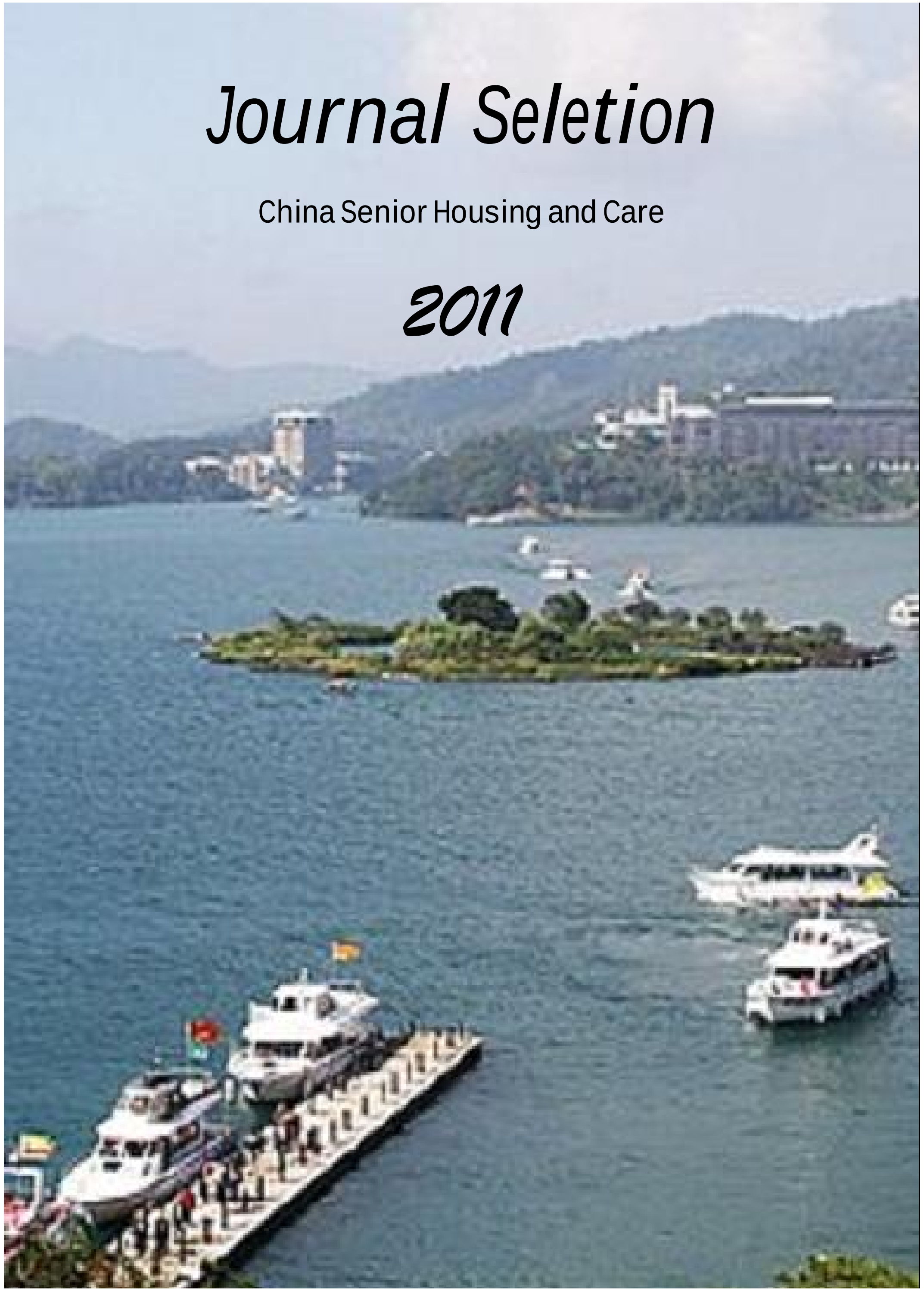
Journal Seletion

China Senior Housing and Care

2011



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• Social Insurance to Foreign Employees Makes Distant Retirement More Viable

The Ministry of Human Resources and Social Security recently released a new nation-wide policy regarding foreign employees' participation in social insurance scheme. According to the regulation, as of October 15, 2011, foreigners employed by companies incorporated in China and those under a secondment arrangement must participate in the social insurance scheme, which includes basic pension insurance, basic medical insurance, work-related injury insurance, unemployment insurance and maternity insurance.

The implementation enables foreigners who have worked and lived in China to stay when they retire, thanks to the pension payment as is enjoyed by Chinese citizens.

Although this seems not to be a trend in the future while the scheme allows an insured foreigner to withdraw his or her individually deposited funds once he or she leaves, and most elderly prefer to live in their hometown after retirement. In addition to the fact only enterprise annuity can be resorted to as a supplementary pension, and personal pension saving plans like US's 401k or IRA is still impossible in China, it seems the pension enjoyed in a social insurance scheme is not enough at all.

However, we have to admit that seasonally migrate to a favorite city where social insurance can be enjoyed is a good alternative for some people. This new policy makes it more viable.

• More Stimulation to Be Seen in Senior Care Industry

Since this April the Standing Committee of the State Council promulgated the 12th Five-year Plan on the Development of Chinese senior care, some initiatives are seen from local level of the Chinese authority.

According to the national scheme, private capital include foreign investment is encouraged to take part in the sector. The plan outlines various high-level goals to stimulate the construction of senior living communities, establish more nursing facilities that target to provide 3% of occupancies for nation-wide elderly by 2015, and implement more legislative incentives to attract private and foreign investors.

Some investors complaint they can't find transparent policies governing the senior care sector, however that's not the whole picture. Since the Civil Affairs Bureau is responsible for senior care industry, and different localities have varied financial capability on supportive measures, so searching for policies from a local level could be easier. For example, Beijing is planning to construct some occupancies for elderly in affordable houses, and the municipal government has increased the subsidy for construction of senior care facilities; in Jiangsu Province, some cities are experimenting on integration of medical insurance and senior care system aiming to enable the elderly to enjoy medical social insurance in senior care facilities. It is also expected, in the near future, preferential policies on land supply and tax treatment will be introduced that will diversify in different cities.

• Legend Holding Invests in Senior Care Industry

Legend Holding as media reported has established an operational enterprise for the business of senior care early this August. The company, with a registered capital of RMB 2,000 million, will focus on operation of senior care facilities, senior housing development and fund management in relevant fields. The company will be navigated by Hony Capital, one sector of Legend Holding engages in PE investment, where funds in RMB and US dollar that value for totally more than RMB 30 billion are in management.

We've find recently capital from home and abroad are targeting at the booming market in senior care industry, not only in real estate and senior facilities, but also very ambitiously aiming to capture the whole profitable chain by equity investment in healthcare, medical, nursing training and financing sectors, etc.

• Fantasia Holding Pilots on Senior Housing Development

Fantasia Holding, a leading property developer mostly famous in southern China has recently announced its pace to senior housing development. As alleged, Fantasia Holding has targeted and started construction of two pilot communities in Shenzhen

and Chengdu, after years of in-depth research in the area. To pursue this, Fantasia Holding is planning to cooperate with experienced service providers from US, Japan or Taiwan.

Apart from housing, developers in senior's communities will provide convenience service, health care or assisted-living and insurance, where unlike traditional business model, value-added products are believed to create more profits. In lack of relevant experience, but with huge resource of real estate on hand to build senior communities, now developers like Fantasia Holding are seeking cooperative partners in western countries, trying to find out a win-win solution in cooperation.

• China Citic Bank Tries on a "Semi-Reverse-Mortgage"Service

China Citic Bank announced on October 9th that it is going to provide a new mortgage loan product for the elderly. According to the introduction, borrower, be senior or his legitimate successor, shall mortgage his apartment to the bank in order to obtain a loan to the senior that paid as monthly pension with a maximum term of 10 years. Among other qualifications for borrowers to apply for this financial product, one is the borrowers should own more than one apartment.

Apparently, this is a product similar to "reverse mortgage" in other countries that we've introduced in our last edition of newsletter. However, we think instead of being a typical reverse mortgage product, this is more like a loan service targeting to aged costumers. Without participation of insurance companies who can calculate risks by factoring in senior's age, average life expectancy, value of mortgage assets and pension amount, the bank is unable to take the risks of unexpected life expectancy and devalue of house—therefore the longest term is only 10 years and at the end of the day, borrower will have to find out how to pay back the loan or otherwise loss his property. We believe as a trial for banks to test the market of elderly service, uncertainty of the market response lies ahead.

