Spotlight on China's Property Market

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Greater Bay Area development and its impacts on foreign inbound investments

China is the biggest internal market in the world with 1.4 billion people and a real estate industry that has been a significant pillar of the national economy in China. It maintained a relatively rapid growth of approximately 10 percent per annum in the past decade. The construction sector also recorded a high growth rate with fifteen percent, five percent and eight percent in 2016, 2017, and Q1 2018, respectively. The real estate and construction sector has become an important market, attracting foreign investors from across the globe to China.

The Greater Bay Area expects to be the largest economy among global bay areas by 2020

The development of the "Greater Bay Area" refers to the Chinese government's scheme to link cities in the Pearl River Delta into an integrated economic and business hub. The Greater Bay Area project may provide opportunities for investors on large-scale infrastructure and will create investment opportunities in real estate. The Greater Bay Area in southern China comprises two special administrative regions and nine mainland cities, namely Hong Kong, Macao, and the nine municipalities of Guangzhou, Shenzhen, Zhuhai, Foshan, Huizhou, Dongguan, Zhongshan, Jiangmen, and Zhaoqing in the Guangdong Province.

The Greater Bay Area has an estimated population of 70 million, covering an area of 56,000 square kilometers and had a combined GDP of US$1.58 trillion in 2017. It is considered key to the strategic planning of the country's development blueprint in building a dynamic and internationally competitive bay area and world-class city cluster. The development of the Greater Bay Area will induce a significant increase in investment demand. With the population inflow into these cities, it is believed that there will be a surge of high quality living environments, with high demand for industrial and commercial properties as well as shopping malls. Additionally, the opening of the Hong Kong–Zhuhai–Macao Bridge by the end of 2018 will further improve the communication within the Greater Bay Area.

The area is expected to be the largest economy among global bay areas, including Tokyo, New York, and San Francisco, by 2020.

