No Longer Lagging Behind: China Within the Past Five Years

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Not too long ago, the usual stereotype still depicted China as an under-developed country — whether politically, socially or technologically. Now, times have changed. Anyone who has yet to pay a visit to one of the cities in China is considered to be outdated or behind instead. Every corporation, regardless of whether they are international or local, large or small, wants a share of the profit pie by establishing a presence in the PRC with its 1.2 billion population.

During the 9th Five-Year Plan period, which covered 1996 to 2000, China recorded remarkable economic achievements and its living standards experienced rapid improvements. In fact, growth has been so striking that China has truly become the focus of attention on a global basis. Every pair of commercial eyes is adamantly focused on China's rate of development, hoping to capture the perfect timing for entry or seizing the opportunities of the market. Between 1996 and 1999, China's gross domestic product (GDP) increased by an average of 8.3% each year, and by the end of 2000, the annual GDP per capita in China was expected to surpass US$800. Thanks to China's steadily growing economy, the average urban citizen's annual income increased by 5.6% while the average farmer's income experienced a surge of 5.4%.

One of the main reasons for robust economic growth in the past five years has been strong and steady foreign direct investment. As of the end of July 2001, foreign direct investment reached a total of US$372.8 billion. Lured by low costs, productive and industrious workers, an abundance of talents and the hope of a huge domestic market, manufacturers worldwide are expanding their operations in China. Although China has already become a global centre for manufacturing, it has also been rapidly building its capability in the more knowledge-intensive areas of software development and services. China is experiencing what may be considered a virtuous cycle: a steadily more prosperous China will mean a larger market; a larger market will generate more investment opportunities; and ample attractive investment opportunities will allow China to become a more significant trading partner. As China exports more, it will also import more. And it's market will only continue to get larger in the future.

But that would be the long-term effect. In the short term, an emerging China will lead to dislocations as industries restructure and trade patterns change. Some workers will become jobless while other industries will demand workers of different and/or specialised skills. Countries that are in the same markets and competing head-on with China may suffer from painful adjustments. The attrition is ruthless, but the survivors will be formidable. Many multinational manufacturers have already shifted their plants into China to utilise the low cost production resources and to enhance their profit margins and competitiveness in the global market. As a result, China has attracted an enormous amount of foreign direct investment, which in turn has created immense job opportunities. Thanks to its potentiality and appealing characteristics, China owes itself a big vote of gratitude for its formidable economic growth in the last five years.

This remarkable economic growth has also played an important role in establishing a solid foundation for China's successful housing reform policy. Sales of residential properties to individuals in 2000 achieved their highest level in history. Urban citizens spent a large portion of their money buying properties, and by the end of 1999, 70% of urban families owned their homes. The average living space in cities increased to 10.0 sq.m. per person in 2000, from 8.1 sq.m. in 1995. Nevertheless, China still has a long way to catch up with the living space standards of developed countries.

10th Five-Year Plan (2001-2005) Dedicated to Property Development

In March 2001, the National People's Congress passed the 10th Five-Year Plan, considered to be a roadmap for 2001-2005. The country's construction authorities aim to increase living space for average urban residents to 23 sq.m. by the end of 2005. According to the Ministry of Construction, this will be the main priority of the housing departments during the 10th Five-Year Plan period. Over the next ten years, there exists great potential in the housing sector due to the gap in average living space between China's housing and that of developed countries. According to economic models, residents will invest more in properties if their average annual income reaches US$800 to US$1,500, and according to the World Bank, rational housing prices should be three to six times a family's annual income.

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To catch up with world standards, China will aggressively speed up housing reforms and apply advanced technology to housing construction. For the upcoming five years, China aims to increase the trading of old for new houses, since the expansion of residential rental markets is another priority of the housing authorities. At the same time, the government will build more low-cost houses for rent to low-and middle-income families in order to take care of those with less financial capabilities. With its imminent entry into the WTO, China will prepare itself for this highly anticipated event by strengthening the reform of its building companies. Despite all the efforts dedicated to speedy development, the scale of Chinese real estate firms is still a far cry from those of developed countries, both in terms of capital funding and of technical capabilities.

