

Prospects of Real Estate Markets in China

– Challenges and Opportunities

Liu Hongyu, Huang Ying

Institute of Real Estate Studies, Tsinghua University, Beijing 100084, China
liuhy@tsinghua.edu.cn, huangy02@mails.tsinghua.edu.cn

Executive Summary

China real estate market started in late 1980's and has experienced significant growth along with land use system reform and housing system reform. Because of the ever increasing of private housing demand in the past five years, it was the housing market that drove the rapid growth of real estate market as well as the national economy of China.

Based on the analysis about the current situation from the aspects of housing supply and housing conditions, real estate development investment, real estate prices as well as the real estate finance, the paper provides the readers with a rough map of real estate market in China. By analyzing development potentials and prospects of the market toward the long-term sustainable development, the paper also indicates the opportunities for foreigners in the areas of real estate related professional services, real estate financial service, institutional investment, and building technology.

Key Words: Real Estate Market, Housing Industry, China

© “2004, Liu Hongyu and Huang Ying, Institute of Real Estate Studies, Tsinghua University, Beijing 100084, P. R. China”

All rights reserved. No part of this paper may be reproduced, distributed, published, or transmitted without the prior permission of the copyright owner.

Prospects of Real Estate Markets in China

– Challenges and Opportunities

Liu Hongyu, Huang Ying

Institute of Real Estate Studies, Tsinghua University, Beijing 100084, China
liuhy@tsinghua.edu.cn, huangy02@mails.tsinghua.edu.cn

1. Introduction

China real estate market started in late 1980's and has experienced significant changes along with land use system reform and housing system reform. At present, state land use rights for profitable developments only can be granted by public tender, auction and listing. By the end of 2002, the owner occupation rate for urban housing reached to 79.1% through the privatization of the existing public housing and the development of private housing. According to the urban survey conducted by the National Bureau of Statistics of China, the home equity took about 47.9% of the household wealth in 2002^[1].

Because of the ever increasing of private housing demand in the past five years, it was the housing market that drove the rapid growth of real estate market as well as the national economy of China. During the year 1996 to 2000, it was estimated that the added-values of housing industry was about 6.7% of the national GDP on average and the contribution rates to GDP growth was 14.9%^[2]. The real estate industry had been one of the pillar industries of China's national economy.

Based on the analysis about the current situation of the real estate market in China, the paper provides the readers with a rough map of real estate in China. Furthermore, by analyzing the prospects toward the long-term sustainable development of the market, the paper also indicates the opportunities in the market especially for foreigners.

2. The Current Situation of Real Estate Market in China

The development process of China real estate market can be subdivided into four phases. The initiation and exploration phase from 1987 to 1991, the abruptly expansion phase from 1992 to 1993, the contraction and recession phase from 1994 to 1997, and the recovery and continuing expansion phase since 1998. The current situation of China's real estate market can be outlined as following:

2.1 Restructured Housing Supply System and Housing Conditions

In 1998, China abandoned the traditional administrative housing allocation system and began to restructure its new housing supply system. The new supply channels consist of private housing for middle to upper middle- and high-income groups, affordable decent housing for low- and middle-income households and low income rental housing for the lowest income families.