• Beijing Release Local 12th Five Year Plan on Senior Care Industry

Beijing Civil Affair Bureau this October releases its 12th year plan on senior care industry. Compare with the nation-wide plan, Beijing's is more specific and practical. From an investment and legal perspective, we think the following points, among others, are worth noting:

--Explore finance products. Lacking of finance innovation to support senior care industry has been a systematic problem in China for years, and it will not be solved over night. Beijing's plan encourages trials on long-term care insurance, which is proven an essential supplementary of social insurance in many countries, and "house-for-pension scheme" or "reverse mortgage" with insurance companies, banks and Housing Fund Management Centers involve in.

--Regulatory support on in-home care service, including encouraging private investment in in-home care service, tax preferential and subsidiary policies for service providers. Aiming to establish an industry mechanism that regulate entry and exit threshold for service providers and standardize service criteria and charging rates through industry associations, it is anticipated within year self-discipline alliances may be created with government playing a supportive role.

--Explore preferential policies on land providing and prices for utility fees, improve foreign investment environment. High cost to acquire senior facilities has always been a big concern for many foreign investors. It is still not clear how these preferential policies could be, but Beijing's plan does shed some lights on a loose regulatory trend in land control.

--Strengthen standardized management in senior facilities by promulgating relevant regulations. If a comprehensive system on service level, assessment methods and match-in charging rates are established in the near future, we believe some illegal or unregulated phenomenon in the market will decrease and eventually customs will benefit.

--Positive on cooperation between profitable provider and non-profit facilities. Recent report has shown big cities like Beijing and Tianjin are constructing senior communities under an affordable housing mechanism, creating a big market for service providers that governments are unable to serve without participation of

private players. As a result, well-trained providers with experience in Chinese market are more likely to be selected as government's partners. Moreover, to run a franchise with a famous brand and mature management seems to be a huge market with great opportunities.

How government can fulfill its targets and to what extent their support could be? And what are situations in other cities? We will continue to probe.

• Shanghai is to Revise Provisions of Administration on Senior Care Facilities

As a city of the most aging population, Shanghai has as of 1979 become an aging society—almost 20 years earlier than other cities in China. With continuous emphasis on development in senior care industry, it was alleged in the period between the first and fourth section of the 13th Municipal People's Congress Meeting, that there were 24 pieces of advice with respect to senior care been adopted out of totally 43 that were received by Civil Affair Bureau.

Recently, Shanghai Civil Affair Bureau are planning to revise Administrative Rules Governing Senior Care Institutions promulgated in 1998, and intents to update the legislation according to the current environment and national policy. The report said research and legislative draft have already been filed for approval through due process.

By implementing the country 12th five-year plan on encouraging senior care industry, Shanghai's local regulations are definitely out of date. Many issues regarding land provision, tax treatment and foreign investment, among others are still in blank. We find Xiamen is a frontier in local legislation update while on November 21 the city promulgated Xiamen Administrative Rules Governing Senior Care Institutions. However, the Rule only regulates those senior institutions for welfare or non-profit purpose, in other words, only those registered as private non-enterprise units are subject to this Rule. According to current polices, this type of senior institutions cannot do for-profit business and all incomes can only been used for welfare purpose. It seems still unclear on how to establish private-run (including foreign-invested) for-profit nursing homes, and whether preferential treatment can be enjoyed. We expect Shanghai's Rule in the near future can have some breakthrough or innovations.

- ## Shanghai and Beijing Plan Pilot Scheme of Individual Income Tax-deferred Pension

This November, Shanghai and Beijing municipal government separately announced plans to roll out pilot scheme of individual income tax-deferred pension plan (IIT-deferred pension plan). According to Beijing's plan, the pilot scheme will be started from commercial pension insurance products and then maybe extended to other supplementary pension plans where appropriate; while Shanghai's scheme aims to contribute to the development of insurance industry in the construction of Shanghai's "Two Center" goal.

Apart from Beijing and Shanghai, Xiamen is also actively planning such scheme and memorandum between China Insurance Regulatory Commission Shanghai Bureau (SIRC) and Xiamen Municipal government has been reached last year. As reported, six insurance companies including China Life, Pacific and Ping An are entitled to take part in the preparation phase of the pilot scheme.

In essence, under the proposed IIT-deferred pension plan, qualified individuals will be eligible to claim IIT deduction for personal pension contributions with a monthly ceiling applied, and defer the IIT payment until receipt of the pension in retirement. IIT-deferred pension plan has become an international practice, such as the 401(k) plan and Individual Retirement Account (IRA) plan in the U.S. and Mandatory Provident Fund in Hong Kong that in order to encourage personal contributions to supplementary pension plans.

Actually early in 2008, the China State Council has for the first time from a legislation perspective clearly encouraged research and exploration on IIT-deferred commercial pension insurance plans. However, Circular (2009) No 694 from the State Tax Bureau clearly regulated that individual contribution to basic pension plans can be claimed for IIT deduction, whereas individual contributions to enterprise annuity and commercial pension insurance are both nondeductible for IIT purposes. From a legislative perspective, the IIT-deferred pension plan at this moment is in lack of legal basis. With the increase of threshold of IIT and pilot implementation of value-added tax reform, finance burden from the government is increased. Therefore, the IIT-deferred pension plan, which may sacrifice current tax revenues to local government, should find a better way to balance different factors.

- ## Urge for Long-term Care Insurance

With rapid growth of elderly population from world wide and roaring expense on medical and care, long-term care insurance has become one of the most important health insurance in the world. Over years, people in China are urging an introduction of long-term care insurance, and hence attract more attention on this subject.

Long-term care insurance derives from US in 1970's, and then expanded to Europe and South Africa. In Asia, Japan as of 2000 integrated long-term care insurance into social welfare system where people over 40 are compulsory to take part in long-term care scheme.

However, in China, long-term care insurance is at an infant stage. Due to the lack of experience of statistics and ability on product design and pricing, only few insurance companies such as Cathay Life Insurance and China Health Insurance are selling this type of product. Given the high cost of commercial insurance premium that makes it impossible for long-term care insurance to have a full coverage within seniors, some experts suggest to placing long-term care insurance as a part of social insurance. Similar to the practice in Germany, long-term care insurance can be paid together with medical insurance and refer to its proportion, where the government, employer and individual are all contributing according to a certain percentage.

- ## Senior Housing, Harder than Imagination

As the year draws to a close, control policy from central government on real estate has forced most developers to tighten their fund, and some have to slow down on their senior housing development. Early on March, RK Properties announced to focus on senior housing in the coming years with its debut in Shanghai's project coming soon. The Company also announced it had reached a cooperative deal with Masen Group from Japan, which would provide care service and staff training. However, media recently says no more progress are seen on any of the senior housing projects since its announcement more than half a year ago.

At this moment, you find most developers are active but still very precautious on involving in senior housing. In practice there are two types of business models: one is selling and the other is membership (or sometimes a hybrid of both). Selling model is attractive for its rapid payback of investment but on the other hand impossible for developers to obtain continuous cash flow in the future. It reflects the capability of developers in product design and targeting, quality control and service provide. In a membership model, represented by Cherish Yuan from Shanghai, developers can gain profit from selling of membership cards and charging of monthly fee during seniors' stay. But it also means long payback term, requires proven experience and sustain funding for the developers, and therefore keep many players outside the door. Since senior housing is related to many other businesses apart from real estate, such as in-home care, medical, entertainment and catering, no matter the developer intents to operate by its own or by third party providers, it is only suitable for those with long-term goals but not for short-term speculators. Seems reality is much harder than imagination if the senior services are just propagandas for the developer to sell more houses.

• Highlight on the State Council's Plan for Systematic Construction of Social Senior Care Service

General Office of the State Council in December released its 12th Five Year Plan on Systematic Construction of Social Senior Care Service following a prior plan on senior care industry published earlier this year. This time, the plan is more concentrated on social welfare from a government perspective, and aims to establish a system that can provide in-home care for most elderly and placing communities and nursing homes as supplementary resorts. Seems nothing special, but having read in details, we find there are some places worth noticing especially for private investors in senior care.

