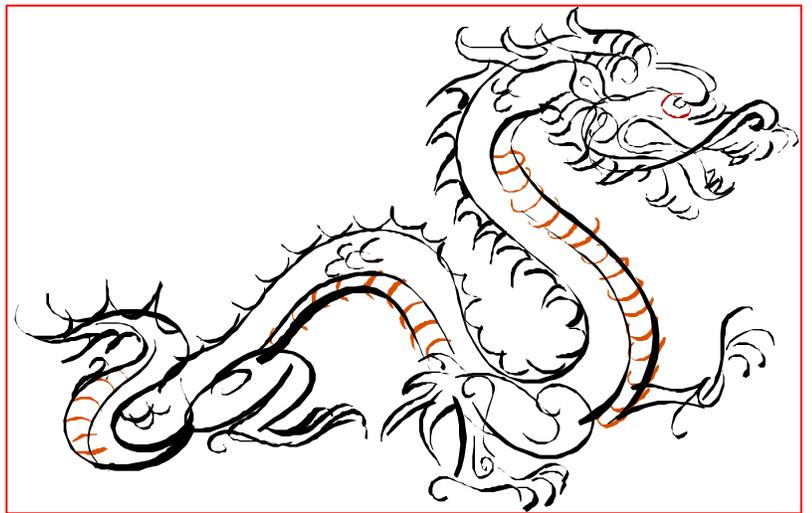


10 Future Trends

Shaping the Chinese Residential Real Estate Markets



A WHITE PAPER AIMED AT FORWARD-LOOKING INVESTMENT AND
BUSINESS STRATEGIES FOR THE EMERGING MARKETS OF CHINA

Prashant Das

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Background

In the United States, housing has been a part of social welfare and community development policy, serving as an important means of income distribution¹. Market forces have played important role and housing has often been seen with a consumer's perspective emphasizing on his sense of ownership. In contrast to this, in China 'production' has generally subdued 'market creation'. This equally applies to residential development sector.

Immediately after the People's Republic of China was founded in early 1950s, the communist party began stressing upon production rather than consumption²; and practically confiscated the ownership of most land rights from private hands. Thus until 1978, the urban housing system in China remained a system in which no interest in any real property could be granted or transferred³ to individuals. This policy did foster urbanization; but failed to cater to the housing requirement of burgeoning cities; thus widening the gap between supply and demand. The situation remained so until early 1990s when the Chinese government realized the shortcomings of the system and went ahead with the much awaited housing

reform. The new goal was to reduce the burden on the government and share it with private players to provide quality housing. It is believed that the transformation of housing from a public good to a commodity has been a success in China⁴. Now, land use rights can be sold, exchanged, gifted, leased or used for mortgage⁵. This was the beginning of a new era for residential development and real estate in the Chinese economic landscape which significantly changed its outlook in the global real estate market.

In addition, the Chinese government has recently enforced several other regulations that have strong implications on residential development. Apart from the land reform, the capital markets serving residential developers and homebuyers are also gradually transforming 'the American way'. On the other hand, the monetary policies are being practiced to control the real estate markets that have witnessed tremendous growth. Banks have imposed a minimum of 33% equity requirement on residential development borrowers. The Chinese government policies require residential developer to include a fixed minimum proportion of affordable housing in their product portfolio. The reserve ratios of the banks were raised to 7.5% in 2004. In September 2007, the mortgage lending rate

¹ Hays, R.A. (1995). *The federal government and urban housing: ideology and change in public policy*. Albany: State University of New York Press

² ShuZe Gao, *Socialist Politics and Economy Studies* (2002)

³ Jianbo, Lou; Palomar, Joyce (2006). *Housing policy in the People's Republic of China*. *United Nations World Urban Forum, Vancouver, Canada*

⁴ Yu, Zhou (2006), Heterogeneity and dynamics in China's emerging urban housing market: two sides of a success story from the late 1990s. *Habitat International* 30 277-304

