An Introduction of the Development of the Real Estate Industry in China

[Key words]
the property system of land and housing in China, sharp increase of house price, the industry influences to the country’s economy, the phenomenon of bubble

Introduction
China might be the hottest spot in the world economy. Since China adopted the economic reform and opening-up policy more than 30 years ago, China’s economy grew at an average rate of higher than 10% per year. The nation has obtained huge wealth (the country is now the second largest economy by GDP) and its people enjoyed the re-pay from this hot economy- their living standard raised, life expectation extended, and living-style changed to more western-way.

The fast development brought not only the benefits but also some side-effects, for example pollution and income gap. As a result, instability and divergence of the society and sharp increase in housing price had occurred.

The housing and land prices had been at stake in the economic problem so that no one can avoid conducting study of this phenomenon if he/she is conducting research on China or is considering business with China.

Here is a discussion on some issues regarding the real estate industry in China.

1. The property system of land and housing in China
   - Division of the property right of land and house

   Accompanying the establishment of the People’s Republic of China, several reforms concerning the ownership of the land in the Chinese land property structure were introduced in a relatively short period of time (5 years). With some sequential legal adjustments of the system, current land property (and utilization) system was established.


   All lands in urban area (cities and towns) are owned by the state, and the administration and management of these lands are conducted by the city (town) governments. Forests, mountains, mineral resources and river lands are also owned by the country. The rural lands belong collectively to the local village. A small portion of rural lands is allocated for peasants’ houses, but the rests are
designated only for the purpose of agriculture.

The real estate industry in China has to develop their businesses on urban lands, not on the rural ones. In the real estate business, the owner (state) sells the urban lands to the developers, and then the developers build houses (or apartments) on those lands to sell to individuals. The difference in the Chinese housing legal status compared to other countries is the ownership of the land. Chinese law does not allow private ownership of lands, therefore, as an alternative solution to the house keepers, they can own the right to utilize the land for a period of time (70 years). This legal right (right of utilization) sounds like tenure. At the end of 70 years, the keeper has to sign the permission contract with the local government again for utilization.

While all the land ownerships belong to the state, the ownership of the houses on the land belongs to the house buyer. This is where the developers earn their profits in China.

Like the citizens in the urban cities, the farmers cannot gain their ownerships of a piece of land. They sign tenure contract with the village which owns all those rural lands. Usually the duration of farming land contract is for 50 years.

2. Historical development of real estate industry and their prices in China

- Sharp increase of house price in the past 7 years

Beijing is one of the most notable cities which reflect soaring housing price in China. It has also been one of the leading cities (together with Shanghai and Shenzhen) in terms of construction by the real estate industry. The index which determines such condition is the housing price.

The prices in fig. 1 and 2 are the average prices calculated by analysis, which include houses in the suburban area (outskirts of Beijing) and the governmental welfare houses.

![Average House Price in Beijing](image)

Fig 1: Average house price in Beijing (1999-2008) by Beijing Statistic Bureau. Average annual
increasing rate is 20% from 2003 to 2008.

![Average House Price in Beijing](image)

In reality, the prices of commercial houses in some major cities in China after 2008 were the double of the prices shown here.

Up to 2003, the prices of lands and houses were increasing at a moderate rate. Although prices fluctuated, they did not cause much criticism as in recent years.

Prior to 2003, the country was in a period of regulation (of real estate) establishment and people and developers were adopting themselves to the new housing market environment. The concept of house property right and commercial housing development was established in the early 1990s. When edging region (Hainan Province) went too far in the house construction and huge bad-performed loans/assets evoked in 1993, the house market collapsed right in front of Chinese people’s eyes for the first time in China. Later-on a very familiar word “rectification” (治理整顿) was invented (to rectify the house market) which became a frequently appeared word in the future under the condition of over-heated macro-economy in the country. Yet most Chinese people’s true feeling (of expensive price) towards real estate did not get established until 1998 when mortgage loans for individuals were fully offered to people by the banks in the country. The bank institutions had brought huge money to the real estate industry and the weight of the housing industry in GDP of China increased significantly while the house prices also soared higher and higher. Accompanying with an average GDP growth of 10%, the increase in the housing price has become even higher than 10% since 2003.