Firstly, the Plan widens the land usage and resource for senior care institutions. As one of the big problems many investors are facing, how to find a well-located and qualified place in order to open a nursing home is always confusing. The Plan lists three resources: elderly care facilities as infrastructure in newly-build communities; utilization and remodeling of unused housing belong to hospital, enterprises and villages and all kinds of existing premises and facilities such as public training and entertainment centers, sanatoriums, hotels and hostels; and allocate land use right under specified conditions. As for the land issues we are concerning, the Plan leaves

a great space in practice. Cities like Shanghai and Guangzhou with limited land resources may be encouraged to open small-sized nursing home inside communities, as is done in Japan, Hong Kong and Singapore.

Secondly, the Plan prompts the participation mechanism for private enterprises. According to the Plan, models of government build—private operate, private build—government assisted, government purchase of private service and government subsidies and allowances are workable for private investment; the government will promote professional teams to export their expertise by taking part in operation of senior care institutions and encourage them to take more responsibilities for settling elderly care needs in a way of sharing resources with government.

Thirdly, it refers to expansion and innovation of financing channel for senior industry, including increase credit volume for construction of senior facilities and senior care operation enterprises, and try on direct subsidy or interest discount. While finance for senior housing construction is usually treated as loan for real estate projects, under the current tightening credit policy, investors can hardly borrow money from the bank. So an uprising amount of PE or real estate funds nowadays contribute a big resource for senior housing finance.

In addition, the Plan specifies requirement on suburb-urban senior care, capital raising mechanism, staff training and utilization of high-tech equipment. As most part of the Plan needs to be implement by local government in detail, we will wait and see.

• 2011 Foreign Investment Industrial Guidance Catalogue Promulgated–Some Good News to the Industry

The National Development and Reform Commission and the State Administration of Commerce promulgated the 2011 version of the Foreign Investment Industrial Guidance Catalogue (2011 Catalogue) on December 24, 2011, which will take effect January 30, 2012. The revisions revolve closely around the theme of accelerating the change in the direction of China's economic development, and place great emphasis on improving the foreign investment structure, promoting technological innovation, as well as industry upgrade. We notice some adjustment and changes in the 2011 Catalogue as summarized below will have profound impact to foreign investors that are interested in senior care, real estate and retail industry:

1) Promote the development of the service industry. The 2011 Catalogue encourages foreign investment in the modern service industry including venture capital enterprises, intellectual property rights services, occupational skills training and home service. Further, foreign-invested medical institutions and finance lease companies have been moved from the restricted to the permitted category. We've noticed occupational skills training and home service will be major business by those expertise export oriented foreign investors in senior care, so this adjustment has actually pave the way for a following introduction of preferential policies in the industry. However, details on industrial qualification and conditions for new entrants is needed to be clarified, so we advice those who were previously trapped in obtaining related business scope while establish their enterprises may consider to make adjustment upon implementation of relevant policies.

2) Open policy for commercial management companies. The 2011 Catalogue has moved various kinds of commercial companies engaged in franchise business, commission business and business management from the restricted to the permitted category. Franchise has a bright future for senior care service industry, so cancel it from restricted category is definitely good news. We will continue to introduce legal environment of franchise in the coming newsletters. Meanwhile with rising amount of commercial projects being constructed throughout the nation, demands for professional commercial management companies are increasing, the new Catalogue encourages international experts with advanced technology and abundant experience to form their domestic team. And we also notice the new Catalogue places construction and operation of large-scale wholesale market of primary produces into restricted category.

3) Real estate in continuous restriction. 2011 Catalogue makes no major change upon the 2007 version with regard to the restricted and prohibited category on real estate other than moves the construction and operation of villa from restricted to prohibited category. Actually, as of early this year, the State Land Resource Bureau has already clearly abandoned any further provision of villa plot. However, thanks to unclear definition of villa, in practice developers will have various types of "semi-villa" apartment products to avoid being considered as villas. Therefore we believe the adjustment seems to be more symbolic.

- **Active Movement on Construction Standards of Senior Facilities**

Recent years, senior housing has drawn extensive attention and real estate developers such as Vanke, Poly and Fantasia have all announced their plans pacing towards the senior housing. The first issue they will definitely face is the design specification regulating the construction of senior houses. As we predict, design and construction standard for senior houses will evolve from enterprise to industrial level, and then adopted by local and national authorities as compulsory regulations.

Developers and construction companies are practicing as frontiers in the field. Boloni Home Décor Group recently introduces Chinese version of Handbook on Senior Housing Design from Japan. The Handbook is widely adopted in Japan as a targeted practical guide in senior housing.

On the other hand, industrial standard in real estate seems to be more practical. The national Committee of Aging supported by Aging Association, CRECC and American Seniors Housing Association has recently issued guidance for development and operation of senior housing community. By means of setting up flagship projects of green house communities and establishing a system of evaluation and appraisal for the projects participated by real estate developers, the guidance aims to gradually standardize construction design on senior communities and senior care services.

However, at the state level, only the Code for Design of Buildings for Elderly Persons promulgate by Construction and Civil Affair Bureau in 1999 can be referred to. Early this year, the Civil Affair Bureau issued two regulations—Construction Standard on Community Day Care Centers and Construction Standard on Senior Care Nursing Homes, the latter of which specifies construction scale, location, planning, construction specifications, fitting and equipment and interior design with related to the construction of nursing homes, senior apartments and other elderly facilities. It is worth noticing that Technical Guidance for Construction Specification on Intelligence System in Senior Communities drafted by the Center for Housing Industrialization is still seeking public opinions, and standards from the MOHURD is expected to be released in the coming months.

- **New Legislation on In-home Care Service**

In the 12th five-year plan, in-home care is placed as a priority for elderly to choose after retirement. Namely, in-home senior care service covers a wide variety in assistant living, house keeping, nursing and mental care, among others, which supposed to be provided by government as a dominant resource and private providers as a supplementary. The soaring elderly population in the nation has increased the demands for professional senior care providers. Now both the government and private sector play an important role in the in-home care business.

Take Fujian's practice in government dominated service as an example, local Committee on Aging will establish Elderly Care Centers responsible for providing personnel support, and Civil Affair Bureau establishs Management Centers for Senior Care responsible for guidance and monitoring of the care providers in the region. Meanwhile the local government will try cooperative ways with third party providers by means of government purchase of professional service.

On the other hand, private investors are mostly counting on policy support from government. In Tianjin, for example, companies engaging in the in-home care service are exempted from business taxes or enjoy occupational, social welfare and income subsidiaries under certain conditions. And in Shanghai, A Sweden and Singapore-backed firm, Econ-SCA Health Management Co Ltd, is now carrying out pilot projects in Zha Bei District. Kicked off as of this September, this first of its kind wholly foreign invested project received fully support from Shanghai local authorities.

With related to the quality control of senior care service, Hangzhou, a model city famed by its favorable living environment, walks ahead of the whole nation. Local Provision on In-home Care Service and Management (DB 33/T 837—2011) was published this September, in which service standards on management requirement, service scope and specification, classification of service institution and appraisal on service quality are regulated in detail. The Provision also empowers the management departments, namely Civil Affair Bureau and local government, to alter, degrade or cancel the classification of service provider according to the appraisal or feedback from service receivers or their relatives or unrelated third parties.

- **KKR forms China RE fund A Typical Transaction on Fund Establishment and PE Investment**

On 5 September 2011, SOL HK (a wholly-owned subsidiary of Sino-Ocean Land "SOL"), Chance Bright (a non wholly-owned subsidiary of SOL through Gemini) and KKR SPRE (an affiliate of KKR China Growth Fund L.P.) entered into a Framework Agreement in relation to the establishment and management of a Fund and JV Entities.

According to the Framework Agreement, SOL HK and KKR SPRE respectively agreed to inject USD 70 million into the Fund as limited partners. The Fund has a term of five years since the date of accepting capital injection. Besides, Gemini and KKR SPRE will subscribe for shares in the joint-venture entity at face value to hold 50% shares each, in order to manage and administer the affairs and investments of the Fund.