By the end of the 10th Five-Year Plan period, China's GDP is expected to reach Rmb1.25 trillion and GDP per capita will reach Rmb9,400. This translates into an average annual rate of 5% growth in income per capita.

Policies To Stimulate Economic Growth

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As an effort to boost domestic demand and to achieve an average annual growth of 7% during the 10th Five-Year Plan period, the Chinese Government will take measures to stimulate state investments and public consumption in order to sustain the economic boom. It has announced a series of massive investment plans that will be financed through bond issues and bank loans for the coming years. These ambitious schemes include the “Go West” campaign for the western provinces, an expensive pledge to rebuild Beijing for the 2008 Olympic Games, and a gigantic diversion project to transport water from the Yangtze River to irrigate the arid northern provinces. The much awaited Three Gorges Dam — the biggest hydroelectric project in the world — is already under construction and will be completed in the near future.

Other government measures include an increase in the social welfare fund, a 30% salary raise for civil servants, tax rebates on exports, and the opening up of more industries to foreign investment, ranging from building, finance, tourism, education and infrastructure, to services trading and information technology. It also intends to encourage foreign investment in the western part of the country through tax concessions.

Update On Housing Reform Policy

After abandoning the traditional welfare housing allocation system at the end of last year, China will strengthen its housing reform policy this year with a formal inauguration of the new system, which aims at privatising the country’s residential housing sector by encouraging state workers to purchase their homes. Currently, amongst China’s 35 major cities, 30 have already implemented and executed the new policy. With the help of the government’s fiscal and banking policies, housing reform has achieved remarkable progress in the last three years. Individual home purchases accounted for more than 90% of residential sales in most cities.

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The new reforms are dedicated to the establishment of seven systems: housing allocation, supply, market, finance, agency, property management and government macro-control. After the plan is initiated, the government will push ahead with the seven systems and lay particular emphasis on implementing them in different periods. Several policies or regulations have been introduced since the announcement of the new policy:

(1) To further enhance state workers’ home-purchase power, the Chinese Government announced that the salary of civil servants would be raised by 30% by the end of 2001, which is equivalent to 100 Yuan added to basic salary. This is the fourth salary hike since 1988 and is estimated to cost the government 70 billion Yuan.

(2) On the supply side, with an average living space of only ten sq.m. per capita in urban areas, housing for the Chinese is far below average world levels in terms of space. To improve the situation, the Chinese government has decided to speed up construction of residential housing in its 10th Five-year Plan period (2001-05).

(3) In a bid to reduce the tax burden and encourage people to rent out their properties, the tax authorities announced that starting from next year business tax levied on rental income would be trimmed from 5.5% to 3%. At the same time, individuals' income derived from rent will be taxed by 10% rather than the much higher rate applied to Individual Income Tax.

(4) To protect buyers' interests and build up their confidence in home purchasing, new regulations for property sales have been introduced. The new property sales regulations that took effect in June 2001 will help the development of China's residential market. The regulations impose pre-conditions for applying presale consents, require the preparation of sales brochures, and provide measures to ensure that the final products do not differ from show flats.

(5) Increasing efforts are being made to regulate property management and property brokerage business in light of the growing complaints of malpractice. In order to bolster the confidence of homebuyers, China will introduce a property management law by the end of this year.

(6) Business tax and contract tax imposed on unsold apartments constructed before 30th June 1998 will continue to be exempted until 31st December 2002 in order to facilitate sales of these vacant flats.

(7) In April 2001, the State announced the elimination of 47 fees charged previously on real estate developers so as to make development costs lower, and ultimately, to make housing more affordable for individuals.

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(8) To further strengthen its housing reform policy, the Ministry of Construction is mulling over the relaxation of requirements for real estate companies listed on the PRC stock exchanges.

Land Policy

Having announced a stricter control policy over the usage of land for building last year, the major tasks of the Municipal House and Land Administration (MHLA) this year will focus on the administration of the new policy. Under the new regulations, the municipal government will take over the responsibility for authorising the usage of non-farming land below 0.70 square kilometers and

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farming land (excluding the most-protected farmland) below 0.35 square kilometers. The MHLA will strengthen its measures to clamp down on illegal land supply activities, such as the change of land usage and plot ratios without proper approval and to supply more land than that allowed by the municipal government. It will also enforce the land policy on reclaiming site areas left vacant for more than two years.