From fig (1), we can see a stagnation of the housing prices in 2007 and 2008; this is because after many years of rapid increase in the housing price (and the overheated economy), the central government issued a series of macro-adjustment policies to control the surge. The policies, which
some researchers called as “squeezing the bubble,” were effective and the economy seemed to become healthy with decline in housing prices. However, the financial crisis (USA’s Sub-prime crisis) of the western world pushed the export-oriented country into an economic winter. The central government then made a U-turn in its direction of the adjustment for the housing industry. Many economists commented as that was the beginning of “out-of-control” housing prices in China.

The side-effect of such high prices has surfaced and became notable, especially when the housing industry occupied significant share in the country.

3. The big weight and influence of housing industry in China’s economy
   - The industry influences heavily on the country’s economy

   The real estate industry has increasingly gained its importance in China’s economy over the years. If we consider all involved businesses surrounding the real estate industry and add all involved industries from its upper to lower stream (e.g. coal mining, steel, cement, construction, inner building decoration, furniture, home electronics, electricity, etc), they cover nearly all segments of investments in the economy.

   As we previously mentioned, the central government of China had a chance to stagnate the country’s house price by controlling the increasing rate to a moderate level in 2008. However, in order to recover from non-optimistic economy influenced by the US sub-prime loan crisis, the government issued significant amount of investment (4000 billion RMB). It is believed that the most part of this investment went to the real estate construction industry. The housing price (both property price and leasing price) soared.

   High housing price in turn attracted nearly all investments from other manufacturing industries (like electronics factories) because return on capital was much higher than the average industrial return.

   Fig 3 shows the trend of the ratio of real estate production to China’s GDP (the real estate production in the figure is relatively small compared to GDP but if all the numbers of construction related industries are added, the number could be much bigger), which indicates that the housing industry is taking heavier and heavier weight in the country’s economy.

   Fig 4 shows the same trend that the investment in real estate industry is increasing faster than the total society investment: again, symbolizing more resources had gone to the real estate industry.
Fig 3; the annual ratios of real estate production to GDP; the numbers were calculated from the data by National Bureau of Statistics of China (NBSC).

Fig 4; the annual ratios of investment to real estate to total society investment; numbers were calculated from the data by National Bureau of Statistics of China (NBSC)
4. Discussion of bubble in the real estate industry in China

There has been a lot of discussion in recent years that China is experiencing its bubble in housing industry. We do not make a judgment on whether or not there has been a bubble in this industry without looking at composite indicators, series of data, plus historical observation on the economy and the industry.

Let’s look at indicators which explain what is happening in the real estate industry now.

Ratio of empty houses (房屋空置率), which is non-occupancy rate calculated by the empty room square (or rooms) over the total room square (or rooms) in a certain period (for example, 6 month). Beijing’s Population Administration of Police Bureau issued the ratio in June, 2012: 28.9% (3.81 million empty apartments over 13.2 million total apartments, for the 1st half of 2012 in Beijing). Shanghai is believed to have the similar ratio. It is traditionally considered economy-in-danger (bubble) if this ratio is higher than 10%.

The ratio of the empty houses is also considered as the indicator of speculation. It is commonly considered that this high figure (28.9%) is supported by typical coastal cities namely Beijing, Shanghai, Shenzhen (深圳), and Hangzhou (杭州) which have attracted strong investment intention and action (and speculation) from a group of wealthiest people in China.

Another indicator is the ratio of the house price to individual disposable income (房价收入比). Chinese scholars have done significant calculation on this ratio in Beijing (“Research of the Ratio of Commercial House Price to Disposable Individual Income in Beijing”, Peng Hongbin (彭鴻斌), Ren Hong (任宏), (Qiusuo Journal 2010/1)), which indicated 14.8 in 2006, 15.0 in 2007 and 14.6 in 2008. Those numbers were considered dangerous because they were much higher than the World Bank experts’ safety ratio definition 4-6. Fig (1) shows that the housing price of Beijing has increased more than 2 times in 4 years after 2008 (the increasing rate has more than doubled during this period), and we would allege that the current ratio is much higher than that of 2008. The house price has been out of reach for the local people. Similar observations have also been drawn in Shanghai and other major cities in China.