⁵ Mak, Stephen W.K.; Choy, Lennon H.T.; Ho, Winky K.O. (2007). Privatization, housing conditions and affordability in the People's Republic of China. *Habitat International*.31 (2007) 177-192

for five years or longer was raised to 5.22%. Speculations are being controlled by more strict property transaction laws. In 2005, selling of a property was restricted unless the mortgage was paid-off completely. In July 2006, a capital gain tax of 5.5% was enforced on the sale price of a property if the landlord sold his flat within two years of title issuance. Corporate Income Tax Law, Labor Contract Law and Anti-monopoly Law among others are means through which the Chinese government now practices greater control over companies, especially the foreign enterprises. In the wake of all these regulatory changes, Chinese market is still experiencing tremendous growth in the residential development sector.

During coming 10 years Chinese residential developers will build more than 100 million homes amounting to around 10 billion square feet, as various industry researches report. China has around 55 cities with a population of more than one million, compared to 22 in the United States. The number of such cities will increase drastically in future. Chinese per-capita GDP had grown at an average rate of 12.64% per annum for more than 25 years. The house price indices are in a phase of stabilization indicating a maturing homebuilding market. The social values of the Chinese middle class are increasingly influenced by the west. Yet, Chinese homeowners retain a unique lifestyle that has created the need for specialized studies like this one.

Future Trends Prediction*

Clearly, while the government policies are becoming more market-friendly; they have also been used to shape the private housing development industry in a particular fashion. This has led to a business environment in China that requires intensive study on past and current developments. The background study for this paper included a comprehensive survey of the past and future trends in The Chinese residential market treating the United States of America as a benchmark. The arguments thus put forward were extremely helpful in reaching to conclusions about the way the Chinese residential market is poised to transform in future. This white paper summarizes those trends in ten parts. The 10 most probable future trends in Chinese residential development market thus deduced will help the prospective investors and foreign direct investors in adopting the right strategy for investment:

1. Consolidation of Residential Developers

The trend of consolidating residential development entities is fueled by the advantages large residential developers have over smaller ones in the capital market and sales volume. Three top real estate enterprises in China take up around 15 per cent of the national market share. Several

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This section gives only a snap shot of the predicted trends. Contact the author for detailed descriptions of all the 10 predictions.

consolidations with mergers and acquisitions have been taking place at multiple levels—local to international; and the trend will continue in future.

2. Mass Customization of New Homes

As the customers remain dissatisfied with the poor workmanship and construction delays of shell houses (maopei); custom designed interiors will gain popularity. The government, too, has started mandating the builders to pre-install the features. Customization at mass level will benefit from the knowledge and experience of the American players.

3. Affordable Housing Made Profitable

As the gap between demand and supply widens, the Chinese government is ensuring to make more affordable houses available to the burgeoning middle-class buyers. In spite of increasing volume, the share of affordable houses in China has been decreasing. This trend will reverse; and both the realtors and the government will learn from the American counterparts about how 'affordable' can be made 'profitable'.

4. New Business Models

With the adoption of a City planning Law in 1989 Public Private Partnership (PPP) will be the next big thing in Chinese residential development sector. The knowhow of successful PPP models will be borrowed from successful foreign counterparts. With the new type of non-conventional 'condominium' development model, Chinese developers shall

take help from the global real estate and management consulting firms.

5. New Construction: Material and Processes

Chinese Ministry of Construction introduced a new building code in 2003 that, for the first time, included provisions for wood-frame construction. The proportion of such homes has been considerably low so far (only 0.05%) yet it represents a large number (50,000) which is poised to grow in future. In addition, several new business avenues for homebuilding sector shall be opened by prefabricated houses.

6. Maturing of the Residential Mortgage Market

Chinese banks are traditionally biased towards primary mortgage loans; and the secondary mortgage market is under-developed⁶. This will create opportunities for a competitive secondary mortgage market in China. Given stringent underwriting processes, the market is not likely to witness a self-caused subprime crisis. As the international market will recover from the credit crunch, the global mortgage players will try their luck in the Chinese markets making it more competitive.

⁶ Tang, Bo-Sin (2006). Housing mortgage and housing transaction in China: Bridging the missing links; *Housing Finance International*; May 2006, 30-37.