To ensure the transparency of land supply and avoid wastage of land resources, state-owned land supply will be centralised by the municipal governments and granted through public land auction and tenders. This new regulation helps to establish an open and fair disposal system to complement China's accession to the World Trade Organisation. At present, developers are building up their land banks in the city through private negotiation with district government units. The new system aims to better control and coordinate land supply and to help foster the long-term development of the property market.

Starting from 1st August 2001, the demarcation between so-called domestic-sale houses and foreign-sale houses has been lifted in Shanghai. Previously, expatriates and Chinese from Hong Kong, Macau and Taiwan were restricted to buying specially targeted houses — foreign-sale properties — while Chinese on the mainland could only buy domestic-sale houses. Foreign-sale houses are generally more expensive than apartments targeted for local Chinese buyers, since plots designated for foreign-sale house development were sold to developers for almost double their value on the domestic-sale market. The lifting of the demarcation will ensure more housing demand from overseas buyers and help to stimulate the property market.

Secondary Market

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China's second-hand housing market is expected to start booming as more and more provincial governments take action to deregulate the housing market. Formerly, there were four main obstacles keeping the secondary market from development:

(1) Complicated and time-consuming procedures on the completion of sales registration.

(2) Heavy taxes such as contract tax and value added tax together with the payment of land premium costs on the purchase of public housing contributed to high transaction costs.

(3) A lack of qualified brokerage agency firms with the result that malpractice on fee charges and services caused many complaints.

(4) Insufficient mortgage financing from banks.

Major cities like Beijing, Shanghai, and Guangzhou have already taken steps to address these problems in the past few years. Nowadays, the purchase and sales registration procedures have been simplified with the result that the transaction period has been largely reduced to around two weeks. In Shanghai, the contract tax of 1% on transaction prices charged by the government on any property transaction has been waived for public houses bought before 2000 and sold anytime in the future. Whereas for pubic houses bought in 2000 and thereafter, the contract tax to be charged will be 1% of the purchase cost. Starting from 1st July 2001, Shenyang will also adopt a new policy to stimulate the secondary housing market. The procedural fee charged on any property transaction will be reduced from 1% to 0.5% of the transaction price and the threshold for charging contract tax will be raised from Rmb 4,000 per sq.m. to Rmb 8,000 per sq.m. For public housing purchased before 1st January 2002, there will be no need to repay the land premium to the State Land Bureau when the unit is sold in the future. For individuals using bank loans to finance home purchases, the mortgage instalment repayment from their salary is tax deductible on calculation of the Individual Income Tax.

In order to regulate property sales agents following the increasing number of complaints of malpractice, the Chinese government has decided that sales agents need to be trained professionally and agency firms need to acquire legal business licenses before they can carry out business, effective as of 1st June 2001. In addition, apart from sales commission, they cannot procure any other fees or charges. This is to ensure that homebuyers obtain the best and most professional services.

To enable more people to buy their own homes, Shanghai's commercial banks have promoted housing loan programs and simplified the mortgage application procedure. Banks have also adopted measures to help lower-income families to enter the property market. For example, the Industrial and Commercial Bank of China in Shanghai is allowing buyers to use other property as security for 100% mortgages. Mortgages and public housing funds for second-hand property have also recently become available for consumers.

A new type of house lease, or the so-called "house bank", has been launched in the Shenzhen, Shanghai and Beijing markets recently. The main function is to provide house owners with a comprehensive personal finance service and to diversify the banks' consumer business sector. Once a client or house owner wishing to lease a house agrees with the rental amount evaluated by the bank, he or she can leave the often very complicated and tedious renting process to the bank; for example, looking for suitable tenants, signing the contract and collecting the rent. Regardless of the house being let or not, the agreed rental will be transferred to the client's account automatically at a designated date every month by the bank. If the actual rental is higher than the evaluated amount, 80% of the higher figure goes to the client and the rest belongs to the

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bank. Other fee collection services the bank can provide range from water and gas to electricity and telephone. The bank will deduct 45 days for tenant searching every year, during which no rental income will be paid to the client. The client is therefore free from intricate house leasing and management as long as he signs the lease contract with the bank. Most importantly, this service is commission-free, or in other words, neither the landlord nor the tenant will need to pay for the service. The introduction of such a leasing service will help standardise and boost the development of the house lease market.