2nd tier cities such as Wuhan and other cities located in central China are also facing the same price problem: although their housing price is a half of Beijing’s, their income is also a half of Beijing’s as well.

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1 Mr. Peng and Mr. Ren define the ratio as the median price of per capita house area over the median annual individual disposable income (income excluding taxes);
2 In The Atlantic’s recent report “China Has the Most Unaffordable Housing in the World”(http://www.theatlantic.com/business/archive/2013/07/china-has-the-most-unaffordable-housing-in-the-world/277428/), calculated from IMF’s data, a cross-country comparison shows even severe current ratios in Chinese cities, though the definition of the ratio being the median house price over the median family disposable income: Beijing 23.3, Shanghai 15.9, and Shenzhen 12.7, the top 3 in the world, far ahead of Tokyo’s 10.0 and New York’s 6.2.
The authorities do not wish to follow Japan’s foot steps to break this “bubble” because it is inevitable that such burst will bring much sever social problems in China. They hope to hold the acceleration rate of the housing price hike while developing its economy and increasing income in order squeeze the “bubble” softly.

We are looking forward to the effective policies.

5. Reasons for high housing price in China
   - Many reasons, hurting the real economy

There are many reasons for such high housing prices. Some are unique to the Chinese market and others are similar to the other countries.

(1) High demand for houses. There are always new young people and their parents who come into the market; they are the most needing groups in the society. They are afraid of further price increase in houses. Since they are very young, usually a couple of years after graduation, youngsters tend to arrange purchases of their apartments under the support of their parents. Geographically speaking, those newly migrated people come to the big cities such as Beijing and Shanghai and become the purchasing powers.

(2) Speculation and its vicious cycle. Many nosy people invest their money in houses, and their huge investment pushes the housing prices higher as a result.

(3) High return on capital. Under the circumstance of high housing prices, there is no other investment which re-pays such high return on capital than the real estate construction; no assets appreciate at the same speed as the prices of houses. Both companies and individuals invest their money into the real estates, not to mention the manufacturing industries are hurt by this fact (fewer re-investment, fewer innovation and management, capital liquidity stagnated, etc.).

(4) Structural reason (property right). As we explained in section 1, the property ownership belongs to the state, and governments in all levels are the agencies to manage and administrate the property ownerships. To make money, it is quite natural to think that the local government does not execute strict policies to control the house prices from Central government. In Chinese, we call it Governmental Land Financing (土地财政), an economic ecology which governments rely on even more than the taxes they collect.

6. Opportunities for foreign countries in the real estate industry in China
   - There is still big opportunity for foreign companies

The overseas capital and real estate companies have never stopped taking a part in the development of China’s housing industry. They have gained significant amount of profits directly and indirectly. Mainly those overseas developers are Hong Kong companies, like Cheung Kong
Holding (長江集團) and New World Land (新世界地產), but many foreign capital or developers found their ways by joint venture business exploration and investment in real estate industry in China. For these companies, there still exists opportunities because the demand of houses is still rapidly growing (this explains the continuous rise in prices in Beijing and Shanghai to some degree). The second generation of the baby boomers is forming their families now. Big pressure of housing market in major cities pushed those buyers to the 2nd tier cities, and they will still form the market.

The targeted regions for new investment could be the 2nd tier large cities in central and western China, for example, Chongqing, Chengdu, Wuhan, Changsha, etc, where the residents are increasing their purchasing power and business space has not been congested by existing giant real estate developers.

Upgrades of the existing houses also form the market. For a long period of time, the quality of houses in China has been poor. With people’s income increasing, they started to demand living in a good quality house and investment opportunities exist there.

Soft-landing policies for over-heated economy are also assurances to protect the investments. As our above analyzed conclusion, the housing industry is still the key sector in the economy. The country does not want to take the risk to suffer from the break of the bubble. We believe more adjustment policies on the economy will come in the future. Doubtlessly, these policies will make the industry healthier.

The housing industry has been developing in China for more than 20 years, and companies have provided various houses to satisfy Chinese people. To make profits, foreign developers and constructors need to provide new concept, high quality, and differentiated and well serviced houses to customers, and we believe their accumulated experiences will be helpful.