7. Inland Development

China has come to realize that the development of economic activities in the western inlands would be the key to greater economic success and numerous steps have been taken to achieve this goal. Several big multinationals have already moved their operations to the inland. This trend will continue; and give rise to tremendous growth of housing-market in western inlands of China.

8. New Business opportunities

The ridge between 'economic analysis' and 'market analysis' is deep for Chinese residential developers hinting at a need for dedicated firms that could provide project-specific data and analysis. The legal due diligence process is less formalized in China; thus creating opportunity for title insurance companies as the real estate market will grow more complex with time. Also, as two thirds of the mortgage insurance is dealt in by public entities in China, private players will capture a good market share in this domain.

9. Application of IT Systems

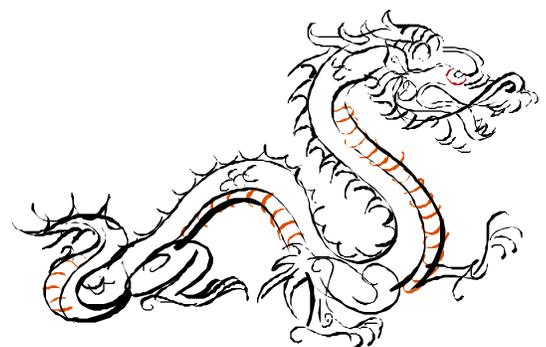
IT has increasingly been used by homebuilders in expediting material management, quality control, project scheduling, job costing etc⁷. Significant activity can be noticed in the area of setting

⁷ Augenbroe Godfried (2006). ERP for the Home Building Industry. *College of Architecture, Georgia Institute of Technology*.

up brand new Customer Relationship Management (CRM) systems in the Chinese residential development already. In order to gain competitive edge, more developers will purchase IT solutions for Enterprise Resource Planning (ERP), Customer Relationship Management (CRM) and construction-specific Supply-Chain Management (SCM) systems.

10. Sophistication of Supply-Chain Process

Construction activities shall be optimized for time and cost and a well-established supply-chain management system for building materials and other construction resources is the next big thing in the Chinese residential development sector. Prefabricated homes will be another set of factors that will encourage the trend for more sophisticated supply-chain management. As the IT industry has already penetrated deep into China, the expansion of SCM in Chinese residential development is a phenomenon which is more than likely to happen.



About the Author



Prashant Das holds strategic business development experience in emerging markets working with multinationals. He has engaged in several research projects with non-profits and corporate organizations in India and the United States. His research has ranged from the study of real estate development processes to business strategies. His special interest lies in international business and real estate development, especially in China and India.

He is a Master in Land & Real Estate Development from Texas A&M University, USA and a Bachelor of Architecture from the Indian Institute of Technology (IIT), Roorkee. Throughout his graduate and undergraduate studies he played leadership roles in several institute level endeavors and held scholarships throughout.