The Fund, called Sino Prosperity Real Estate, had been registered in the Cayman Islands where the KKR China Growth Fund is also established. A statement by SOL to the Hong Kong stock exchange said the investment platform was intended to invest in certain real estate projects in the People's Republic of China.

SOL also signed an investment cooperation agreement with the Fund, on basis of which the fund and SOL subsidiary Chance Bright signed an investment agreement. The Fund will purchase part of equities and bonds of Chance Bright held by SOL HK but excluding the interests and rights of a hotel contained in a Dalian-based project under construction.

From our perspective, we think on one hand, funds are established through offshore vehicle so to make equity investment from abroad, while more often, RMB funds incorporated onshore will be more convenient for equity investment, especially for real estate funds; on the other hand, equity investment usually counts on the settlement of a project as quit solution, or otherwise being brought out by another investor. On top of that, even though long-wait REITs regulations are still pending, we have seen most fund investment prepared in a pattern ready for future REITs adoption. We will discuss REITs updates in China from a legal perspective in our next edition of newsletter.

• Does “House-for-Pension Scheme” Work — Be Careful

By Michael Qu Attorney at Law

In China, it is only those from civil services and a very few selected ones are fortunate to have enough employee pension who will have a steady income to afford retirement life in private senior houses. Even though recent year we’ve seen some companies have started the enterprise annuity business and provide commercial pension insurance products for the employees in order to make up for the inadequacy of social security and to meet citizens' higher needs for pension insurance, retire pension for seniors at this moment is still insufficient.

The situation is that most elderly have capital locked up in real properties with no steady income, so their only real option would have been to remortgage their flat or to sell it to raise capital. A house-for-pension scheme or a reverse mortgage program may solve the problem. However, by far neither seems to be easy in China.

Apart from the traditions that most elderly prefer to leave properties to their descendants rather than sell for living, a workable scheme to unlock paper appreciation of the real property owned by the elderly to at least support themselves a decent life is still required by some elderly, especially the ones in “empty nest” families. Among others, house-for-pension scheme is definitely a good choice. Unlike reverse mortgage, in a house-for-pension scheme, homeowners usually sell their homes, whether to service providers or buyers in the fair market, in the first place, while in a reverse mortgage the property is still held by the homeowner until he or she passes away or chooses an early termination in some cases.

A House-for-pension Case

To be clarified, there is no officially legitimate practice in reverse mortgage, and house-for-pension schemes are only piloted in some cities, those who want to provide such a scheme can only make this happen by reach an agreement with the homeowners. However, reaching a legal binding agreement sometimes seems to be uneasy. One case recently sentenced by a Shanghai district court may find a snapshot.

In this case, a service provider at the end of 2010 closed a deal with an elderly homeowner of 88 years old. The elderly sold its house of 55 square meters to the company at a price of RMB 550,000; in return, the elderly is entitled to live in the senior house provided by the company free of charge until his death. In

homeowner would no longer enjoy the appreciation of real property and the company would take the risk of increase in life expectancy of the elderly. First instance of this case rules that the deal should be withdrawn resulting in restore of the house to status quo ante.

(relatively lower than the market value of the house); and failure to performing disclosure and informing obligations by the service company.

While the court did not in essence say no to the practice, similar house-for-pension agreement between homeowners and service providers, from our opinion, is still legally binding and workable subject to the following requirements.

(a) Fully disclose the rights and obligations of the deal. In the abovementioned case, the court thought for elders at that age, service provider should inform his children or relatives, or even take notary to clarify rights and duties throughout the deal, in order to make sure the deal is concluded through a fair and sufficient consultation.

(b) Fairness of a house-for-pension deal. Among other terms and conditions in the agreement, the most important one is that the selling price of house reflects its market value. Taking into consideration of the expenses arise from the deal, the service company should pay by lump sum or installment as pension to homeowners. While most of the elderly prefer to leave any surplus to their children upon their passed away or reserve their right to redeem the property in case they change their mind, technical fitness to the deal needs to be designed to meet that kind of demands.

(c) Being granted confirmation by the homeowner’s children or couple. Whether or not the homeowner, legally speaking, has sole and full discretion to make decision on his or her properties, this essential step may mitigate many risks and trouble in the future. In cases that service providers give a fixed term commitment to their customers coupled with specific repayment date, they will have to consider the risk the elder’s children may not be able to or willing to take guardianship of their parents once the term expires. A prior guarantee from the children therefore will be helpful to some extent.

Urge for Reverse Mortgage

Given the ambiguity of legal formation of house-for-pension scheme, we anticipate policies on reverse mortgage to be released in the near future. Recently we've seen Hong Kong for the first time introduce its Reverse Mortgage Program ("RMP") that enables homeowners to use their self-occupied properties as collateral to borrow from a participating bank whilst continuing to stay at the properties for life. Reverse mortgage enables the elderly to stay in their homes, and at the same time obtain steady loan payments to help improve their quality of life.

According to RMP, a reverse mortgage is a residential mortgage product specifically designed for elderly people. Participants will use their self-occupied and non-mortgaged homes as collateral to apply for reverse mortgage loans with banks, and will receive a secure stream of monthly loan payments. At the same time, the elderly can remain in their homes for the rest of their lives. They do not need to repay the loan or pay any interest or mortgage insurance premiums during their lifetime. The banks will possess and dispose of the properties upon the death of the elderly to cover the accrued principal, interest and mortgage insurance premium. Any surplus will go to the inheritors.

Even though market response will determine whether the scheme will operate in the long term, we anticipate this could be a good model for China given the similar traditions and social environment.

One report we've found from an insurance company that they are preparing a reverse mortgage scheme, which is waiting for approval from authorities and could be implemented as early as the end of this year. Before this announcement, we've seen some unsuccessful practice, whether in Shanghai or in Nanjing, mostly failed due to unbalance between profits and costumers' acceptance.

Lawyer's advice

Taking out a house for pension deal may be a major decision for elderly homeowners in their twilight years. Especially when their homes are likely to be their most valuable asset, it is important for these elderly homeowners to fully appreciate the nature of a house for pension deal in order to make an informed decision for themselves. Many successful schemes elsewhere provide a counseling service for those who are interested, and therefore we advice service providers to establish an effective counseling mechanism whereby lawyers can help people understand the details before they decide whether to join the scheme.

• A Justified Pricing Mechanism in Senior Care Facilities

A pricing mechanism in senior care facilities may be related to its service, market environment, customer demands and industrial standards. We may find some investors are always complaining about its unprofitability but unable to raise their price, while some others setting up unimaginable high price to target super high-ending market. People can't help asking-- what happens to the pricing mechanism? Is there any regulatory governing this industry?

A typical situation in senior community

A private senior community in Guangzhou is planning to raise its monthly fee for RMB 100 in response to inflation and increase of operational costs. However, only one out of thirty-six agrees the proposal in a community conference attended by resident representatives. As alleged by a resident, presenting an admission agreement entered into in 2007, he is entitled to live in the community until death after paying entry fee of around RMB 70,000, which is for the purpose of room decoration, and continuously paying a fixed amount of monthly fee to enjoy senior care services. According to this agreement, he thought any price alteration without a prior consent is a breach of contract, even though the service provider had a reasonable excuse of increasing cost of labor and materials.

The dispute here arises is very common in practice, where illustrates the importance of a justified and reasonable pricing mechanism in senior communities.

Regulatory environment on pricing in senior community

Pursuant to PRC Price Law, prices of most commodities and services shall be the market-regulated prices and prices of an extremely small number of commodities and services shall be the government-guided prices or the government-set prices. Market-regulated prices mean those prices determined autonomously by the operators and formed through market competition, while government-guided prices and government-set prices are determined by authorities either in the range of price fluctuations based on benchmark or the specific price mandatorily to act.

There are no nation-wide laws or regulations on pricing requirement in senior communities. However cities such as Guangzhou and Tianjin have their own regulations, saying, prices and service items in private nursing facilities are following market-related price mechanism while in public or non-profit facilities are government-guided. Does that mean private-owned senior care facilities can determine the price as high as they wish? Not that simple.

Administration on pricing and its supervision

First of all, as a principle in Price Law, operators shall, in determining prices, abide by the principle of fairness, being in conformity with law, honesty and credibility. Therefore, production and management costs and market supply and demand situation shall be the fundamental basis for the determination of prices by the operators.