Mortgage Market

On 21st March 2001, the Industrial and Commercial Bank of China (ICBC), the country' largest commercial bank, disclosed that it will grant 155 billion Yuan (US$18.7 billion) in housing loans this year to further optimise its credit structure. Out of the total, 80 billion Yuan (US$9.6 billion) will go to housing loans for individuals while the rest will go to housing construction projects and other large developments. ICBC has been increasing the volume of individual loans since 1995 as an effort to develop consumer loans and to help the State revitalise domestic consumption. Individual housing loans may constitute some banks' best assets because the delinquency rate is very low. According to statistics by ICBC, less than 0.6% of individual borrowers could not afford to make payments on time last year, which puts them on par with international borrowers in terms of reliability. The figures released by the China Construction Bank also indicated that only 1.97% of individual banking loans resulted in bad lending in its six-year practices. ICBC said it would continue to accelerate its housing credit businesses over the next few years. By 2005, the bank expected to provide no less than 500 billion Yuan (US$60 billion) in housing loans to at least five million families nationwide. To realise this goal, ICBC has begun developing new housing-related products, including mortgage loans for second-hand houses and individual remodeling loans.

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Such relaxed credit policies, however, were clouded by a circular issued by the People's Bank of China in June 2001 regarding regulation of the housing financial sector. The circular demanded that all commercial banks must strictly examine related conditions for real estate development loans. Borrowers of such loans should be qualified developers with a good credit record and the loans should be put into housing development projects with good market prospects. In addition, the developers' self-owned capital should be no less than 30 percent of the total investment in the projects. When granting mortgage loans to individuals, the actual value of the pledged assets should be strictly evaluated, the proportion of the loan to the pledged assets should not be higher than 80%, and zero down payment is forbidden for individual housing loans. The circular also called on commercial banks to further improve housing financial services. Efforts should be made to expand new credit businesses while minimising credit risks.

Many people think that the circular portents a change in the easy credit policy and is the first step to a curb on housing mortgage loans. But if we examine the circular more closely, it actually aims to rectify the housing financing market rather than to tighten up credit policy, since the delinquency figure for individual banking loans is still relatively low. The circular's intention is to standardise housing financial business and to minimise housing loan risks in order to boost the development of housing finance. Indeed, there is a possibility that the circular might push smaller, financially weaker developers out of the market and might squeeze more loan quota for the big real estate developers.

In August, the State Economic and Trade Commission announced that China's pawnbrokers could now provide mortgage loans, not only on moving assets but also on non-moving assets. In effect, this means that they can provide housing mortgage loans. The new regulation provides another channel for individuals to obtain house financing and to make home purchasing more affordable.

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Property Management Sector

China currently has roughly three million millionaires, most of whom are self-made and beneficiaries of the reform and opening-up policies. They account for approximately 2.5% of the country's total urban population. 17% of the rest of the urban population are also classified as high-income earners.

As a result of the increase in the quality of life, mainland buyers now expect much more than just ordinary property management services, such as cleaning and security. Value added property services with a personal touch are now considered essential in order to attract buyers and outperform competitors. Such an expectation is even more notable in developed cities such as Beijing, Shanghai, Guangzhou and Shenzhen. People expect dedication to good housekeeping from the property management office. Should a technical problem arise, such as a dripping faucet during the odd hours of the night, residents expect prompt action from the management office.

Expectations also include a consolidated bill from the management for all utility services, and the courtesy of being addressed by name by the security guard as they enter the building to demonstrate attentiveness and genuine concern for residents. Moreover, residents expect to have their laundry, daily milk supply, newspapers and mail delivered to their doorsteps daily, punctually and regardless of whatever weather conditions are prevailing. Such attentive and meticulous management services, however, are very costly.