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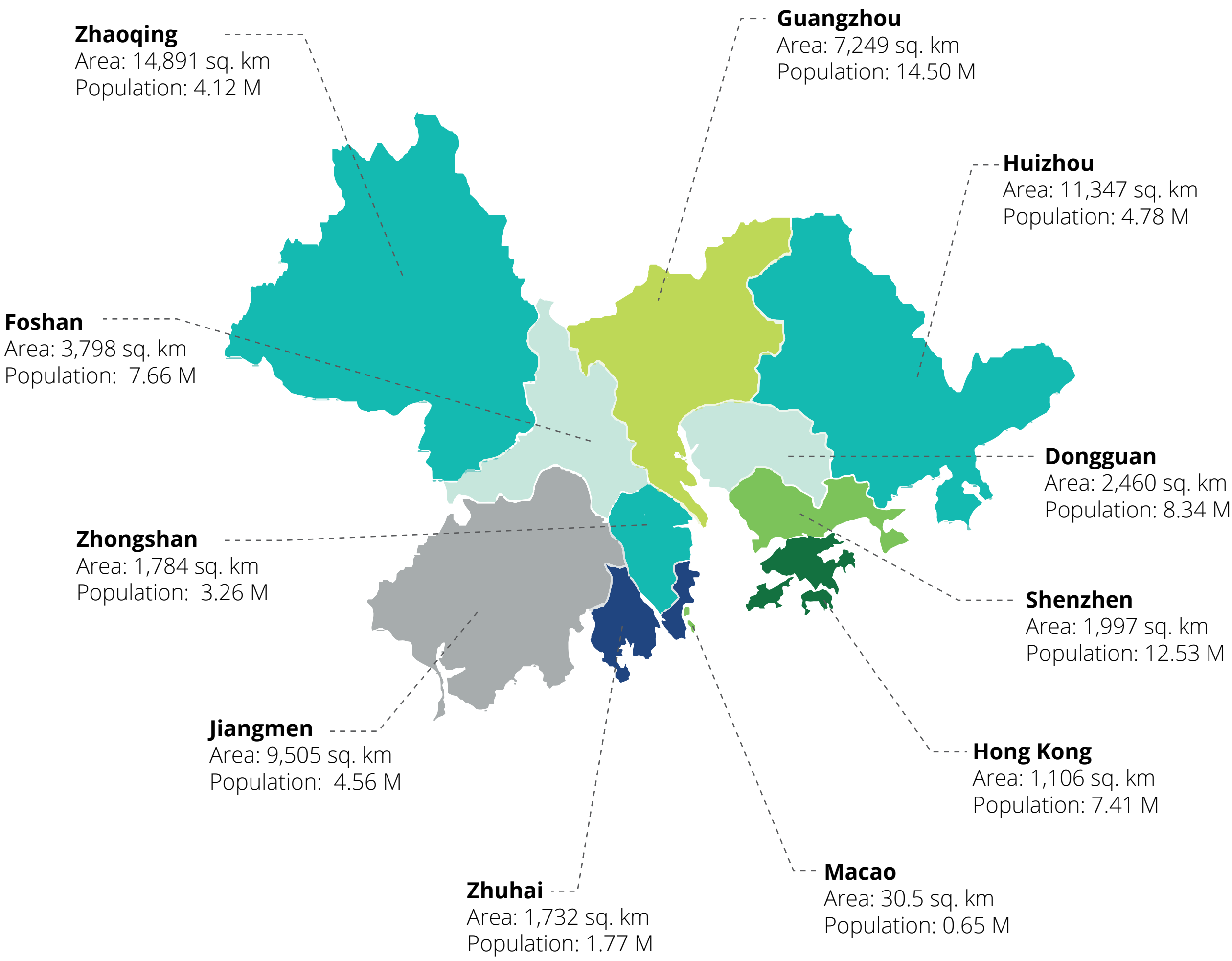
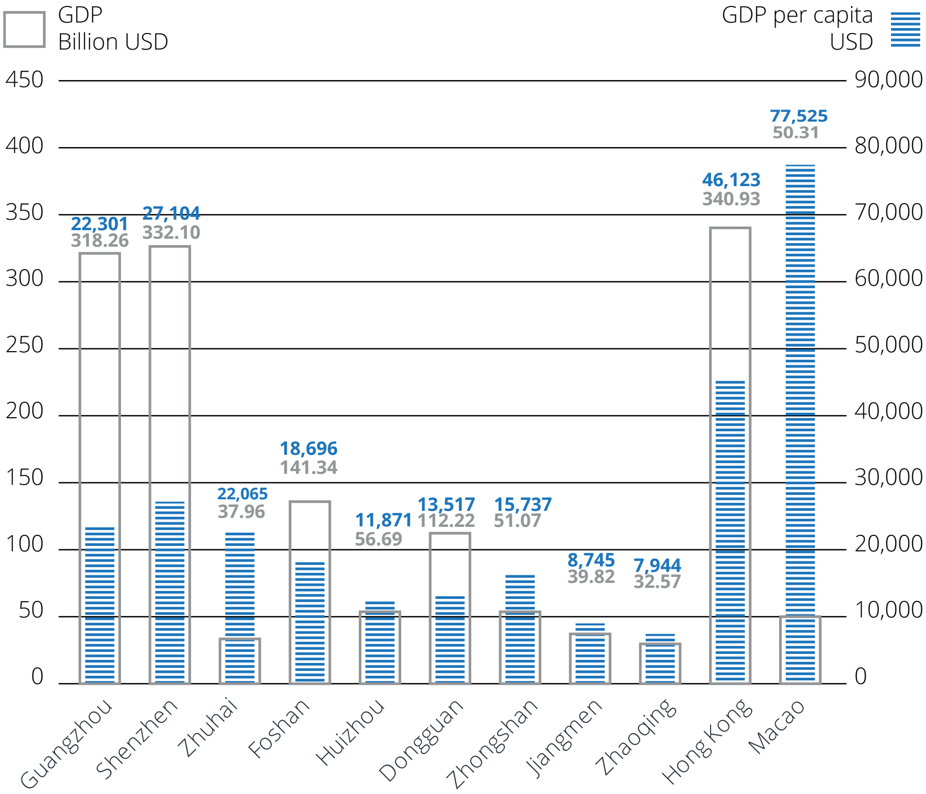
Greater Bay Area cities comparison



Gross Domestic Product and per-capita Gross Domestic Product by cities in the Guangdong-Hong Kong-Macao Greater Bay Area (2017)



Sources of data: Statistics Bureau of Guangdong Province, Census and Statistics Department of the Government of Hong Kong SAR, and Statistics and Census Service of Macao SAR

China's extraordinary economic boom has gone hand-in-hand with urbanization

Urbanization is driving economic development in China. The Chinese central government has attached great importance to the urbanization plan in order to speed up the urbanization process. The percentage of the population living in urban areas was 56.1 percent in April of this year, with a target rate of 60 percent by 2020. There is no doubt that transforming rural residents into urban residents will have a huge impact on the economic well-being for the entire country. To help alleviate the housing needs of residents, municipal governments have allocated underutilized industrial land suitable for habitation for affordable housing. The scale of China's urbanization promises substantial new markets and investment opportunities. This will create opportunities for those cities' properties such as residential buildings, industrial parks, and commercial facilities. If current trends hold, China's urban population will hit the one billion mark by 2030.

Widely using the Public-Private Partnership business model

The Chinese central government opened the door to private sector investment in infrastructure several years ago. The government has shown a positive attitude toward encouraging and supporting private investors to participate in infrastructure construction projects, offering large investment opportunities for Public-Private Partnership (PPP) in China. The introduction of institutional PPP is a joint venture established together by a public authority and a private company to raise funds and provide a public service, as well as to construct and operate infrastructure projects. In 2017, there were a total of 14,000 PPP projects and investments, possessing an overall value equal to US$2,300 billion. These infrastructure projects include toll highways, bridges, elderly care housing, hospitals, and schools. Under PPP development mode, the construction market has undergone rapid growth in the past few years.

