

Current Developments on the Chinese Real Estate Market

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Abstract: This paper examines the current situation in the Chinese property market. We have analyzed the current literature and statistics for this purpose. First, the general significance of property ownership in China is presented. Then the market is analyzed from four perspectives: Central government (growing concern over the indebtedness of significant property developers while the sector accounts for a large share of GDP), regional government (importance of revenue from land use transfer and regular tax revenue), property developers (business model designed for rapid growth, financed to a large extent by customer down payments and debt) and buyers (delayed completions of prepaid housing leading to financial burdens from financing, as well as other aspects such as the hukou system and population decline). The analysis of these four perspectives shows the current complex environment in the property sector. Due to the high macroeconomic importance of the property sector in China, stabilization is seen as one of the most significant challenges for economic development in 2024.

Keywords: China, Real Estate, Evergrande, Hukou, Whitelist

1. Introduction

In China, private homes and houses are not only the center of traditional family life but have also always been a social status symbol and an expression of precise hierarchical levels. Already in traditional Chinese architecture, clear building regulations on the size and decoration of buildings provide information on the social status and rank of government officials as is recorded in writing in the Tang-period's Yingshanling (Building and Repair Code) and the Song-period's Yingzao Fashi (Building Methods) dating 1103 C.E (Ma, 2020).

This cultural phenomenon has not changed from the post-dynastic societal changes of the 20th century to the present day. On the contrary, during the 20th century, there was first a clear focus on building a national identity that was aimed at nourishing the Chinese people's self-consciousness. The latter had been essentially harmed since the times of semi-colonization by Great Britain, France, Germany, and Japan, leading to the so-called unequal treaties pursuing the opium wars and the Japanese period of occupation in northeastern China. The public buildings that were then devised in Republican China were thus to be modern but traditional at the same time. Elements of traditional Chinese architecture followed a clear hierarchy (be it in terms of size, symmetry, or decoration) and were intentionally incorporated into these buildings. Also, the field of architectural preservation was born at this time and in it, the traditional hierarchies of the Song period were idealized and highlighted. Even during the communist regime, the idea of clear hierarchies in architecture persisted. Working units followed a traditional Chinese floor plan, were gated in four directions and the apartments varied in size and facilities depending on the status of the residents within the Communist Party. Not even Mao dared to tear down the Forbidden City and instead incorporated all important government buildings of the People's Republic of China such as the Great Hall of the People, The Chinese Museum of History, and the Party's administrative headquarters (Zhonghai, Nanhai) into the

overall layout of dynastic Beijing. (Liang Sicheng and the Beginnings of Modern Chinese Architecture, 2006).

Although there are no longer eight separated hierarchical levels based on a certain number of intercolumnia, it is now instead the globally common factors of size, rarity, location, and exoticism (e.g., copies of European castles) (Herr Liu sammelt Schlösser, 2013) and furnishings (the German kitchen association AMK maintains its working group on China and sees German kitchens as a status symbol) (Herausforderungen in China, 2020) that document a correspondingly high social status. In China, home ownership still has a higher status than in most Western countries, for example, which leads to a high percentage of home ownership. In December 2018, the proportion of homeowners stood at 90% (China – Wohneigentumsquote, no date). Even though there are still no official figures on whether the coronavirus crisis and its associated loss of purchasing power among the population have led to a drop in the homeownership quota, it is still likely to be significantly higher than in Western countries such as the USA (66% in September 2023) or Germany (46.7% in December 2022) (Wohneigentumsquote – Daten – Wirtschaftsindikatoren, no date).

After the collapse of the communist danwei system in the 1990s, in which the labor unit brigade had previously provided almost every Chinese person with a secure job and a home, the private construction industry in China has boomed. At the same time, significantly more has been built than the market required for some time already, particularly in second and third-tier cities (Gus, 2020). Construction projects with a total area of around 1.5 billion square meters were launched in 2021. In 2023, the total area of new projects decreased to 693 million square meters (Müller, 2024). According to a study by Nomura, there are currently around 20 million pre-sold but unfinished apartments which will cost around 3.2 trillion yuan to complete (China drohen 20 Mio. unfertige Wohnungen, 2023). Overall, too much has been invested in real estate in China for a long time. At its peak in 2020, investment in real estate development accounted for almost a third of all fixed asset investment (Huang, 2023b), and a further slowdown will have a direct impact on China's gross domestic product (Weitere Abschwächung im Immobilienmarkt wird Chinas BIP drücken, 2021).

2. The Four Perspectives

To analyze the current situation, the real estate market can be viewed from four perspectives which are mutually dependent and influence each other: The perspective of real estate developers, the state government, local governments or administrations, and buyers.

As the perspective of real estate developers is concerned their rapid growth is based on a highly credit-financed business model that can be described in four steps (Hendy, 2022):

1. raise funds for the purchase of land from local governments.
2. advance sale of the to-be-developed plots to buyers.
3. start of construction for the project.
4. using the income from the project to secure funding for the next project.