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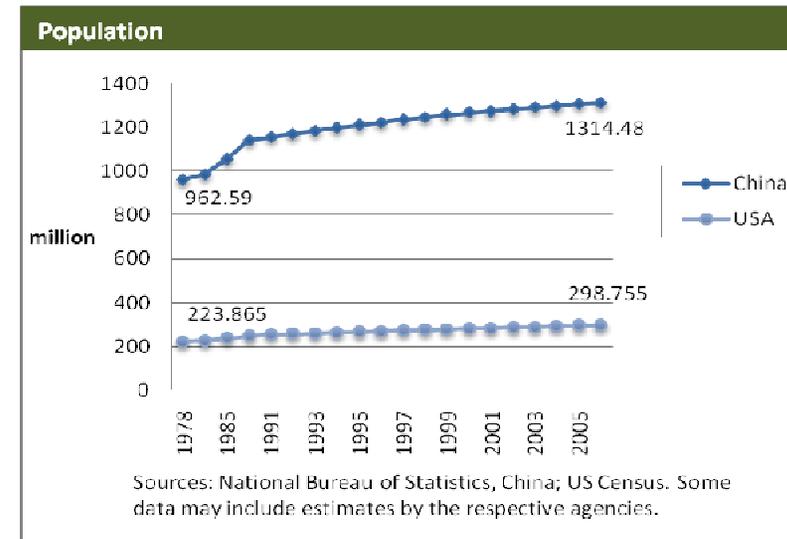
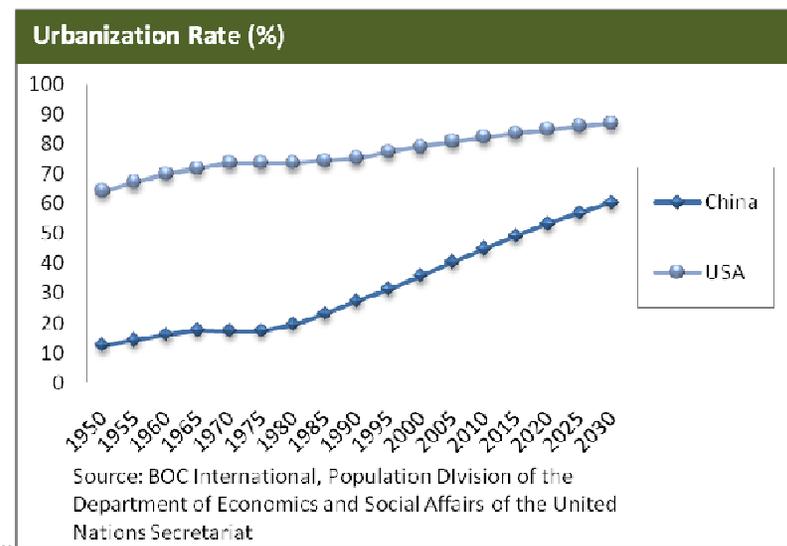
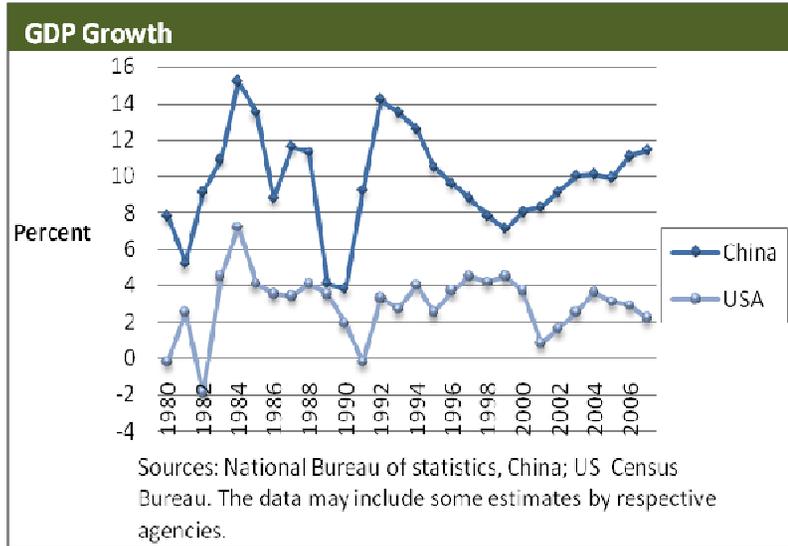
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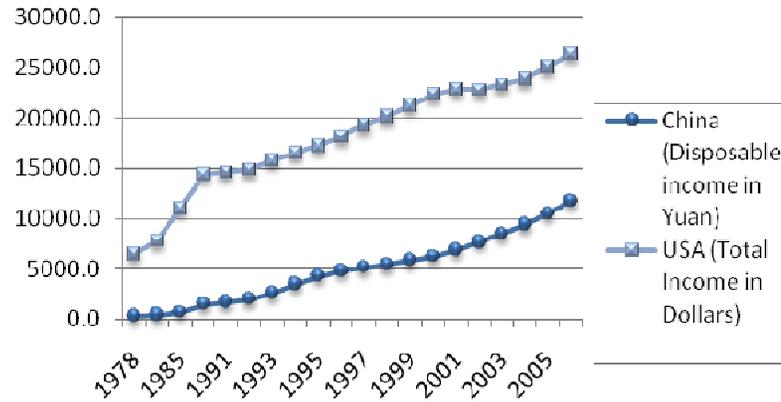
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Appendix: Key Data and Graphs