Secondly, pricing in senior care facilities is under double supervision from Civil Affair Bureau and Bureau of Commodity Price. Price can be determined by operators with respect to the service quality and market demand, but certain procedures are to be followed—bulletin the price items and levels in noticeable places and then filing it with the Bureau of Commodity Price. Failure to follow the above procedure, the pricing may be deemed as fraud pursuant to the Consumer Protection Law, and as a result the price mechanism may face great challenge, or more seriously, be imposed of administrative penalties—for example fine and business suspension.

Thirdly, freedom to determine the price for their products and services by operators doesn't necessarily mean they can alter—in most cases raise the price-- at will after consumers have purchased the products or services. Operators shall abide by the admission agreement they have reached with the residents, meaning any unilateral price rising is invalid. However, operators can insert some clauses in the admission agreement that, under certain circumstance price can be adjusted only by notification of the operator. In order to make it legally binding, operators shall avoid this clause from being considered as "form clause" that usually are unfair to consumers by wording the clause very carefully.

Last, if practicable, we advice operators to file their form of admission agreement with relevant authorities. This is not a must step, at least not as required in some industries such as property management, public utility service, house purchase and tourist, etc. And failure to the filing will not result in void of agreement either. However we anticipate while authorities realize regulating price in senior care facilities is of great importance for many people's long-term benefit, it will sooner or later find some method to supervise those at-will price mechanism.

Discuss on some practices

In light of the very principle regulatory environment, some practices are worth discussing:

A. Pre-payment: deposit, entrance fee and membership fee

Deposits are usually paid by residents to reserve a right of admission during project construction, whereas for developers are used as assistance to project financing. As required by Contract Law, 20% of the product price is at top for a deposit. However in practice it is hard to apply in the admission deposit because most of the "products" that monthly paid are without a fixed price. Questions are not only on how much can a deposit be, but also on how deposit will be refund, or deducted from entrance or monthly fee.

Considering of entrance fee, there will always be the types of refundable and non-refundable. By nature of long-term care essence of the service, we think both types are acceptable as long as it can survive the test in marketplace. For refundable model, usually refund certain percent of entrance fee upon death of the resident based on a pre-agreed calculation, it is more acceptable especially for Chinese people; and for non-refundable model, as is practice in western countries for decades, is also proven workable since usually residents will be entitled to enjoy higher level of service with less expense after admission. So the importance here is to specify services and rights that can be enjoyed by residents in connection with the entrance fee, for example specify the condition of accommodation facilities, type or coverage of caring service or meal standard, etc. Moreover, the mechanism of "grace period" can be introduced, whether for non-refundable or membership card practice, in order to give residents a complete reflection of what they really want.

On the other hand, membership card—a variation of ownership-style structure—is very popular in the Chinese market. Customers may have opportunity to receive a return on investment through resale or redemption by developers. In practice, membership cards are sold before construction completion of senior facilities, enables developers to finance their project, or in some cases provides developer with capital to fund other unrelated projects. To avoid being considered as illegal financing of real estate development and take control of financial capability, we advise investors to proceed with selling membership cards only when construction is completed or at least main body of buildings are completed, and reserve certain percentage of income for construction and early operation of the senior housing project.

As long as regulatory enforcement on monitoring pre-payment to protect the resident is in lack, and no requirement for developers to establish escrow account, residents may concern about the financial capability of the developer. It is time for developers come up with affordable guarantee instead of pure promises to convince and educate costumers to accept their product. In addition, investors shall be aware of any future restriction or even prohibition of pre-payment obtained by developers if regulators are afraid of massive financial problems result from real property overheat that may lead to losses to senior customers.

B. Monthly fee

Nowadays, monthly fee for the service plus entrance fee is commonly adopted in senior care communities. Instead of lump sum entrance fee or membership card payment, monthly fee is flexible in items freely for residents to choose and reduce risks in inflation and cost increase on a long-term basis, and therefore, some investors choose this as the single pricing model. As a result, monthly charge varied a lot in different facilities. While it is hard from legal to restrict ranging of pricing, given the nature of senior housing neither a landlord-tenant relationship (which can refer to market rental), nor a proprietor-lodger relationship (which will have a industry-regulated price level), we can only advice operators to strictly follow the rules we mentioned above to mitigate regulatory risks.

In the future, ranging of service rates match up with its standards is to be introduced by industry association and local regulators. It is also worth mention that sometime monthly fee in dependent-living facilities are more like a rental, therefore it may not cover expense on dining, advanced nursing or assisted-care, recreational, medical or use of other facilities. These plus and optional fees should be priced as reasonable as possible, especially where services are provided with by third-party vendors.

• Analysis on Land Acquisition or Cooperative Models Based on Collective-owned Construction Land Use Right

Citing from one article of Asia Healthcare Blog wrote by Benjamin—(investment in China's eldercare industry is) an unproven business model in a foreign culture with foundational questions about whether the target market will pay for the services provided all taking place in the midst of a real estate market in China that is very, very expensive.

High price of China's real estate has always been an obstacle for senior housing developers, especially for new entrants. This article aims to discuss the possibility of using collective-owned constructive land use right to open nursing facilities and its approach. Meanwhile we will pay more attention to legal risks that inevitably arise together with lower costs.

Overview of the Chinese land tenure system

First of all, we will have a brief on Chinese land tenure system. The most distinctive feature of the Chinese land tenure system is that land ownership is independent of the land use right. Land ownership is divided into two categories: state-owned land and collective-owned land. Natural persons or other organizations can only acquire land use right and as a result it is impossible for any of them to acquire the ownership of land in China.

Land in China is further classified into three usage categories: (a) Agricultural land, i.e., land directly used for agricultural production purposes, including cultivated land, forest land, grassland, agricultural irrigation land, etc.; (b) Construction land, i.e., land on which buildings and structures are built, including land for urban and rural housing and public facilities, industrial and mining land, land for military and tourism purposes, etc.; and (c) Unused land, i.e., land that does not fall within the above two categories.

Given the purpose of construction of senior housing, in this article, all land use right we are discussing is construction land. In China, when land is to be used for construction, the criteria must be followed as below:

First of all, as a general rule, only state-owned land may be directly used for construction of commercial or profit seeking projects such as real estate development. Secondly, only after collective land is requisitioned, i.e., it is converted to state-owned land, may it be used for commercial project construction and development. Thirdly, if agricultural land is to be used for constructing commercial projects, users must go through the approval and examination procedure with government authorities for the conversion of agriculture use to construction use.

As a matter of practice, the foreign invested enterprises, just like domestic Chinese enterprises, may acquire state-owned land use right by grant, allocation, leasing transfer and so on. But as for acquisition of Collective-owned Construction Land Use Right ("CCLUR"), most investors haven't even heard of this.

The following we will introduce three approaches to obtain CCLUR.

Cooperate with township entities

The Land Administration Law stipulates that the transaction of CCLUR only applies when starting up enterprises or joint ventures together with other units or individuals by way of using land use right as shares, whereas circumstances shall subject to general planning for the utilization of land. Therefore, foreign investors can cooperate with township entity by establishing new enterprises with land use right distributed as capital investment.

Given the nature of this cooperation model, it can only be used in very limited circumstances. There are several points to keep in mind that (a) Whereas occupation of land for construction purposes involves the conversion of agricultural land into land for construction purposes, the examination and approval procedures in this regard shall be required and the contribution of land use right as equity share in new enterprises shall be approved by the local government; (b) the contribution of land use right is conducted only by township entities, and as a result land use right is owned by the new enterprise; and (c) it is use right of the land that contributed in the enterprise rather than its ownership. Therefore the land is still owned by rural collective economic organizations and term of land use right depends on the business purpose of the enterprise.

Transaction of CCLUR

Another way to obtain CCLUR is through legitimate transaction. The transaction of CCLUR includes granting, assignment, leasing or mortgage of CCLUR, etc.

From a local level, the practices and legislation of transaction of CCLUR are very active, especially in Beijing and Guangdong. Take Guangdong as an example, the provincial government has since year 2005 implemented Administration Measures of Guangdong Province on the Transaction of Collective Land for Construction Use to specify condition for transaction of CCLUR.