This reliance on rapid expansion has been quite profitable in the past but has also led to a sharp increase in capital requirements. Part of this capital requirement is covered by down payments from property buyers who have to pay part of the purchase price when the contract is signed. There was also a very high volume of external financing. The real estate giant Evergrande alone has around 300 billion euros in debt (Evergrande: Vom Immobilien-Star zum Krisen-Symbol, 2023).

From the angle of the state government's perspective, this high volume of debt financing attracted the attention and concern of political leaders. The result was that property developers were given regulations in 2020 that would lead to a reduction in debt. Red lines were set in the form of three financial criteria that developers must meet before taking on additional debt. These three criteria are (1) a ratio of liabilities to assets (excluding prepayments) of less than

70 percent, (2) net debt not exceeding equity, and (3) sufficient cash to cover current liabilities. Project developers who meet all three criteria can increase their total debt by up to 15 percent annually. If one or more red lines are exceeded, the permitted new debt is reduced to 10 or 5 percent (UBS, 2021).

However, these rules were already softened at the end of 2023 to support real estate developers. On the instructions of the government, the central bank and the financial and stock exchange supervisory authorities agreed on a so-called "white list" in September 2023. This list comprises 50 property companies to which favourable loans can be granted. If necessary - and this is a novelty - these loans can also be granted unsecured. The Ministry of Construction finalised the list at the end of 2023, but has not yet published it (Hirn, 2024). However, several property developers have already declared that they are among the 50 companies and that they have already received financing commitments for several projects (Zhang, 2024).

From the local government's and administration's perspective, the real estate market is an essential source of income for local governments, as they generate revenue from land in two ways: (1) the sale of land use rights and (2) the collection of land and property taxes. In 2022, tighter restrictions on property developers led to a record number of defaults, triggering the worst housing slump in China since 1998. As a result, local governments struggled to sell properties, and their total revenue from property sales fell to 6.7 trillion yuan in 2022 (-23% compared to 2021). The central government lifted financial restrictions on construction companies to stimulate the economy. However, far-reaching reforms are needed to avoid further downturns. These reforms should regulate the close links between local authorities and the property sector. In addition, local authorities need more stable sources of income than property revenue to maintain their expenditure in the long term (Huang, 2023a).

From the buyers' perspective, owning a property is of great social importance (Levihn, 2022) and an essential part of private capital investment for retirement provision (Oertel, 2023). For Chinese men, owning a home is also often a prerequisite for starting a family (Junge Chinesen unter Druck: Ohne Wohnung keine Ehe, 2019).

For buyers, the business model of real estate developers means that they have to meet payment obligations in the form of down payments and interest payments for any mortgages required as soon as the purchase agreement is signed. Buyers are therefore faced with the financial burden of purchasing a property but are also confronted with long delays in the completion of construction. This also threatens to jeopardize social peace in the country, and therefore the government has launched the Guarantee for Completion program (Müller and Sahay, 2023).

A reform of the hukou system (户口 household registration) can also help to stimulate demand for real estate, as it is considered to be one of the problems negatively affecting the real estate market (Huang, 2023b). In the context of increasing urbanization, many citizens have migrated to metropolitan areas. In 2023, around 933 million people lived permanently in cities, an increase of around 12 million people compared to the previous year. Around 477 million people live in rural areas - a decrease of 14 million people. The urbanization rate (the share of the urban population in the total population) was around 66.2%, an increase of 0.94 percentage points compared to the previous year. (NBS, 2024)

However, people who move from the countryside to a city cannot easily register there - for example, because the government wants to control or slow down the unchecked influx to the metropolitan areas. A local hukou is regularly a prerequisite for purchasing a property in the respective district. In addition to the purchase of real estate, household registration also regulates access to education and healthcare facilities. In metropolitan areas such as Shanghai or Beijing, this has meant that the mere presence of good schools or hospitals increases the value of properties (Huang, 2023).

Demographic trends - in particular, the decline in population and the increasing average age - are also influencing demand for property. In 2023, China's population fell for the second time after 2022. While the decline in 2022 totaled around 850,000 people, the population fell by 2.08 million people in 2023, which corresponds to 1.48‰ of a total population of around 1.41 billion people (NBS, 2024). A further significant decline in the population is expected (Statista, 2024). These four perspectives illustrate the complexity of the issue but also the currently inconsistent approach to solving the problems in the real estate market.

3. Conclusion and Outlook

For the first time - due to the coronavirus crisis and the associated slowdown in economic growth - there is now a looming real estate crisis in the 2020s after more than 30 years of a construction boom. In all areas of the residential real estate sector, growth figures in 2023 are down significantly compared to 2022, as data from the Chinese National Bureau of Statistics shows (Table 1).

Two figures stand out here in particular, as they mark a turning point: 21.2% fewer new housing construction starts were recorded from January to September 2023 compared to the same period in the previous year, while at the same time, 11.8% more living space was sold in 2023 than in the same period in 2022 (NBS, 2023). This indicates that the population continues to have a strong belief in housing as a sustainable form of investment (which is not the case in countries with real estate bubble experience, such as the US and Japan). However, investors are exercising restraint in regarding this market (Batarags, 2021).

