Editorial Notes

Welcome to the latest edition of China Commercial Real Estate Insight. A very busy season in real estate transaction notwithstanding the world's fighting with another round of economic turmoil. China is still a booming market for real estate investment. Those interested in commercial buildings and senior housing have never stopped their steps, while some big deals in investment are closed this month very impressively.

As usual, our newsletter tries to pick out lately legal updates that investors in senior housing are mostly care about—one is on a newly implemented social insurance policy to foreign employees that makes distant retirement more viable; another on a snapshot of some stimulations for senior housing from local government. In our case analysis part, we bring about a case on house-for-pension agreement dispute. You may find how risky it could be to arrange a house-for-pension scheme, given the immature legislative environment. Moreover, in this edition of newsletter, we'll see how PE funds are keen on real estate investment in China.

—Michael Qu

Legal Update *Senior Housing and Care*

Social Insurance to Foreign Employees Makes Distant Retirement More Viable

The Ministry of Human Resources and Social Security recently released a new nation-wide policy regarding foreign employees' participation in social insurance scheme. According to the regulation, as of October 15, 2011, foreigners employed by companies incorporated in China and those under a secondment arrangement must participate in the social insurance scheme, which includes basic pension insurance, basic medical insurance, work-related injury insurance, unemployment insurance and maternity insurance.

The implementation enables foreigners who have worked and lived in China to stay when they retire, thanks to the pension payment as is enjoyed by Chinese citizens.

Although this seems not to be a trend in the future while the scheme allows an insured foreigner to withdraw his or her individually deposited funds once he or she leaves, and most elderly prefer to live in their hometown after retirement. In addition to the fact only enterprise annuity can be resorted to as a supplementary pension, and personal pension saving plans like US's 401k or IRA is still impossible in China, it seems the pension enjoyed in a social insurance scheme is not enough at all.

However, we have to admit that seasonally migrate to a favorite city where social insurance can be enjoyed is a good alternative for some people. This new policy makes it more viable.

More Stimulation to Be Seen in Senior Care Industry

Since this April the Standing Committee of the State Council promulgated the 12th Five-year Plan on the Development of Chinese senior care, some initiatives are seen from local level of the Chinese authority.

According to the national scheme, private capital include foreign investment is encouraged to take part in the sector. The plan outlines various high-level goals to stimulate the construction of senior living communities, establish more nursing facilities that target to provide 3% of occupancies for nation-wide elderly by 2015, and implement more legislative incentives to attract private and foreign investors.

Some investors complaint they can't find transparent policies governing the senior care sector, however that's not the whole picture. Since the Civil Affairs Bureau is responsible for senior care industry, and different localities have varied financial capability on supportive measures, so searching for policies from a local level could be easier. For example, Beijing is planning to construct some occupancies for elderly in affordable houses, and the municipal government has increased the subsidy for construction of senior care facilities; in Jiangsu Province, some cities are experimenting on integration of medical insurance and senior care system aiming to enable the elderly to enjoy medical social insurance in senior care facilities. It is also expected, in the near future, preferential policies on land supply and tax treatment will be introduced that will diversify in different cities.

Case Analysis *Senior Housing and Care*

Does "House-for-Pension Scheme" Work — Be Careful

By Michael Qu Attorney at Law

In China, it is only those from civil services and a very few selected ones are fortunate to have enough employee pension who will have a steady income to afford retirement life in private senior houses. Even though recent year we've seen some companies have started the enterprise annuity business and provide commercial pension insurance products for the employees in order to make up for the inadequacy of social security and to meet citizens' higher needs for pension insurance, retire pension for seniors at this moment is still insufficient.

The situation is that most elderly have capital locked up in real properties with no steady income, so their only real option would have been to remortgage their flat or to sell it to raise capital. A house-for-pension scheme or a reverse mortgage program may solve the problem. However, by far neither seems to be easy in China.

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Apart from the traditions that most elderly prefer to leave properties to their descendants rather than sell for living, a workable scheme to unlock paper appreciation of the real property owned by the elderly to at least support themselves a decent life is still required by some elderly, especially the ones in "empty nest" families. Among others, house-for-pension scheme is definitely a good choice. Unlike reverse mortgage, in a house-for-pension scheme, homeowners usually sell their homes, whether to service providers or buyers in the fair market, in the first place, while in a reverse mortgage the property is still held by the homeowner until he or she passes away or chooses an early termination in some cases.

A House-for-pension Case

To be clarified, there is no officially legitimate practice in reverse mortgage, and house-for-pension schemes are only piloted in some cities, those who want to provide such a scheme can only make this happen by reach an agreement with the homeowners. However, reaching a legal binding agreement sometimes seems to be uneasy. One case recently sentenced by a Shanghai district court may find a snapshot. In this case, a service provider at the end of 2010 closed a deal with an elderly homeowner of 88 years old. The elderly sold its house of 55 square meters to the company at a price of RMB 550,000; in return, the elderly is entitled to live in the senior house provided by the company free of charge until his death. In other words, the property was sold to the company in the first place — the homeowner would no longer enjoy the appreciation of real property and the company would take the risk of increase in life expectancy of the elderly. First instance of this case rules that the deal should be withdrawn resulting in restore of the house to status quo ante.