According to Guangdong's regulation, any transaction regarding collective-owned

non-construction land is prohibited before it is legally converted to construction land; the title of land use right shall be clear with peasants' residential land use right excluded; the use of CCLUR shall be complied with general zoning plan for the utilization of land; and the usage of the CCLUR shall be approved by local government. No CCLUR can be used for the development of residential apartments.

As a long-waited implement protocol, Guangzhou Municipality passed its provision on September 19, 2011 to outline the requirement and procedure for transactions of CCLUR. As stipulated, transaction of CCLUR for the purpose of commerce, tourism or entertainment shall be conducted through public auction, bidding or listing refers to relevant procedures applied to granting of state-owned land use right; the benchmark of land grant price of CCLUR can be at most 30% lower than similar ones as state-owned.

Procedure for transaction of CCLUR includes:(a) issue a bulletin before transaction; (b) hold a meeting within township entity and publicize the resolution of the meeting for more than 15 days; (c) A majority consent letter shall be obtained from all villagers of township entity before transaction; (d) transaction of CCLUR been witnessed by notary public; and (e) be registered of the land use right title in local government.

Leasing premises on CCLUR

More often in other cities like Beijing and Shenzhen, investors may face the situation that no practical procedure can be followed while they just want to lease existing buildings on CCLUR. From a legal perspective, lease of premises built on CCLUR inevitably results in the lease of CCLUR, which will be deemed as a way of transaction of CCLUR. Legal validity of such lease agreement will be arguable given the abovementioned state law and regulation. However, according to a judicial explanation from Guangdong High People's Court, which we believe are also applicable in other cities, the lease contract of premises built on CCLUR is legally valid once permits of construction completion and fire completion are obtained for such premises.

In practice we do find many projects acquired by leasing did not follow the abovementioned procedure but to obtain a majority consent letter from villagers of township entity. The risk here, however, is that the government has the right to requisite the CCLUR for public interest in the terms of lease contract. The landlord and tenant must obey such requisition but only requiring compensation from government.

Lawyer's advice

Obviously, CCLUR and senior housing are very matched with each other given the huge demand of senior care facilities in rural areas. However, coupled with lower costs, risks remains to be highly aware of, that among others, regulatory uncertainty, land use right term and financing difficulty are the biggest three.

First, In the long run, we believe government will implement a more loose and flexible policy. We advice for now investors be very careful at acquisition procedure, government approval on land usage and planning, and, most importantly to obtain majority consent from villagers of township entity. Secondly, unless transaction of CCLUR though due procedure, more often leasing of such a land use right will not result in a secured use term. In case of governmental requisition or breach of contract by landlord, vast investment is at risk. Protect investor's rights under a contract and guarantee method in some cases is a must. Thirdly, pursuant to practice, CCLUR is unable to mortgage to banks for finance purpose, and as a result will bring finance burden to some developers who are aiming to expand in a rapid pace.

• New Trend on Real Estate Finance—Analysis on Real Estate Trusts and Private Equity Investment

Generally speaking, there are four types of resource of real estate finance, which are from banks, security market, trusts and funds. With the tightening controls the central government is taking toward developers on real estate finance, an emerging finance practice of trusts and funds is forging a new trend of indirect finance for real estate developers, who are usually counting on lending from banks. In this article, we will discuss two channels for real estate finance—real estate trusts and private equity investment.

Real Estate Trusts, from Prevalence to Surveillance

A real estate trust (RE Trust), also referred as "real estate pooled investment fund", is where trust companies raise funds from investors by ways of issuing trust plans, and work with real estate developers on real estate projects, in order to provide beneficiaries with profits in return.

<u>Legal Structure and Risks</u>

Compared with strict requirement of lending for real estate development, where four certificates of land title, zoning, planning and construction shall be sufficient and self-investment for the developer shall exceed 30% of total volume, trust companies can design flexible fund structure catering to different types of real estate projects. In practice, RE Trusts generate returns through specific assets, equity investments, loans, or a hybrid thereof.

Unlike other finance model, RE trusts can be less risky, given the severe supervision on compliance from the China Banking and Regulatory Commission ("CBRC") (e.g. according to circular 54 on strengthening supervision on RE Trusts, ratio of beneficiary interests between priority and secondary cannot exceed 3:1 in one trust product). However, legal structure of RE Trusts is more complex that make it difficult to surveillance, and therefore as a result, a lot of non-compliance exists, essentially illegal lending in name of equity investment, interest investment or assets trust. As of December of 2010, the CBRC issued a warning circular to control risk, more surveillance are taken until recently Shanghai Bureau of CBRC has suspended seven trust companies from RE Trusts business for non-compliance reasons.

Risks of RE Trust may arise from breaching of developers, which on the other hand is tied up with China's real estate market. Statistic from a trust company shows there are around one third of projects in the trust plans they issued since 2009 are unable to commence or complete construction on time, and hence may lead to breaching of trust deeds. Usually, the reason of delay is varied from different projects, and trust companies will come up with some solutions, for example, prolong payment terms upon consent of beneficiaries, refunding from issuing a new trust plan, dispose assets by selling project interests to purchaser, etc. However, if none of the above works, investors may suffer massive losses if the developer unable or unwilling to pay back their investment. In that case, investors can only resort to assets liquidation and lawsuit procedure that may extend for a long period.

Notwithstanding the above risks, RE Trusts is still promising. Now the business is moving from residential projects to commercial buildings and subsidiary houses, while more are targeting listed companies, large-scale groups or regional leading developers, and in the end may bring out REITs product.

Waiting for REITs

REITs, even with a legal structure similar to RE Trust, are in essence a typical investment tool of assets securitization that issued and available to individual investors. A REIT is defined as an entity that invests primarily in real estate properties that can generate rentals continuously and qualifies for special tax status, so there is single taxation at the investor level.

There are still no Chinese REITs (C-REITs) products to be offered to the market. Chinese authorities are now studying two types of pilot schemes of C-REIT products—one is regulated by CBRC, the other by the China Securities Regulatory Commission (CSRC). The CBRC REITs will not affect the ownership of real property that the property owner finances from the trust by using rental as collaterals. It is essentially a scheme of securitization of revenue streams from a pool of real estate assets that will be offered to institutional investors and traded on the inter-bank market. The CSRC REITs, on the other hand, are traded in an open market by packaging a portfolio of real estate with sustainable rental income. It will be offered to retail investors and will resemble the REIT products offered in Hong Kong and Singapore. With reference to Hong Kong's experience of introduce its first REITs product on a subsidiaries houses project and its affiliated commercial and parking space, by far cities of Tianjin, Beijing, Shanghai and Haihan have already submitted their pilot scheme with regard to subsidiaries houses projects.

However, compare with international mature market, C-REITs legislation need to be enacted premised on the existing national legislation governing trust products, securities offerings, investment fund management and securitization. At this moment,

lack of tax exemption, incentives or tax pass-through to the investors, unclear policies on property title transfer to REITs SPV and short of expertise on assets management and financial analysis make C-REITs even more difficult. As a result, some developers resort to offshore REITs, such as YueXiu REIT (00405) and recently Hui Xian REIT (87001) in Hong Kong. Capital Land also announced recently planning to issue offshore REITs with a portfolio of real property in mainland that values 5.3 billion USD. Apart from the market factors that foreign countries are different from China, such as evaluation method and profit expectation of returns, China's restriction on foreign investment in real estate and foreign exchange control makes offshore practice challenging. It is expected when C-REITs are finally introduced, those offshore REITs will definitely return to the Chinese Market.

Real Estate Private Equity Funds, in a Wild West Route

Real Estate Private Equity Funds (REPE Funds) refers to PE funds that focus on real estate investment through ways of M&A or project development. The year of 2011 is a milestone for REPE in its robust, where PE contributes to a large part of fundraising for real estate developers while on the other hand provides wealthy group with another channel of investment.

Compare with ordinary PE funds that prefer IPO exit, REPE Funds, usually in great scale, is aiming at shorter payback term and higher profit. Nowadays, REPE Funds formed by real estate companies are dominant in the market, in which real estate companies such as Gemdale, Vanke and Soho China are PE sponsors. Apart from that, the others are independent REPE Funds, e.g. real estate investment by CDH.

