

# Client Alert.

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## Snapshot of China Real Estate Market 2012

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For China's real estate sector, the last 18 months has been a relatively quiet period on the legislative front. It has nonetheless witnessed continued efforts by the PRC authorities to control the property market. This client alert reviews some of the efforts and discusses opportunities in some niche areas of the real estate market.

A key theme since the end of 2010 has been efforts to cool the residential market. The price of housing in China's cities has come down from the lofty heights achieved in 2011, but the Chinese government continues to remain concerned about the lack of affordable urban housing. PRC authorities have implemented a series of policies and regulations building upon restrictions first put in place in 2006 through promulgation of Circular 171. (See our [July 2006](#), [February 2007](#) and [January 2011](#) client alerts on Circular 171 itself and subsequent measures.)

The current posture of the PRC authorities is a reversal of the policies adopted during the 2008 financial crisis to encourage the purchase of residential properties and is specifically intended to rein in the rapid increase in the price of urban housing. For the reasons discussed below, the more restrictive policies appear to be here to stay, at least for the time being.

That said, opportunities remain in PRC real estate, especially in the high-end retail sector, office space and sectors that the authorities are promoting, such as senior citizen centers and low income housing.

### 1. CHALLENGES IN THE RESIDENTIAL SECTOR — GOVERNMENT REMAINS COMMITTED TO CURB RESIDENTIAL PROPERTY SPECULATION

Amidst concerns regarding residential real estate speculation and the rapid rise in housing prices, the PRC government has, since April 2010, implemented a series of measures aimed at cooling down the overheated residential property market. Some of the key measures include:

#### (i) Raising Down Payment Requirements and Restricting the Availability of Mortgages.

For example, mortgages for a first residential property currently require a minimum 30% down payment.<sup>1</sup> Higher down payment requirements and mortgage rates apply for a second residential property, and mortgages currently may not be issued for purchases of a residential property beyond a second residential property.

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<sup>1</sup> See (i) the Circular on Determined Suppression of the Exceedingly Rapid Rise of Urban Housing Prices in Certain Cities (国务院关于坚决遏制部分城市房价过快上涨的通知) issued by the State Council on April 17, 2010; (ii) the Circular on Issues Concerning Improving Differentiated Housing Loan Policies (中国人民银行、中国银行业监督管理委员会关于完善差别化住房信贷政策有关问题的通知) issued by the People's Bank of China and the China Banking Regulatory Commission on September 29, 2010; and (iii) the Circular on Issues Regarding the Further Regulation and Control of the Real Estate Market (国务院办公厅关于进一步做好房地产市场调控工作有关问题的通知) issued by the General Office of the State Council on January 26, 2011.

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## **(ii) Implementing Residential Real Estate Tax Pilot Scheme in Shanghai and Chongqing.**

In January 2011, the municipalities of Shanghai<sup>2</sup> and Chongqing<sup>3</sup> implemented pilot schemes imposing real estate taxes on residential properties owned by individuals. The Shanghai property tax scheme only applies to second or additional residential properties purchased after January 28, 2011, while the Chongqing scheme only applies to “high-end apartments” and “villas”. Although currently limited to Shanghai and Chongqing, it is expected that the program will be expanded to other cities.

## **(iii) Approximately 40 Cities Currently Limit the Number of Residential Properties that a Household May Purchase.**

Since the beginning of last year, approximately 40 Chinese cities, including Beijing, Shanghai, Tianjin, Dalian and Guangzhou, have issued measures that restrict the number of residential properties residents may purchase.<sup>4</sup>

## **(iv) Foreigners Continue to be Restricted to Buying One Residential Property for Self-Use.**

A November 2010 measure underscored the rule first introduced by Circular 171 that only foreign nationals residing in China for one year or more are eligible to purchase one residential property for self use.<sup>5</sup>

## **(v) The Newly Amended Catalogue Guiding Foreign Investment Moves Villa Projects from the Restricted to the Prohibited Category.**

As reported in our [January 30, 2012 client alert](#), the latest revision of the *Catalogue for the Guidance of Foreign Investment in Industry* prohibits foreign investment in the construction and operation of villas. Under previous iterations of the catalogue, foreign investment was allowed but restricted in these sectors.

## **(vi) Enforcement of Regulations at the Local Level.**

In response to the nearly two-year long government curbs, housing prices in February 2012 in 100 major Chinese cities fell for a sixth consecutive month, and such curbs appear to be here to stay, at least for some time. Attempts by local governments to ease these curbs have been quickly reversed. For example, within one month of announcing a relaxation of restrictions, both Shanghai and Wuhu (a city in Anhui Province) re-implemented

<sup>2</sup> See the Tentative Measures of the Shanghai Municipal People's Government on the Launch of the Pilot Scheme for Levy of Real Estate Tax on Certain Residential Real Estate Properties for Individuals (上海市开展对部分个人住房征收房产税试点的暂行办法) issued by the Shanghai Municipal People's Government on January 27, 2011.

<sup>3</sup> See the Tentative Measures of the Chongqing Municipal People's Government on the Launch of the Pilot Scheme for Levy of Real Estate Tax on Certain Residential Real Estate Properties for Individuals (重庆市人民政府关于进行对部分个人住房征收房产税改革试点的暂行办法) issued by the Chongqing Municipal People's Government on January 27, 2011.

