

Government policy to stimulate the sector

One of the major targets in China's 10th five-year plan is to improve people's living standards. Residential housing development can be expected to contribute more to economic growth over the next five years. We forecast housing investment to grow by at least 20% pa between 2001 and 2005.

Homes now more affordable

1Q01 home sales continued to strengthen, with turnover up 49% YoY. The greater availability of bank mortgages, housing subsidies and rising proceeds from a growing secondary market are making homes more affordable for the average Chinese family.

An office market rebound is sustainable

We do not envisage office supply rising sharply in the next two to three years, and strong take-up from both local corporations and foreign companies should drive up rentals and occupancy in China's larger cities. The country's office market rebound should also push up the profitability of those companies with office exposure.

Home demand robust

With the state's opening up of the residential property market, buying homes is now the top priority for most Chinese families. This is particularly so now that most families already own televisions, refrigerators and telephones. A survey carried out at the end of 1999 on consumer patterns showed that around 30% of respondents intended to buy a new home. The state is also eager to grow the industry as a means to both boost the economy and raise overall living standards. In its 10th five-year plan (2001-05), the government aims to improve per-capita living space (in GFA) to 23 sq.m. for the urban population by end-2005, from the current level of 20 sq.m. however, this is still much lower than those of most developed countries in the early 1990s, eg, 60 sq.m. for the us, 38 sq.m. for the UK and 31 sq.m. for Japan.

Analyzing nationwide residential property demand is difficult given the lack of consistent market data. For a rough estimate of potential new demand, we look at the increased living space targeted by the government, together with the expansion in the urban population. This translates into average annual demand for new property of around 371m sq.m. until 2005. This is about 119m sq.m. more than the total completion of new residential floor area in 2000. We expect demand to grow by 32% pa through 2005.

Homes are now more affordable

When the government extended public holidays to stimulate the retail and tourism sectors, it never expected the property market to be boosted the way it was during the recent seven-day May Day holiday in Shanghai. At a four-day property sales promotion, 2,391 units were pre-sold with a total transaction value of over Rmb1.2bn. the total transaction value was about 130% higher than at the same fair last year, with the average selling price at over Rmb500, 000 per unit, or Rmb4, 200psm assuming an average flat size of 120sq.m. this exceeds our previous expectation of Rmb3, 500psm for Shanghai.

In our view, the success of property sales during the holiday period in Shanghai is a reflection of how quickly local Chinese have changed their views towards both home ownership and how it can be financed. For a while, international stock market investors have been worrying over low affordability, particularly when they compare average income levels with above-average property prices.

However, as we have noted, average incomes are not the last word. Greater availability of bank mortgages proceeds from secondary transactions and monetised housing benefits have all improved affordability, although the latter two are not widely available yet in most cities. In addition, the fact that property prices rose by 12.3% in 5M01 on increasing volumes should put paid to worries over the ability of local buyers to afford property. With a will, money can be found.

During 2000, total revenue from home sales increased by 35% to Rmb295bn. Of this amount, 65% was financed by bank mortgages (versus 38% in 1999). Bank mortgages have become the major financing source for home purchases since the People's Bank of China (PBOC) lowered mortgage rates and relaxed mortgage terms in 3Q99. As at end-2000, the amount of total mortgages granted by government -owned commercial banks reached Rmb330bn, a sharp increase of 162% YoY (versus 145% in 1999). This is much higher than our previous expectation of Rmb260bn. Mortgages now account for 3.2% of total bank loans (versus 2% in 1999).

Since mortgage loans have less risk of default compared to loans to developers - and with the PBOC encouraging mortgage lending - all of China's commercial banks are planning to increase their portion of mortgage loans to total loan assets to at least 10% over the next three to five years. Current low mortgage rates (5.31-5.58% pa) and relaxed mortgage terms (maximum period of 30 years and 80% loan-to-value ratio) should continue to encourage homebuyers to borrow from banks for financing. In Shanghai, over 80% of home purchasers chose to borrow to purchase their homes. We now expect the total bank mortgage balance will increase 87% YoY to Rmb 596bn in 2001 and a further 62% YoY in 2002.

Monetised housing welfare is effectively a cash housing subsidy, which is tax exempt and must be used for house payments (capital and interest repayment or rent). But policymaking has been slow for most cities. Since housing reform began in 1998, only 35 cities in China have announced details of their monetised housing welfare. Even fewer cities have started payments; most local governments have been waiting for an announcement of the central government's policy to use as reference. Early this year, the central government finally announced that it would start payment of monetised housing welfare to its staff in Beijing. We expect other local government to follow suit later this year or early next year.

The central government plans to pay its Beijing employees Rmb2bn in 2001, Rmb2.5bn in 2002 and Rmb3bn in 2003. Assuming employees use the cash as a 20% downpayment for their homes, total additional funds flowing into the residential property market would be Rmb10-15bn each year (a multiple of five on the downpayment). The amount would account for 24-37% of total residential property sales in 2000. We expect similar beneficial impacts in other cities when more local governments finalize their policies.

Selling old units and buying bigger, new ones is becoming very popular with Chinese citizens as they seek to upgrade their overall living conditions. As secondary markets become active in more cities, proceeds from the sale of their old units (including privatized staff quarters) make new homes more affordable. In Shanghai, secondary market transaction value has increased by nearly 100% each year from 1988, with secondary market transactions accounting for about 47% of the total transaction value in 2000. About 80% of proceeds from such sales were used to buy bigger flat in the primary market. The average size of new flats purchased in the primary market was over 100 sq.m., compared to an average size of 70 sq.m. for the original unit.

In 2000, the average selling price of residential property rose by 8% YoY nationwide as demand growth outpaced supply growth. Since some big cities such as Beijing and Shanghai have now increased their pre-sale standards by requiring a higher level of investment before pre-sale begins, we expect supply growth in 2001 to remain lower than demand growth. This should result in price rising another 6-8% in 2001. However, after 2001, we expect home prices to remain at end-2001 levels, after supply picks up from 2002. In addition, we expect that the state will also be actively monitoring property prices via the approval of new projects. This is to ensure that house prices are kept affordable.

Office property market bottomed out

It was not just the residential property market that boomed in 2000; China's office market also had a strong rebound. After hitting the bottom in 4Q99, the office markets in China's major cities started to recover from 2Q00, with Beijing at the forefront. Strong take-up from domestic and international companies, as well as limited supply, were the driving forces. With some developers delaying their office projects after Asia's financial crisis began in 1997, we expect to see only very limited office supply to come onstream over the next two to three years. We expect rentals in Beijing Grade "A" offices to increase 15% pa in FY01-02, after a 50% surge in 2000. Rentals for Shanghai offices should see a stronger increase of 30-50% this year given the lower rebound in 2000.

We believe that China's entry into the WTO will be a strong fillip for the office property market in the long run. Indeed, strong take-up by both local and international companies last year points to companies beginning to expand their presence ahead of our expectations. Since there is very little likelihood of huge supply coming onstream in the next two to three years, we expect strong demand to keep vacancy rates low and push up rents further.

Home Demand Analysis		
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Average urban living space (GFA sq m)	20	23
Total urban population (m)	456	471
Total floor area addition before 2005 (m sq m)	-	1,850
Average annual demand (m sq m)	151	370
Demand growth % CAGR through 2005	-	32

Source: Ministry of Construction of China, ING Barings estimates

ChinaReal Estate Price Index - Local Residential