Legal Structure

REPE Funds are usually structured in forms of corporate, limited partnership or trust scheme. Partnership in practice is more common thanks to its flexibility on internal set up, tax treatment and liability and profit allocation, and therefore adopted by most fund raisers. Pursuant to provisions on limited partnership in China Partnership Enterprise Law, there is no specific requirement on capital amount and its injection when incorporate a limited partnership. Investors can freely decide their investment amount depending on the essence of real estate projects. In addition, there will be local regulations on PE investment updated from time to time, we recommend investors to follow in fund incorporation.

However, the limitation of a topped 50 partners in a partnership enterprise brings quite a trouble for some REPE Funds where vast capital requirement is companied by exceed partner numbers. As a consequence, recent years we've seen a new model of

"Trust + Limited Partnership". Under such, investment companies or fund management companies will first set up a partnership enterprise as general partners ("GP") before trust companies would issue trust schemes to raise trust funds. After the trust schemes are set up, the trust funds raised will be invested in the partnership enterprise, where the trust schemes are limited partners ("LP"). Combined with both trust scheme and partnership, this model also to a large extent solve the tax and exit issues, but in practice still facing with continuous doubting. Insiders alleged that in essence this is real estate trust finance—only by means of PE. Meanwhile, on Dec 23 National Development and Reform Commission ("NDRC") in its Notice on Promoting Regulatory Development for Equity Investment Enterprises (Notice 2864), for the first time challenges the legitimacy of such practice. The Notice requires that investors spring from trust or partnership that serves as LP in a fund shall be counted pass-through as qualified investors, except for those are funds of funds. It seems the door to circumvent the limitation of investor number has closed, but the attitude of Chinese authorities whether there will be a thorough enforcement is still unclear.

Overseas Power

Speaking of PE, early entrants are really those overseas funds in the Chinese market. Under the regulatory circumstance, foreign invested PE funds are formed mainly in three structures: investment company pursuant to Circular (2004) No.22 promulgated by MOFCOM, foreign-funded venture investment enterprises pursuant to Circular (2003) No. 2 and foreign-funded partnership pursuant to Partnership Enterprise Law and Circular (2010) No. 47 of State AIC.

While from year 2006 the Chinese authority has strengthened to curb in foreign investment in real estate through a series of regulation, particular prohibited Foreign-funded PE from any direct or indirect foreign investment in non self-use real properties regardless investment is pursued through property purchase or equity investment in real estate companies.

As of early this year, cities like Shanghai, Beijing or Tianjin have started pilot schemes on Qualified Foreign Limited Partner ("QFLP"). A foreign-fund GP that has obtained the pilot qualification is permitted to convert its foreign currency into RMB for investment in an RMB Fund, provided that the amount so converted does not exceed 5% of the aggregate capital commitments of the RMB Fund. Such investment would not change the nature of the RMB Fund. This seems to imply that the RMB Fund formed by the structure may be treated as a domestic partnership as opposed to a foreign-invested partnership that have investment restrictions; provided there are no

foreign LPs. However, due to the complexity and time-consuming procedure, only very few funds are trying this approach, while most foreign PE funds are invested through establish of WFOE or JV despite of the policy restriction. In practice, foreign-funded PE will establish a domestic management company as GP to sponsor and establish an RMB Fund, provide investment management and related services to RMB Funds. The Fund will eventually invest in real estate projects after fundraising.

Supervision and Risks

With respect to supervision of PE Funds, in early 2011, NDRC in its Circular 253 has Regulated the Administration on mandatory filing of equity investment enterprises under certain circumstance in Pilot Areas of Beijing, Tianjin, Shanghai, among others, and furthermore in the abovementioned Notice No. 2864 expands such mandatory filing to all newly founded and existing equity investment enterprises all over the country and requires legal opinion from law firms being presented regarding the compliance of such business. However, due to the low hierarchy of NDRC's legislation, only sanctions of "warning" and "notice of black-name on website" can be taken to supervise investors' behavior, we believe the enforcement of such regulation may face challenges. Meanwhile in other local areas, the policies are continuously issued with an appropriate monitoring attitude in general. In a recent revise draft of Securities Investment Fund Law, we've found PE is included in the territory of fund to be regulated.

On the other hand, REPE Funds grow with a national policy on curbing the real estate market, no mature model and standard have yet been established, and many practice on investment orientation, tools, strategy or exit approaches are still in an experimental stage that no best solution can refer to. We've seen some are raising money in a name of PE investment, but in fact engaging real estate speculation activities, or in essence are pure lending disguised with equity investment—both will be risky to the investors being little regulatory protection out there.

Last but not the least problem to be solved is exit solution. Normally, foreign-funded PE will seek three capital exits by disposing their invested equity, which are (a) partially or wholly sell of equity share in the target enterprise; (b) purchase-back by target enterprise or its shareholders subject to specific conditions; or (c) IPO in security market home and abroad. These exit solutions sometimes will face different limitation or restriction in practice, and we believe by its nature of real estate investment, REPE is definitely suitable for an exit strategy of issuing REITs product in a capital market, as we discussed in first half of this article.

• Entering into Senior housing & Care Market in China A Legal Perspective

1、Chinese Senior Housing & Care Market

(1) Aging of the Chinese Population

According to a recent study by Chinese Ministry of Civil Affairs, more than 166 million people are aged 60 or older, representing 12.5% of the country's population and almost one-fifth of the total senior population in the world. In some urban areas of medium to large Chinese cities, such as Shanghai, the percentage of senior citizens among the total population has already exceeded 20 percent. By 2030, it will have more than doubled to 360 million people, and the percentage of senior population over age 65 in China will surpasses that of Japan, being the most aging country in the world.

Senior care industry is expected to be an emerging marketing in China that covering various sectors such as senior living institutions, nursing training, supplies for the elderly, financial products for the elderly, elderly entertainment and healthy facilities, etc. For some investors, the integration of the senior care sector will generate numerous prospects. Among others, senior housing development and senior heath care are the most attractive for investors.

(2) Introduction of the Chinese Market

In China, elderly care services are supplied by both public and private/NGO nursing homes and community elderly services, with premium elderly homes emerging as a new service segment.

Community elderly service includes services for seniors living in their own homes, but using community resources and being taken care of by their communities. Roughly there are only around 8,000 community service centers in China.

Nursing homes includes those for seniors living in external elderly nursing homes operated by government or private companies. The market for nursing homes operated by private companies is very fragmented, and most of them are currently believed not to be profitable.

Premium elderly homes include the homes of seniors who purchased or rent elderly apartments, living in communities and being taken care of by service vendors. Most of the premium elderly homes provide high-standard-of-living

facilities with high-quality medical and nursing services, entertainment and sport facilities, and tourism plans. Some even offer residence swap programs between cities.

Currently, only a small percentage of consumers are actually using external elderly care services. However a significant portion of elderly may consider them in the future that will constitute a market share of 1.8 trillion by 2020 and 7.6 trillion by 2050.

In recent years, some local developers have invested in large scale senior care communities which are targeting to provide premium elderly homes to rich people. And some big investments by foreign players have already been made and further investment is believed to soar in the future.

2、Regulatory Environment

(1) China’s 12th Five-year Plan

On 17 April, 2011, Standing Committee of the State Council promulgated the 12th Five-year Plan on the Development of Chinese senior care (中国老龄事业发展“十二五”规划) following the National 12th Five-year Plan for National Economic and Social Development (中华人民共和国国民经济和社会发展第十二个五年规划纲要) issued early this year, showing the termination of the Chinese authority to generally develop a healthy senior care market. According to the scheme, private capital include foreign investment is encouraged to take part in the sector. The government is trying to stimulate the construction of senior living communities, which is considered as the most suitable and acceptable elderly care model in China, and establishment of nursing home facilities that target to provide 3% of nation-wide “nursing beds” by 2015. At the same time, more legislative incentives is planned to be formulated and improved on the preferential policies in land planning, infrastructure facilities, taxations, etc, with a goal of boosting a transparent and healthy market on senior care industry and therefore attracting more private and foreign investors.

(2) Related Land Policies

（a）Ways for land acquisition

To startup a senior housing and care business, such as develop a elderly community or startup a nursing home, the first step is to acquire land use right and buildings. The most common way to acquire a state-owned land use right is to purchase from local government through bidding procedure, or to purchase or lease premises from an owner. In some cities, pursuant to local legislation, it is possible to acquire collective-owned constructive land use right through due process thanks to the opening up policy of making good use of land resource in the suburban areas which are collectively owned by villagers.