Real Estate Development and Sales for Jan-Apr

Indicators	Absolute Value	Growth Rate YYY (%)
Investment in real estate (100 million yuan)	35514	-6.2
Of which: Residential buildings	27072	-4.9
Office buildings	1392	-9.2
Buildings for commercial business	2587	-17.4
Floor space of buildings under construction (10,000 sq.m)	771271	-5.6
Of which: Residential buildings	542968	-5.9
Office buildings	30951	-4.5
Buildings for commercial business	67710	-8.5
Floor space of buildings newly started (10,000 sq.m)	31220	-21.2
Of which: Residential buildings	22900	-20.6
Office buildings	626	-19.1
Buildings for commercial business	2109	-22.4
Floor space of buildings completed (10,000 sq.m)	23678	18.8
Of which: Residential buildings	17396	19.2
Office buildings	647	9.8
Buildings for commercial business	1786	3.2
Floor space of commercial buildings sold (10,000 sq.m)	37636	-0.4
Of which: Residential buildings	32966	2.7
Office buildings	728	-14.9
Buildings for commercial business	1767	-21.2
Sales of commercial buildings (100 million yuan)	39750	8.8
Of which: Residential buildings	36020	11.8
Office buildings	963	-10.5
Buildings for commercial business	1849	-16.0
Floor space of commercial buildings for sale (10,000 sq.m)	64487	15.7
Of which: Residential buildings	31429	15.4
Office buildings	4721	23.7
Buildings for commercial business	14103	13.6
Funds for investment this year for real estate development enterprises (100 million yuan)	45155	-6.4
Of which: Domestic loans	6144	-10.0
Foreign investment	12	-89.6
Self-raised funds	12965	-19.4
Deposits and advance receipts	15925	4.0
Individual mortgage	8222	2.5

Table 1: Development and sales situation on the Chinese real estate market for the period January to September 2023 (NBS, 2023)

As demand is now declining overall compared to pre-corona crisis levels due to high real estate prices and lower purchasing power (plus the fact that new construction projects have been financed in recent years through apartments that have been sold and not yet built), many real estate companies are currently facing the threat of over-indebtedness. This scenario is also the reason for the impending insolvency of real estate giant Evergrande, which has repeatedly been granted new deferrals by the Chinese government to restructure its finances, most recently on December 4, 2023 (Kamp, 2023). After no restructuring plan was submitted, the court in Hong Kong ordered the liquidation of Evergrande. This (initially) only affects Evergrande's Hong Kong subsidiary with foreign liabilities totaling around 20 billion euros (Müller, 2024). The appointed receiver of Evergrande can only act based on an agreement concluded in 2021 between Hong

Kong and the People's Republic of China on the mutual recognition of court judgments. According to a decree of the Supreme People's Court of China, this agreement is a pilot project and only applies to the cities of Shanghai, Xiamen, and Shenzhen. The insolvency administrator can only apply to courts in these three cities for recognition of the Hong Kong judgment. However, Evergrande's assets are spread all over China, making it difficult to access them (Kamp, 2024).

Since 2020, there have officially been 68 real estate companies in China that are highly indebted or overindebted. This is also reflected in the continuing decline in the share prices of listed property companies (Warrick, 2024).

The government's official position on the current situation of the Chinese real estate industry can be found in the so-called White Paper on the Development Trend of the Real Estate Industry 2023, which includes three measures published by the Chinese government on 24 July 2023, all of which are aimed at stimulating the market. Firstly, the existing essential capital for purchasing a first property was reduced to 20% of the purchase price and the purchase of a second property to 30% of the purchase price. Secondly, the interest rate on loans for purchasing second homes was reduced, and thirdly, the interest rate on current loans for first homes was reduced. In contrast to the first two measures, the latter measure is probably aimed at reducing the risk of loan defaults while at the same time stimulating the market.

The situation is not much different for commercial real estate. Although domestic consumption in malls picked up again in 2021, it never reached the level before the coronavirus crisis and showed a clear downward trend again at the end of 2022 (CCAGM, 2023). Overall, it can therefore be assumed that demographic change in China will result in less demand for residential and commercial real estate in the future and that the existing vacancy rate for residential real estate will increase (Batarags, 2021). Unlike in Europe, there is no actual immigration in China. Unless the agricultural reform initiated in 2008, which serves to reclaim and increase the productivity of agricultural land (Grassi, 2008), is followed by further government measures in the future, which will further accelerate the continuous urbanization (currently at 63.65%) (Letzte Gnadenfrist für Evergrande, 2023) demand for housing will not increase from this end.

With a share of over 30% of China's GDP (Tan, 2023), the property sector will likely need to tap into new business areas and regions in the coming years. One option is to develop more projects abroad, for example along the Silk Road. This will help to avoid being caught up in an economic downturn for China as a whole.

Huang and Lovely see the real estate downturn as one of the main uncertainties facing the Chinese economy in 2024. Despite the numerous measures taken by the government to stimulate housing demand, it has not been possible to restore consumer and business confidence, and real estate sales have barely increased. Given the sluggish sales, developers continue to struggle with their liquidity crisis. The government's measures have recently focused more on supporting developer financing and less on supporting demand (Huang and Lovely, 2023).

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