The court judged for two reasons — unfairness of the selling price of the house (relatively lower than the market value of the house); and failure to performing disclosure and informing obligations by the service company.

While the court did not in essence say no to the practice, similar house-for-pension agreement between homeowners and service providers, from our opinion, is still legally binding and workable subject to the following requirements.

(a) Fully disclose the rights and obligations of the deal. In the abovementioned case, the court thought for elders at that age, service provider should inform his children or relatives, or even take notary to clarify rights and duties throughout the deal, in order to make sure the deal is concluded through a fair and sufficient consultation.

(b) Fairness of a house-for-pension deal. Among other terms and conditions in the agreement, the most important one is that the selling price of house reflects its market value. Taking into consideration of the expenses arise from the deal, the service company should pay by lump sum or installment as pension to homeowners. While most of the elderly prefer to leave any surplus to their children upon their passed away or reserve their right to redeem the property in case they change their mind, technical fitness to the deal needs to be designed to meet that kind of demands.

(c) Being granted confirmation by the homeowner's children or couple. Whether or not the homeowner, legally speaking, has sole and full discretion to make decision on his or her properties, this essential step may mitigate many risks and trouble in the future. In cases that service providers give a fixed term commitment to their customers coupled with specific repayment date, they will have to consider the risk the elder's children may not be able to or willing to take guardianship of their parents once the term expires. A prior guarantee from the children therefore will be helpful to some extent.

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Urge for Reverse Mortgage

Given the ambiguity of legal formation of house-for-pension scheme, we anticipate policies on reverse mortgage to be released in the near future. Recently we've seen Hong Kong for the first time introduce its Reverse Mortgage Program ("RMP") that enables homeowners to use their self-occupied properties as collateral to borrow from a participating bank whilst continuing to stay at the properties for life. Reverse mortgage enables the elderly to stay in their homes, and at the same time obtain steady loan payments to help improve their quality of life.

According to RMP, a reverse mortgage is a residential mortgage product specifically designed for elderly people. Participants will use their self-occupied and non-mortgaged homes as collateral to apply for reverse mortgage loans with banks, and will receive a secure stream of monthly loan payments. At the same time, the elderly can remain in their homes for the rest of their lives. They do not need to repay the loan or pay any interest or mortgage insurance premiums during their lifetime. The banks will possess and dispose of the properties upon the death of the elderly to cover the accrued principal, interest and mortgage insurance premium. Any surplus will go to the inheritors.

Even though market response will determine whether the scheme will operate in the long term, we anticipate this could be a good model for China given the similar traditions and social environment.

One report we've found from an insurance company that they are preparing a reverse mortgage scheme, which is waiting for approval from authorities and could be implemented as early as the end of this year. Before this announcement, we've seen some unsuccessful practice, whether in Shanghai or in Nanjing, mostly failed due to unbalance between profits and costumers' acceptance.

Lawyer's advice

Taking out a house for pension deal may be a major decision for elderly homeowners in their twilight years. Especially when their homes are likely to be their most valuable asset, it is important for these elderly homeowners to fully appreciate the nature of a house for pension deal in order to make an informed decision for themselves. Many successful schemes elsewhere provide a counseling service for those who are interested, and therefore we advice service providers to establish an effective counseling mechanism whereby lawyers can help people understand the details before they decide whether to join the scheme.

Industry Highlight *Real Estate Investment*

KKR forms China RE fund – A Typical Transaction on Fund Establishment and PE Investment

On 5 September 2011, SOL HK (a wholly-owned subsidiary of Sino-Ocean Land "SOL"), Chance Bright (a non wholly-owned subsidiary of SOL through Gemini) and KKR SPRE (an affiliate of KKR China Growth Fund L.P.) entered into a Framework Agreement in relation to the establishment and management of a Fund and JV Entities.

According to the Framework Agreement, SOL HK and KKR SPRE respectively agreed to inject USD 70 million into the Fund as limited partners. The Fund has a term of five years since the date of accepting capital injection. Besides, Gemini and KKR SPRE will subscribe for shares in the joint-venture entity at face value to hold 50% shares each, in order to manage and administer the affairs and investments of the Fund.

The Fund, called Sino Prosperity Real Estate, had been registered in the Cayman Islands where the KKR China Growth Fund is also established. A statement by SOL to the Hong Kong stock exchange said the investment platform was intended to invest in certain real estate projects in the People's Republic of China.

SOL also signed an investment cooperation agreement with the Fund, on basis of which the fund and SOL subsidiary Chance Bright signed an investment agreement. The Fund will purchase part of equities and bonds of Chance Bright held by SOL HK but excluding the interests and rights of a hotel contained in a Dalian-based project under construction.

From our perspective, we think on one hand, funds are established through offshore vehicle so to make equity investment from abroad, while more often, RMB funds incorporated onshore will be more convenient for equity investment, especially for real estate funds; on the other hand, equity investment usually counts on the settlement of a project as quit solution, or otherwise being brought out by another investor. On top of that, even though long-wait REITs regulations are still pending, we have seen most fund investment prepared in a pattern ready for future REITs adoption. We will discuss REITs updates in China from a legal perspective in our next edition of newsletter.

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