

China Law Update

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Current Situation and Anticipated Trend of Foreign Investments in China's Real Estate Market

Since 2006, China has implemented a string of policies designed to restrict foreign investments in the real estate industry. Recent actions, such as the State Council Order No. 546 promulgated at the end of 2008, which repealed the rigorous treatment of the urban real estate tax, have curbed some of the most onerous of these restrictions; however, the Chinese real estate market remains heavily regulated. As a result, China's attitude toward foreign investment in local real estate may be best characterized as conservative.

Current Atmosphere

In China, the real estate industry is among the restricted industries listed in the Foreign Investment Catalogue (2007). The proper handling of foreign acquisition of local real estate hinges upon whether the real estate will be personally used by the investor. If a foreign investor does not intend to use the real estate personally, then the investor must set up a foreign investment enterprise ("FIE") in mainland China.i[1]

The China Ministry of Commerce ("MOFCOM") provides further details regarding this requirement:

- A foreign-investment real estate enterprise ("FIREE") with an investment amount of more than USD 3 million, must possess a registration capital greater than or equal to 50% of its investment amount. When the investment amount is less than USD 3 million, the registration capital requirement jumps to greater than or equal to 70% of the investment amount.ii[2]
- Prior to the establishment of a FIREE, a foreign investor must (1) acquire a right of land use and ownership of real property attached to the land; or (2) execute a contract granting a right to use the land or other purchase agreement with certain qualified parties.iii[3]
- The foreign investor must pay the necessary fees in order to obtain a Use Certificate of State-owned Land ("Use Certificate"). Based upon the Use Certificate, a FIREE will be entitled to benefits including a formal annual Approval Certificate of Foreign-funded Enterprises, a Business License and the relevant tax registration.

In addition to these requirements, the foreign investor will be subject to certain restrictions regarding their financial activities. While investing in the Chinese real estate market the foreign investor may not use any domestic or overseas loans to fund their registration capital requirement. Further, the foreign exchange department will not approve the settlement of such loans in the event that any FIE fails to obtain a Use Certificate, or the capital of project development does not reach 35% of the total investment amount.^{iv}[4] Additionally since June 1, 2007, the administrative authorities will not approve settlement of overseas loans for FIREEs who have obtained approvals with MOFCOM and are willing to increase investment capital.^v[5] This restriction is designed to prevent foreign investors from relying on leverage and other debt to finance their local real estate purchases. Given the liquidity pressures in this market, these high capital requirements have dampened foreign investment in the local real estate market.

Anticipated Trends

Recent developments suggest China is making efforts to increase foreign investment in the Chinese real estate market.

On December 31, 2008, China State Council issued Order No. 546 to clarify that FIEs are subject to a 12% Real Estate Tax ("RET") starting January 1, 2009. Prior to this clarification, FIEs were subject to an 18% tax rate. The reduction in RET suggests China is attempting to foster increased foreign investment in the local real estate market.

Additionally, many cities in China have released policies designed to facilitate foreign investment. For example, Tianjin Municipality established the Preliminary Application for Assignment of the State-owned Land Use Right ("Preliminary Application"). Under the Preliminary Application, a foreign investor is permitted to obtain a right of land use after providing a deposit in one of a variety of accepted currencies (RMB, USD, EUR, HKD, or YEN) and placing a bid or a permit, participating in an auction, or hanging out a shingle. Fuzhou Municipality has similarly issued a rule permitting Preliminary Applications.

These recent policies are strong signals that China's central and local governments are considering ways to increase foreign investment in Chinese real estate. Expect additional policies designed to increase the flexibility and attractiveness of FIREEs.

Conclusion

In a nutshell: cautious optimism. China has not removed the restrictive regulatory framework foreign investors face when attempting to invest in the real estate market. While it is unlikely China will remove this obstacle to investment entirely, China's implementation of policies that ease the restrictions placed upon the FIREEs is happening with greater frequency. Reductions in taxes and increased options for obtaining critical land use permits are the initial signs in what promises to be a continued relaxation of regulations relating to the FIREEs. However, the high capital requirements still pose a significant obstacle to foreign investment, and interested parties should carefully consider the capital outlay and the cost entailed in securing the necessary approvals prior to embarking upon a real estate investment in China.

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vi[1] According to Section 1, Article 1 of Opinions on Regulating the Access to and Administration of Foreign Investment in the Real Estate Market (*Circular No. 171, 2006*), which was jointly issued by six China central ministries.

vii[2] Notice on Relevant Problems Relating to Opinions on Regulating the Access to and Administration of Foreign Investment in the Real Estate Market (*Circular No. 192, 2006*), which was announced by MOFCOM.

viii[3] See Article 2 of Notice on Further Strengthening and Regulating the Examination, Approval and Supervision of Foreign Direct Investment in Real Estate Industry (*Circular No. 50, 2007*).

ix[4] Section 7, Article 2 of *Circular No. 17*.

x[5] See Notice on Issuing the List of the first Batch of Feign-Funded Real Estate Projects Having Passed the Procedures for Archiving with the Ministry of Commerce (*Circular No. 130, 2007*).