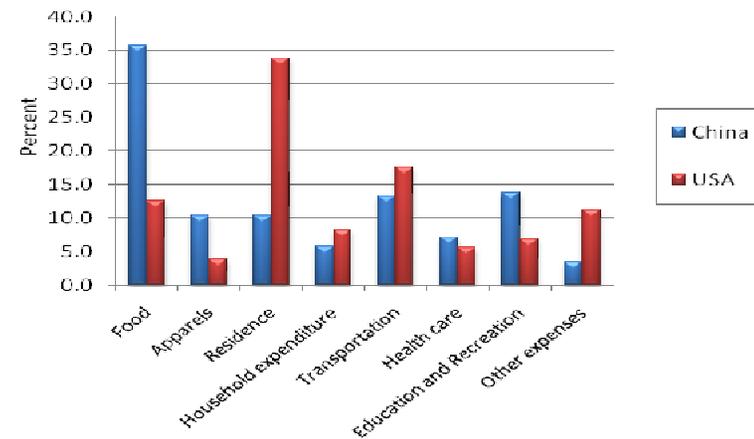
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Average Annual Per capita Income



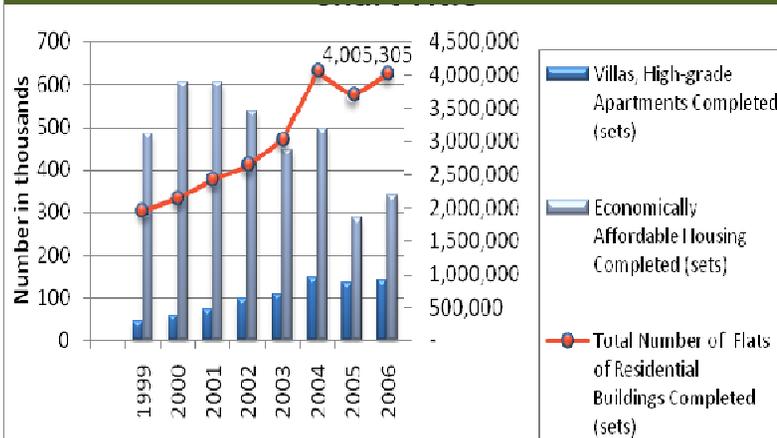
Sources: National Bureau of Statistics, China; US Census

Household expenditure



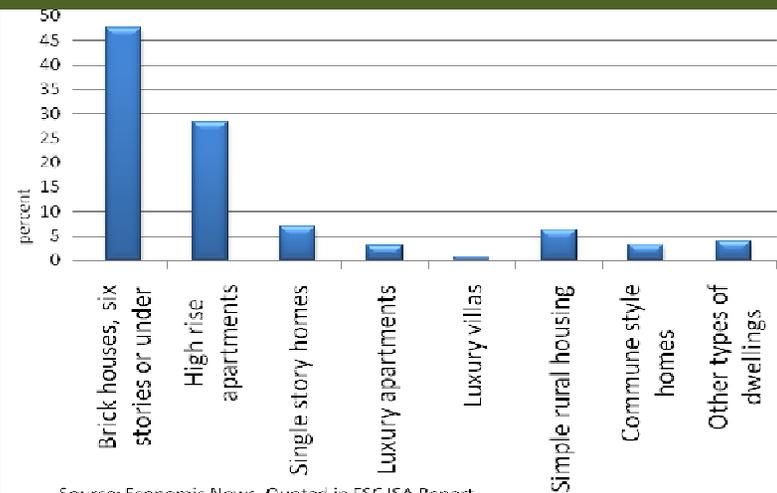
Source: National Bureau of Statistics, China; US Census

House Type Breakup



Source: National Bureau of Statistics, China

China: House Type Distribution



Source: Economic News, Quoted in FSC ISA Report