<sup>4</sup> See, e.g., the Circular Regarding Implementation of the City's Policy to Restrict the Number of Residential Properties for Purchase (关于落实本市住房限购政策有关问题的通知) issued by the Beijing Municipal Commission of Housing and Urban-rural Development on February 16, 2011 and (ii) the Circular on Printing and Issuing the Opinions on the Implementation of the Circular of the General Office of the State Council on Issues Regarding the Further Regulation and Control of the Real Estate Market (上海市人民政府办公厅印发本市贯彻《国务院办公厅关于进一步做好房地产市场调控工作有关问题的通知》实施意见) issued by the General Office of the Shanghai Municipal People's Government on January 31, 2011.

<sup>5</sup> See the Circular on Further Regularizing the Administration of Real Estate Purchases by Foreign Entities and Individuals (关于进一步规范境外机构和个人购房管理的通知), jointly issued on November 4, 2010 by the Ministry of Housing and Urban-Rural Development and the State Administration of Foreign Exchange (“SAFE”).

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curbs on residential purchases.<sup>6</sup> However, there is speculation in the market that minor adjustments to the curbs, but not any major loosening of the current residential real estate policies, may be permitted.

## 2. OPPORTUNITIES IN NON-RESIDENTIAL SECTORS

In the non-residential property sector, we note the following trends:

### (i) Retail.

Despite the softness in the residential market, most cities saw steady and strong upward growth in retail rents, and the market expects to see a further uplift in rents this year. Strong retail rentals are attracting investors' interest in further high-end retail development, which appears to be driving the growth in the retail sector.

### (ii) Office.

Despite uncertainties in the global economy, many major cities recorded increases in office rent, in part driven by a lack of supply. In Beijing, the demand for limited high-quality office space has resulted in the city's "average occupancy costs" surpassing those in New York City (Midtown).<sup>7</sup> Beijing is currently ranked as the fifth highest in the world for average occupancy costs, just ahead of New York City (Midtown).<sup>8</sup>

## 3. OTHER OPPORTUNITIES AND TRENDS FOR 2012

Despite restrictive policies in the Chinese residential real estate sector, there continue to be opportunities for developers and investors, especially in areas where business strategies are aligned with government policies.

### (i) Affordable Housing.

The Chinese government has set a goal to build 36 million affordable housing units (i.e., low-income housing) between 2011 and 2015. To help realize this goal, the government has released a series of measures in an effort to broaden funding sources and increase investments in affordable housing projects, from both the public and private sectors. For example, affordable housing developers may qualify for exemptions from certain government fees (e.g., infrastructure fees) and enjoy certain tax benefits; e.g., reduced urban land use tax and stamp duties. In addition, PRC banks offer preferential lending rates for affordable housing projects.

### (ii) Senior Citizen Care Facilities.

The demand for senior citizen care facilities in China is rapidly increasing. In order to encourage further investment in this sector, the Ministry of Civil Affairs has established a regime with tax benefits and preferential policies for land grants and public utilities for the development of senior citizen care facilities. Industry watchers believe this sector will continue to show strong growth as China grapples with a rapidly aging population and the impact of the one-child policy (which leaves a single child to care for both parents).

<sup>6</sup> On February 12, 2012, Wuhu suspended the implementation of the Policies on Strengthening Housing Assurance and Improving Residents' Housing Conditions (关于进一步加强住房保障改善居民住房条件的若干意见) issued by the Wuhu People's Government on February 7, 2012, which was intended to waive the deed tax for purchases of ordinary housing for self-use and subsidize some purchases. In the same month, the Shanghai government restated housing purchase limitations just a week after it relaxed them by allowing people who have lived in the city for at least three years to buy a second residential property.

<sup>7</sup> Based on Cushman & Wakefield's global report on average occupancy costs for 2011.

<sup>8</sup> *Id.*

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### (iii) Likely Increase in M&A Activities Involving International Investors.

Chinese real estate developers are increasingly experiencing difficulties obtaining financing through traditional channels, such as bank and trust company lending, due to tightening by bank regulators.<sup>9</sup> Given this situation, Chinese developers/investors may increasingly look to foreign investors to come in as joint venture/equity partners to provide needed capital for development projects. We believe this trend will continue.

### (iv) Chinese Buyers Increasingly Looking Overseas for Real Estate Acquisitions.

We see increased activity by large PRC companies looking overseas (mainly in the US, Canada, Australia, Europe and Southeast Asia) for real estate acquisitions. For example, HNA Property Holdings (the real estate arm of Hainan Airlines Group, China's fourth-largest airline group) purchased the 165-room Cassa Hotel in midtown Manhattan from Assa Properties for approximately US\$130 million in January 2012, in addition to its purchase of two Manhattan office buildings between May and June 2011. Since 2008, the Bank of China has increased its loan portfolio exposure to U.S. properties fivefold to US\$2.6 billion, with most of that growth related to properties in New York City.

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<sup>9</sup> In addition, foreign shareholder loans have not been permitted as a source of development funding since the promulgation on July 10, 2007 of the Notice on the Circulation of the Name List of the First Batch of Foreign Invested Real Estate Projects filed at the Ministry of Commerce issued by the General Department of the State Administration of Foreign Exchange (国家外汇管理局综合司关于下发第一批通过商务部备案的外商投资房地产项目名单的通知).