association and local

regulators. It is also worth mention that sometime monthly fee in dependent-living facilities are more like a rental, therefore it may not cover expense on dining, advanced nursing or assisted-care, recreational, medical or use of other facilities. These plus and optional fees should be priced as reasonable as possible, especially where services are provided with by third-party vendors.

We can assist with senior housing developers and service providers in:

- Advice on structuring business models
- Conduct legal due diligence on project acquisition
- Establish legal entities and negotiate with joint venture partner
- Draft and standardize documents on (a) construction, operation and business transaction; (b) third-party agreements and vendor's contracts; (c) policies and procedure for residency
- Advice on finance, tax and government relation
- Deal with issues on intellectual property, licensing, general liabilities and employment.

Analysis on Land Acquisition or Cooperative Models Based on Collective-owned Construction Land Use Right

Citing from one article of Asia Healthcare Blog wrote by Benjamin—(investment in China's eldercare industry is) an unproven business model in a foreign culture with foundational questions about whether the target market will pay for the services provided all taking place in the midst of a real estate market in China that is very, very expensive.

High price of China's real estate has always been an obstacle for senior housing developers, especially for new entrants. This article aims to discuss the possibility of using collective-owned constructive land use right to open nursing facilities and its approach. Meanwhile we will pay more attention to legal risks that inevitably arise together with lower costs.

Overview of the Chinese land tenure system

First of all, we will have a brief on Chinese land tenure system. The most distinctive feature of the Chinese land tenure system is that land ownership is independent of the land use right. Land ownership is divided into two categories: state-owned land and collective-owned land. Natural persons or other organizations can only acquire land use right and as a result it is impossible for any of them to acquire the ownership of land in China.

Land in China is further classified into three usage categories: (a) Agricultural land, i.e., land directly used for agricultural production purposes, including cultivated land, forest land, grassland, agricultural irrigation land, etc.; (b) Construction land, i.e., land on which buildings and structures are built, including land for urban and rural housing and public facilities, industrial and mining land, land for military and tourism purposes, etc.; and (c) Unused land, i.e., land that does not fall within the above two categories.

Given the purpose of construction of senior housing, in this article, all land use right we are discussing is construction land. In China, when land is to be used for construction, the criteria must be followed as below:

First of all, as a general rule, only state-owned land may be directly used for construction of commercial or profit seeking projects such as real estate development. Secondly, only after collective land is requisitioned, i.e., it is converted to state-owned land, may it be used for commercial project construction and development. Thirdly, if agricultural land is to be used for constructing commercial projects, users must go through the approval and examination procedure with government authorities for the conversion of agriculture use to construction use.

As a matter of practice, the foreign invested enterprises, just like domestic Chinese enterprises, may acquire state-owned land use right by grant, allocation, leasing transfer and so on. But as for acquisition of Collective-owned Construction Land Use Right ("CCLUR"), most investors haven't even heard of this.

The following we will introduce three approaches to obtain CCLUR.

Cooperate with township entities

The Land Administration Law stipulates that the transaction of CCLUR only applies when starting up enterprises or joint ventures together with other units or individuals by way of using land use right as shares, whereas circumstances shall subject to general planning for the utilization of land. Therefore, foreign investors can cooperate with township entity by establishing new enterprises with land use right distributed as capital investment.

Given the nature of this cooperation model, it can only be used in very limited circumstances. There are several points to keep in mind that (a) Whereas occupation of land for construction purposes involves the conversion of agricultural land into land for construction purposes, the examination and approval procedures in this regard shall be required and the contribution of land use right as equity share in new enterprises shall be approved by the local government; (b) the contribution of land use right is conducted only by township entities, and as a result land use right is owned by the new enterprise; and (c) it is use right of the land that contributed in the enterprise rather than its ownership. Therefore the land is still owned by rural collective economic organizations and term of land use right depends on the business purpose of the enterprise.

Transaction of CCLUR

Another way to obtain CCLUR is through legitimate transaction. The transaction of CCLUR includes granting, assignment, leasing or mortgage of CCLUR, etc.

From a local level, the practices and legislation of transaction of CCLUR are very active, especially in Beijing and Guangdong. Take Guangdong as an example, the provincial government has since year 2005 implemented Administration Measures of Guangdong Province on the Transaction of Collective Land for Construction Use to specify condition for transaction of CCLUR.

According to Guangdong's regulation, any transaction regarding collective-owned non-construction land is prohibited before it is legally converted to construction land; the title of land use right shall be clear with peasants' residential land use right excluded; the use of CCLUR shall be complied with general zoning plan for the utilization of land; and the usage of the CCLUR shall be approved by local government. No CCLUR can be used for the development of residential apartments.

As a long-awaited implement protocol, Guangzhou Municipality passed its provision on September 19, 2011 to outline the requirement and procedure for transactions of CCLUR. As stipulated, transaction of CCLUR for the purpose of commerce, tourism or entertainment shall be conducted through public auction, bidding or listing refers to relevant procedures applied to granting of state-owned land use right; the benchmark of land grant price of CCLUR can be at most 30% lower than similar ones as state-owned.

Procedure for transaction of CCLUR includes:(a) issue a bulletin before transaction; (b) hold a meeting within township entity and publicize the resolution of the meeting for more than 15 days; (c) A majority consent letter shall be obtained from all villagers of township entity before transaction; (d) transaction of CCLUR been witnessed by notary public; and (e) be registered of the land use right title in local government.

Leasing premises on CCLUR

More often in other cities like Beijing and Shenzhen, investors may face the situation that no practical procedure can be followed while they just want to lease existing buildings on CCLUR. From a legal perspective, lease of premises built on CCLUR inevitably results in the lease of CCLUR, which will be deemed as a way of transaction of CCLUR. Legal validity of such lease agreement will be arguable given the abovementioned state law and regulation. However, according to a judicial explanation from Guangdong High People's Court, which we believe are also applicable in other cities, the lease contract of premises built on CCLUR is legally valid once permits of construction completion and fire completion are obtained for such premises.

In practice we do find many projects acquired by leasing did not follow the abovementioned procedure but to obtain a majority consent letter from villagers of township entity. The risk here, however, is that the government has the right to requisite the CCLUR for public interest in the terms of lease contract. The landlord and tenant must obey such requisition but only requiring compensation from government.

Lawyer's advice

Obviously, CCLUR and senior housing are very matched with each other given the huge demand of senior care facilities in rural areas. However, coupled with lower costs, risks remains to be highly aware of, that among others, regulatory uncertainty, land use right term and financing difficulty are the biggest three.

First, In the long run, we believe government will implement a more loose and flexible policy. We advice for now investors be very careful at acquisition procedure, government approval on land usage and planning, and, most importantly to obtain majority consent from villagers of township entity. Secondly, unless transaction of CCLUR though due procedure, more often leasing of such a land use right will not result in a secured use term. In case of governmental requisition or breach of contract by landlord, vast investment is at risk. Protect investor's rights under a contract and guarantee method in some cases is a must. Thirdly, pursuant to practice, CCLUR is unable to mortgage to banks for finance purpose, and as a result will bring finance burden to some developers who are aiming to expand in a rapid pace.

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In particular, we provide assistance to clients in the fields of commercial real estate development, retail, hotel & leisure, senior housing & care and private equity investment.

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