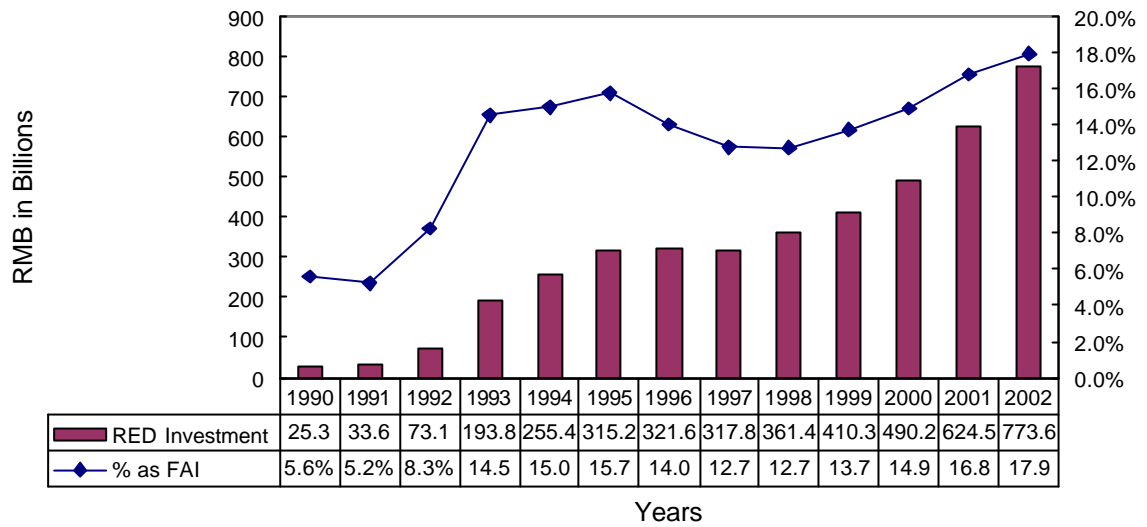
The reform accelerated the favor of private housing and accumulated more active resources for new housing construction. After 5 years development, housing conditions of urban residents had been improved greatly and households had become the major buyers in private and public assisted affordable decent housing market. In 2002, there were about 2.63 million new private housing units completed which represented 54.4% of total new housing supply (The rest of new housing supply came from the capital investment and private construction with percentage of 31.2% and 14.4% respectively). By the end of 2002, the average floor area per cap achieved 22.8 m² which made 83.9% increases than that in 1986.

At the same time, the willingness of urban residents for housing consumption grew abruptly. It is estimated that there were only 20% individual purchase in private housing market in 1987. However, this percentage had increased rapidly thereafter especially in the past five years. According to newly published statistics, the ratio of individual purchase in private housing market reached 91.73% in 2002 which implied that individuals played absolutely important role and had become the principal driving force of China's real estate market.

2.2 Real Estate Development Investment

During the year 1990 to 2002, the investment in real estate development had been kept rising sharply with a compound annual growth rate of 32.98%. In addition, the percentage of real estate development investment took 17.9% of the national investment in fixed assets in 2002 (Fig. 1). These indicators led to extensive arguments for the existence of overinvestment and/or overbuilding in real estate market.

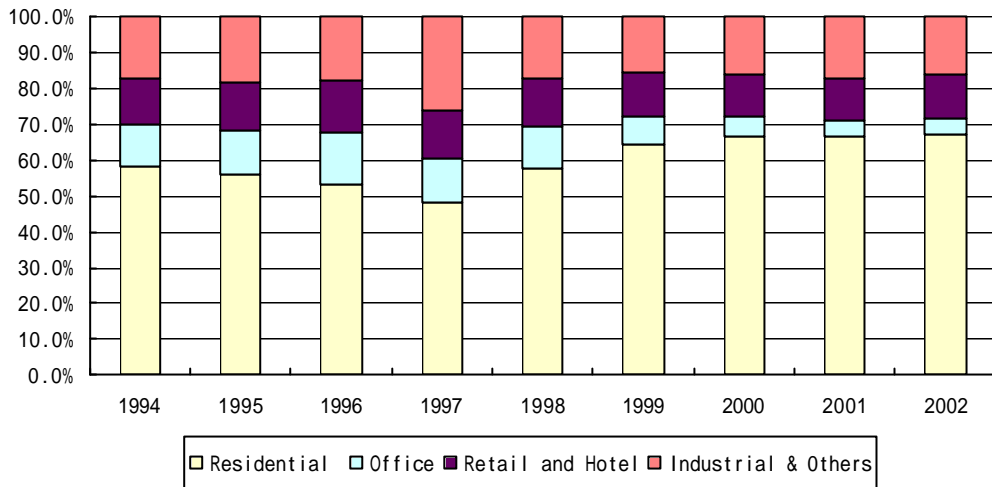
Figure 1. Real Estate Investment and Its Percentage in the Fixed Assets Investments in China,1990 - 2002



Sources: China Statistics Yearbooks, various years

In order to lower the overall market risk, the Central Government implements a series of policies to optimize the supply structure in the real estate market. The major objective is to encourage the supply of affordable housing and restrict the new constructions in commercial property sector by using land supply, taxation and financing. It seems that the objective has been achieved partly with the continuous improvement of real estate development investment distribution in each major type of property use. The share of development investment in residential sector increased from 58.5% in 1994 to 67.1% in 2002. At the same time, the share of the commercial buildings including office and retails declined from 24.2% to 16.9% during the same period (Fig. 2).