Because of increasing demand for such services, residents in coastal cities are accustomed to paying management fees, and are more willing to pay them as long as the fees reflect the quality of the services. In Shenzhen, for example, the approved management fee for high-end residential properties is approximately

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5.22 Yuan (HK$4.95) per sq.m. However, China is a vast country. The distribution of wealth and pace of development varies from province to province. The transition from public to private housing is taking place, but sometimes only gradually. Residents who are already owners of private flats do not always demand quality property management. The traditional definition of property management is simply to provide cleaning and security services normally provided by the government. The cleaning service is nothing much more than garbage removal. The security service means allocating guards to stand behind the desks at the entrance to the building. Residents have been tolerant of such conditions because they have only paid a few cents per square meter as management fees.

Now, times have changed. Property management companies are making an effort to provide quality services. Although the services in the inner provinces may not be comparable with those available in the coastal cities, there is nevertheless an overall improvement in terms of what the government needs to provide. Eventually, the idea of paying a higher management fee for better services will catch on with the general public in the less developed cities and provinces, particularly with residential property owners. This will ensure not only a better living environment for owners across the country but also an effective means to preserve the value of their properties, which can be put up for sale at a good price when offered on the secondary market.

Impact of WTO Entry on:

(i) Banking Policy

After its highly anticipated WTO entry, China will further relax its control on foreign banks to conduct Renminbi business. Currently, foreign banks' Renminbi business is confined to Shanghai Pudong（浦東）and Shenzhen. In other parts of the country, foreign banks can provide loans to foreign-funded companies, but they cannot provide loans and any other services to state-owned enterprises, rural or urban companies or even private companies. After five years of WTO membership, these restrictions will be changed. Foreign banks will not only be able to conduct retail-banking business but also they will have the freedom to conduct business at the place of their choice.

Furthermore, China will also loosen its grip on foreign exchange control and allow commercial banks to transact foreign exchange on current account items without the necessity of prior approval. Capital foreign exchange transactions will continue under the central bank's tight control and supervision, but the changes will definitely speed up the processing of foreign exchange applications.

(ii) Property market

Entry into the WTO will open up the Chinese market to various industries, ranging from financial, insurance, banking, securities trading, telecommunications and trading, to travel and many other intermediary services industries. The need to set up representative companies is anticipated to stimulate the demand for office space in Beijing, Shanghai and Guangzhou in the coming years.

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WTO entry will also boost foreign direct investment in the manufacturing industry. To accommodate expatriate staff and family, foreign companies will buy or rent luxury properties, stimulating demand for luxury properties.

Due to the reduction of import duties and keen competition from overseas companies, car prices are expected to decline substantially, which will lead to an increase in car ownership, and ultimately, make luxury villas and apartments that are usually located in the suburbs much more accessible. WTO entry will thus indirectly cause an increase in demand in this market segment.

To compete with foreign companies that have a strong financial background, rich experience and better management, domestic real estate firms will have to increase their use of advanced technology and improve their design and management. Housing quality will therefore improve with WTO accession.

Conclusion

Undoubtedly, China's real estate industry will undergo extensive development in the next five years, as demand for housing is expected to surge in tandem with the anticipated rise of residents' disposable income. Experience from developed countries suggests that housing demand will surge when a country's per capita gross domestic product (GDP) reaches more than US$800. China already achieved this figure last year. Meanwhile, the country is striving to reach the goal of 23 sq.m. of living space for every urban resident by 2005. This means that China will have to build at least 8.4 billion sq.m. of real estate in the next five years in order to realize such a goal.

High expectations of economic development in the years ahead will provide a strong impetus to the country's real estate development and a much greater opportunity for real estate developers.

High economic growth is expected to continue in the next several years, as the country's economy is further fuelled by Beijing's hosting of the 2008 Olympic Games and the country's impending accession to the WTO. High expectations of economic development in the years ahead will provide a strong impetus to the country's real estate development and a much greater opportunity for real estate developers. It may not be too much of an exaggeration to say that there will be at least 1.2 billion pairs of eyes following the speedy economic development of a country that has the highest growth potential in the world.