Lifting the one-child policy restriction enhances the residential real estate market demand

China's population now stands at over 1.4 billion people. In a recent announcement made by the Standing Committee of China's National People's Congress, China is planning to eliminate its child limitation mandate for families, which has been in place for four decades. China enacted a one-child policy in 1979 but relaxed it to two children in 2016. Under the new policy, families would be able to decide for themselves how many children to have. This is good news for both the families and the labor market. A final decision could come in the next few months or in the run-up to 2019. It is expected that the population will grow significantly as a result of the new policy, and with a higher population, it is likely to increase the demand on residential properties.

Chinese house prices to rise faster in 2018

Home prices and property investment in China are expected to rise more than initially thought this year, as tight controls in big cities continue to push buyers into less-regulated smaller markets. House prices in China, where a near-three-year real estate boom has spilled over from megacities to the hinterland, will rise 5 percent this year and 3.3 percent in the first half of 2019. That outpaces the one percent gain seen in a previous poll in March and would only be marginally lower than the actual increase of 5.4 percent in 2017. Property investment is now expected to grow 8 percent this year, higher than the last poll's 5 percent, as developers look to rebuild their housing inventories and as the construction of public housing accelerates.

How do firms enter into China's property and infrastructure projects?

The "opening up" policy of China's foreign direct investment attracted foreign investors to invest property-related business in major cities of China. The most popular Tier I cities include Beijing, Shanghai, Guangzhou and Shenzhen. Beijing is the capital of the country and Shanghai holds the largest city population in China, as well as being a commercial and financial center and transportation hub. Guangzhou is the capital city of the Guangdong province and Shenzhen is China's first Special Economic Zone and is a famous IT center in the region. Property price and the investment volume of Tier I cities were sharply increased in the past decade. Investors are now looking for certain hotspot cities under the Tier II cities group, which are Chengdu (in Western China), Xiamen (in Southern China), and Dalian (in Northern China); the land cost is relatively low when compared with Tier I cities and thus will generate higher profitability for development.

It is legally required to incorporate a Chinese company to hold the property and the holding company's shareholders may be a foreign company. It would be better to form a JV partnership with a local firm when you consider an inbound investment into the country. Currently, most foreign investors are real estate developers and real estate investment funds. Since 2017, China's property market is entering into a new round of adjustments and the government strengthens supervision to ensure sound development of the industry. The relaxation of foreign direct investment aimed to provide a more relaxed policy environment for the real estate industry. This will benefit the high-end property market in the first and second tier cities—the main targets for foreign investors.

Barriers for foreign investors—tax consideration

Looking back from the year 2006, the Chinese central government was reluctant to open the market to foreign investors, and thus certain "restrictions of foreign investors into China" were introduced. It required that all funds raised in China or overseas must be used as the registered capital of the property holding company incorporated in China, so the fund was entirely blocked. However, the new Chinese Premier revoked this policy in 2015 and there is in fact no barrier for doing business in China for now. Good examples of big name investors are BlackRock and AIA; both companies have substantial funding investments and insurance business in China.

China welcomes foreign direct investment by continually opening up its market toward foreign investors. However, the differences in tax systems may hinder some potential investors' enthusiasm. Subject to Chinese tax laws, Enterprise Income Tax is payable at 25 percent the net taxable income. For the disposal of properties, the holding company has to pay Enterprise Income Tax and Land Appreciation Tax (LAT) too, which is calculated as:

Selling price as a percent of the tax deductible amount	LAT rate
<50%	30%
Between 50% and 100%	40%
Between 100% and 200%	50%
>200%	60%

As said, the property holding company's shareholder can be a foreign company. If profit or a management fee is paid to the shareholder, then 10 percent withholding tax is payable by this property holding company to the Chinese tax authority, only if there is a tax treaty entered into between China and the country in which the shareholder is incorporated.

Given that Hong Kong is a special administrative region of China, Hong Kong companies are allowed to have a withholding tax rate of only five percent. Dividends are not subject to Hong Kong Profits Tax and are taxable only when applied to business activities taken place in Hong Kong. In view of this, most of the immediate holding companies of property holding companies are incorporated in Hong Kong.

China's real estate market plays an important role in the local government's revenue and accounts for about 15 percent of the country's GDP. Any slowing down in the real estate market and price drops would have a negative impact on China's economic growth. In view of this, the Chinese central government has switched between tightening and easing measures in different cities to control the price of the properties in the hope to normalize the market demand and avoid a hard landing of its real estate market.

China's first Special Economic Zone and is a famous IT center in the region.