Figure 2. The Distribution of Real Estate Investment in China, 1994 - 2002

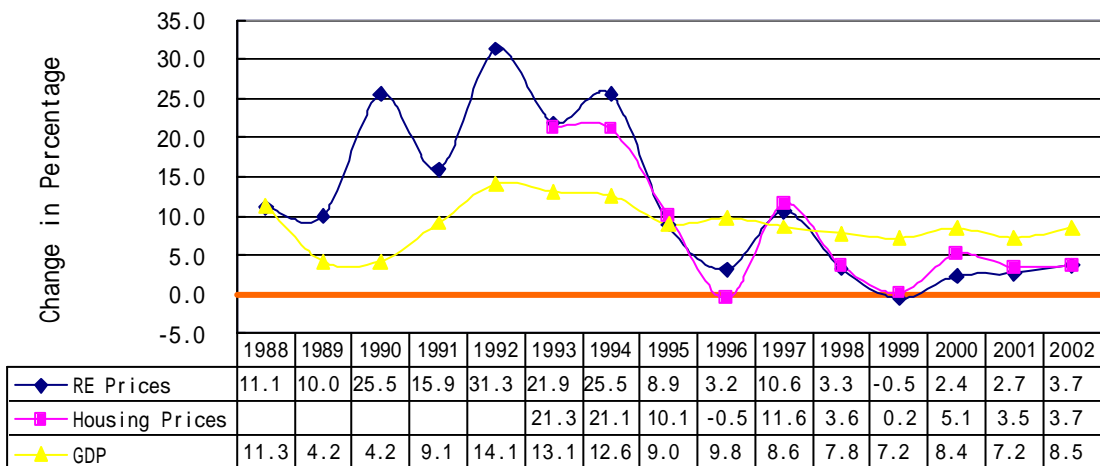


Sources: China Statistical Yearbook, various years

2.3 Real Estate and Housing Prices

Just like most of the real estate markets in the rest of world, real estate prices especially housing prices are always the public focus. The debate about if there are price bubbles in China's real estate market has been lasting for more than 2 years. According to the research conducted by Tsinghua University real estate group that there is no real estate price bubbles in the whole but we should pay attention to some local markets like the cities in the Yangtze River Delta. We can see from Figure 3 that the variations of real estate prices were always under the national GDP in the past five years and the performances were quite different during the bubble years around 1992 and 1993.

Figure 3. The Movement of Real Estate Prices and National GDP in China



The continual improvement of housing affordability also supports the view that there were no national real estate bubbles in China. It was estimated that the price to income ratio for new private and public assisted housing units in urban China decreased from 8.5 in 1993 to 5.87 in 2002. In consideration of the situation that less than one third of households can afford the new private housing units in most of the countries, it is unrealistic that all the urban households in China should buy their homes in private housing market.

2.4 The Development of Real Estate Finance

The role of real estate finance especially housing finance in real estate market is becoming more and more important in China. It is estimated that about 60% of the investment in real estate development comes from the commercial banks in recent years. Of which 25% comes from the construction loan directly and rest 35% comes from the mortgage loan for the forward sale of residential buildings.

It is well known that the outstanding of home mortgage loan takes more than 50% of the national GDP and more than one fourth of the total loan outstanding in most of the developed countries. However, the outstanding of home mortgage debt took only 9% of the nation's GDP and 6% of the total financial loan of commercial banks in China in 2002, the rapid annual increasing rate of the business will be amazing (Table 1). In consideration of the fact that commercial banks are the only major source of funds in real estate market, the People's Bank of China tends to tighten the loan origination in order to control the possible financial risk originated from real estate market.

Table1. Outstanding and Share: Real Estate Loans and Total Financial Loans

(RMB Billion Yuan)					
Years	1998	1999	2000	2001	2002
Outstanding of Real Estate Loans	310.6	433.0	665.8	980.2	1486.9
Home Mortgage Debt	42.6	135.8	337.7	559.8	825.3
Construction and Development Loans	268.0	297.2	328.1	420.4	661.6
Outstanding of Financial Loans	8652.4	9373.4	9937.1	11231.4	13980.3
Share of Real Estate Loans vs Total Financial Loans (%)	3.59	4.62	6.70	8.73	10.64

Source : *The People's Bank Of China*

3. The Prospects and Opportunities in China Real Estate Market

It is obvious that many problems only can be solved in the process of development, whereas solving problems often means the opportunities to the society. As an emerging

market, the rapid urbanization, the continuous improvement of household affordability with the rapid economic growth and social development, as well as the changing style and intention in housing consumption, provide us with enough confidence for the future development of real estate market in China.

3.1 The Accelerated Process of Urbanization

Urbanization is considered a major indicator of social and economic modernization. However, China's urbanization rate stood at merely 39.1%, about 9 percentage points lower than the world's average level in 2002. According to the research conducted by the Development Center of the State Council, the urbanization rate in China will increase to 60% in the year 2020 with the development of national economy. Even with the difference figure of 53.4% forecasted by the experts from the World Bank, there will be more than 15 million population or at least 5 million households move from rural to urban areas each year.

In consideration of the needs of upgrading and improving housing conditions of the current urban residents and solving the housing problems for 60% new urban households, it is estimated that the annual housing needs on average will exceed 0.54 billion square meters annually before the year 2020. It is also predictable for the huge demand on the related retail and office properties.

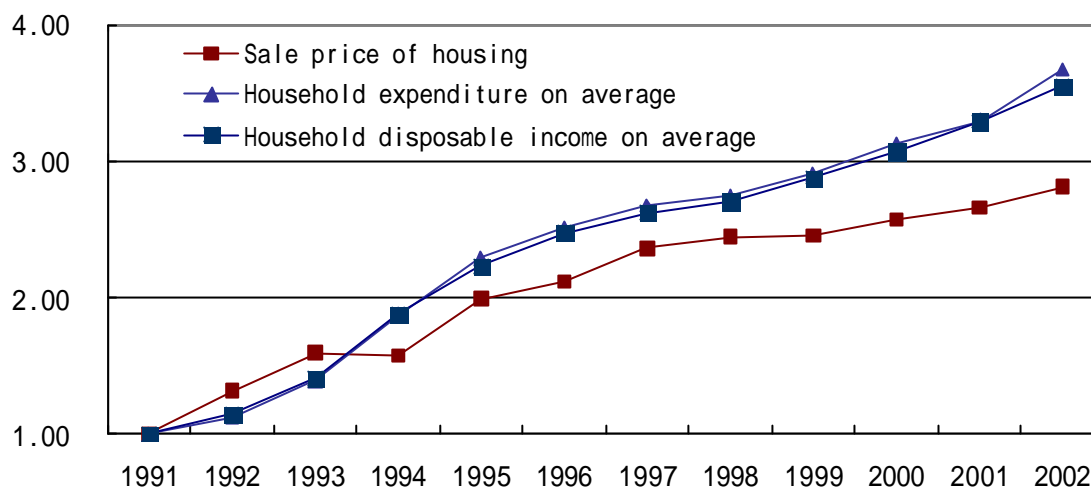
Another important force supporting the potential development of housing market is the current floating population in urban areas, including the migrant workers and seasonal workers. The data of the 5th national population census in 2000 implied that there were more than 44.8 millions of floating population worked in Shanghai and urban areas of Guangdong, Zhejiang and Jiangsu Province. Unfortunately, housing problems for this group of population are still neglected by both policy makers and developers.

3.2 The Increase of Housing Affordability and the Changing of Housing Consumption

The annual household gross income and disposable income are not only the key indicators for measuring the housing affordability of urban residents but also important indicators to support the housing market. Using 1991 as the base year to compare the series of relative indicators, we find that the three indicators were all growing quickly from 1991 to 2002^[3]. During 1991 to 1993, the growth rates of the three indicators were all smaller than that of the housing sale price increased, but since 1994 the former began to exceed the later and further began to grow in high speed from 1998 (Fig. 4). We can conclude that the

increasing of consumption expenditure on housing in China was supported by the growth of resident's affordability.

Figure 4. The Relationship of Housing Price, Household Income and Expenditure in Urban China (1991-2002)



Sources: *China Statistical Yearbooks 2001, 2002 and 2003*

It is a culture that all the Chinese households are willing to own their homes. The reform of housing system and housing market development are well accepted by most of the residents especially in middle and smaller cities. According to the housing choice survey in China's 5 major cities, 85% of residents acquired their home through purchase with 65% from private housing market (Table 2). The survey also finds that the percentage of home purchase for current residents with no registration (Hukou) is only 54% and much lower than the percentage of 83% on average. The relatively lower purchase percentage of the higher income residents serviced in private and foreign invested companies or with higher education is another very interesting phenomenon which may imply the existence of home purchase potential or the future perspectives in rental housing market.

Table 2. Housing Choices in 5 Major Cities in China

Cities	Beijing	Shanghai	Guangzhou	Chongqing	Wuhan	Five Cities
Rent (Private and Public Assisted House)	27%	13%	27%	10%	11%	17%
Purchase (Private and Public Assisted House)	73%	86%	73%	90%	89%	83%
Sub Total	100%	100%	100%	100%	100%	100%
Private House (Rent and Purchase)	46%	70%	71%	68%	62%	63%
Public Assisted House (Rent and Purchase)	54%	30%	29%	32%	38%	37%
Sub Total	100%	100%	100%	100%	100%	100%

Source: *Tsinghua Institute of Real Estate Studies, 2003*

3.3 Opportunities in China Real Estate Market

Though real estate is a sector with the smallest market barriers, it is still benefit a lot for the aboard investors and professionals to explore their business in Mainland China after China joining WTO.

(1) Opportunities for real estate related professionals

As we all know that the real estate related professions include urban planner, architect, landscape architect, engineer, project managers, surveyor, real estate appraisers and brokers, real estate investment analyst, mortgage broker and title insurance broker, property manager and facilities manager, and so on. However, the participation of aboard professionals focus mainly on the foreign invested projects and the international public tendering projects like Beijing Olympic Game and Shanghai World Exhibition Projects. Along with China market becoming a part of the international market, there will be more and more market space for aboard professionals in China. The key problems might be how to localize their mature service model and find the effective ways to cooperate with local profession.

(2) Opportunities for real estate financial service providers and institutional investors

It is an urgent issue to develop the real estate capital market through real estate finance innovation. Though there is a strong need from commercial banks to secure their mortgage debt in order to diversify the long term financial risk, the operation of residential mortgage-backed securities is still at the research stage and there is not any work on CMBS currently. Besides, the fact of insufficiency in legal investment channels for institutional investors leads to the inefficiency and high risk for both investors and developers. Therefore, the real estate financial service providers will have bright prospects in assisting China to build up real estate financing infrastructure, to innovate real estate service products, to develop advanced mechanism and instruments for controlling of the related financial risk. In addition, the developing commercial property market and rental housing market also provide attractive potentials for institutional investors to participate.

(3) For homebuilders with advanced building technology

With the rapid development of national economy, urban residents have begun to pay more and more attention to housing quality and environment. It was for this reason that The Center for Housing Industrialization was established under the supervision of Ministry of Construction in July 1998. One of the major objectives of the Center is to strengthen the links and technical exchanges with other countries and regions.

Like most of the other parts of the world, the sustainable property developments obtain more and more support among the Chinese society. Some frontier developers have obtained a great success in making profit through adopting new building techniques and materials. However, popularities of new techniques covering green building, manufactured housing, energy saving building materials and building components are far from our expectation. As a signal of foreigners' attention to this area, the National Association of Home Builders recently proposed a program for the Chinese Annual Builder Practices Survey to gather reliable information on builder practices and material usage in new residential construction in collaboration with Tsinghua University. It is estimated that the survey results will make it possible to make informed decision regard to the current and future residential construction market in China.

4. Conclusion

In general, China's real estate market is going on the way of healthy, steady development. There are broad growth potentials in this emerging market as a result of the rapid urbanization, the improvement of housing affordability and large group potential purchasers for new houses. There are, however, some challenges in this sector which create a lot of opportunities for foreigners in such fields as professional service, housing industrialization, and real estate finance innovation.

Reference

- [1] Liu Hongyu and Zheng Siqu ,(a) Home Assets: Its Role in Household Asset Portfolio, Journal of Economics and Management Research, No. 4, 2003, pp39-41;
- [2]]Liu Hongyu and Zheng Siqu, (b) Classification of Real Estate Industry and the
- [3] Shen Yue, Liu Hongyu, The Research on the Relationship between the Housing Price and the Indexes of Macro-economy. The Theory and Practice of Price[J] Vol 8, 2002, , P20~P22

© "2004, Liu Hongyu and Huang Ying, Institute of Real Estate Studies, Tsinghua University, Beijing 100084, P. R. China"

All rights reserved. No part of this paper may be reproduced, distributed, published, or transmitted without the prior permission of the copyright owner.