Is it worth mention that curving the real estate bobble has been a dominant voice in the Chinese real estate market resent years, and hence may affect the availability for investors to acquire land use right. Even though it is encouraged by the government to invest in the construction of senior housing, it is still hard for the investors to acquire land at a very low price.

In practice, some investors will choose to lease land use right or existing premises from landlord to startup its business. Legally, there are some restrictions to be aware of that, among others, the longest lease terms is 20 years, investors cannot sell the property to individuals whilst a lot of people wants to purchase a senior housing for investment purpose, and it would be hard for the investors to obtain preferential policies from authorities.

（b）Unclear on land usage

There is no such catalogue in the land usage as senior living or nursing purpose, while in practice land use right for residential, commercial, tourism, medical or even industrial purpose are possible to develop a senior housing project. Market price of land use right varies a lot—for example, land for tourism purpose is only half or one third of residential ones, so in the long term we predict it is a must for Chinese authorities to rule this regime, otherwise ultimately the government will suffer the lost of land grant premium.

Based on zoning regulations, there are restrictions on different land usage. For residential land, it is allowed to build a community for senior living; for medical land, only non-profitable purpose is permitted for the business; and for tourism or industrial land, the advantage of low price is coupled with the restriction of sales model of the senior housing products. For commercial buildings, due diligence has to be done on whether the zoning and design specification is fit for living. [i]

In our view, with the upgrade of industrial sectors in some one-tier cities, quite a lot industry projects will be evacuated and therefore provide more

land available for service sectors, senior housing and care is definitely a good option. A successful project in Shanghai named Cherish-Yearn is operate on industrial land and has made its name by selling its membership card to seniors.

(3) Regulatory on Nursing Homes and Foreign Invested Medical Institutions

In the regulatory regime of nursing homes, the profitable and non-profitable institution differ a lot in policies, especially in the zoning and construction of facilities, taxations, infrastructure cost, and most important, for non-profitable nursing homes, the local government is prefer to give some financial subsidies, which is however only enough to cover daily costs of the services, and investors cannot enjoy profit. It seems not an option for profit-driven foreign investors to directly invest in a non-profitable nursing home, leaving service provider as the only option. The five models we discuss in the following contents are generally based on profitable purpose.

One essential element for a successful senior housing project is medical facilities, since most retired seniors are counting on social insurance to pay their medical fees occurs from the treatment in authorized hospitals. The more convenient and efficient a connection is created between a nursing home and hospital, the more attractive and accountable the place is for seniors to live in.

Definitely open up a hospital directly in one community is the best choice. Foreign investment in founding medical institutions in China has in the past been limited to equity or cooperative joint venture operations. In December 2010, the State Council announced to gradually relaxing the foreign equity restrictions on medical institutions in China and the position has been reflected in the removal of the joint venture requirements in the recent proposed amendments to the Catalogue for the Guidance of Foreign Investment Industries that foreign investors will, in the near future, be able to invest in medical institutions in China via a wholly-foreign owned vehicle.

(4) Legislative Expectation

By analyzing the regulatory environment in China, we find the following aspects are urgently to be improved.

（a）More clear supervision by competent authorities

Non-profitable senior care institution right now is under double supervision by Civil Affair Ministry and Elderly Committee, but with no self-discipline industrial organization; on the other hand, profitable institutions that mostly invested by private investor are to some extent in lack of any industrial supervision.

（b）Forming standardized industrial criteria

Despite that the State Council and Civil Affair Ministry have promulgated a series of regulations on the guideline of managing senior care institution, and some local governments, such as Beijing also bring out their local standards for senior care services, it is far from forming a standardization of industrial criteria. When different service providers bring in various type of standard, whether from US or Japan, supervision will then be hard for Chinese authorities.

（c）More supportive policies

Learned from the successful experience of western countries, the booming of senior care industry definitely depends on a series of incentive and preferential policies in land price, taxation benefit and financial instruments, among others. Now the Chinese authority has realized that importance, but as for the legislation, no guarantee or timetable is assured. So it is up to the investors to find its own way of making profits under current circumstance.

With the implementation of China's 12th five year plan, the Chinese authority is committed to introduce more supportive policies for the development of senior care industry, set up a series of criteria for service provider, and proactively encourage more private investors to involve in this market.

3、Investment Models for Foreign Investors

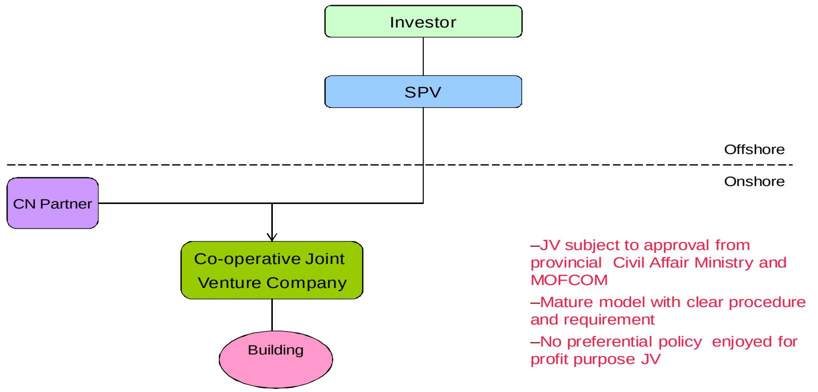
Whereas the senior housing and care industry may cover a wide variety of sectors and each may face different requirement or restriction for foreign investors, we hereby only choose the following five most used models that advisable for foreign investors to enter into this emerging market.

(1) Establishing Nursing Home JV Enterprises

According to the "2007 Guidance Catalogue on Foreign Investment" (外商投资产业指导目录 2007), senior care service is classified as "encouraged" category and therefore shall subject to no restriction for foreign investors.

However, according to the Provision on Administration of Social Welfare Institution (社会福利机构管理暂行办法) issued by the Civil Affair Ministry in 1999, foreign investors shall seek equity or cooperative JV model to startup a nursing home, which is obviously conflict with the essence of the above Catalogue. We believe, as a promise as of China entered into WTO, this obsolete requirement will sooner or later be canceled. Since this model is practiced by decades and before the Chinese authority finally liberalized this regime that allowing foreign investment via a wholly-foreign owned vehicle, procedure to set up such a nursing home is quite the same in different localities even though it is still up to be approved by several authorities.[iii]

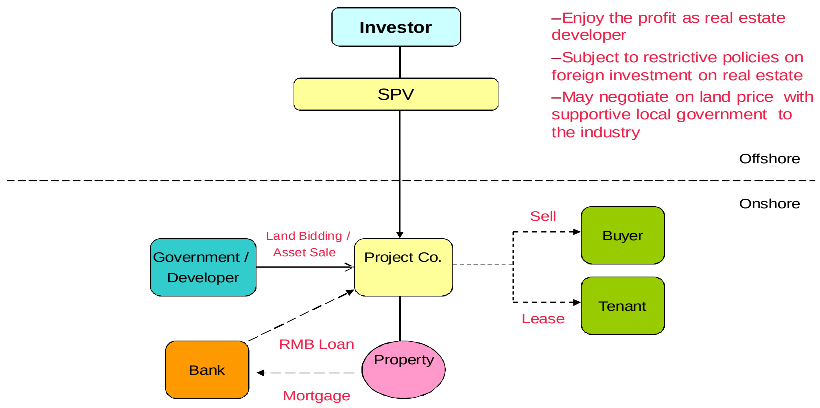
Model I Establish Local JV



(2) Being a Senior Housing Developer

Contrary to Model I that encouraged by Chinese authority, investment in real estate is in recent years under severe curbing, especially to foreign investors, in order to control the housing price and avoid "hot money" from flow in. However, this model is still attractive because real estate investors can use care homes to promote their business and get local governments to back them, especially to acquire land use right at a relatively low price.

Model II Senior Housing Developer



Pursuant to Circular 171(关于规范房地产市场外资准入和管理的意见）and Circular 50 (关于进一步加强、规范外商直接投资房地产业审批和监管的通知) issued in 2006 and 2007 respectively, foreign institutions or individuals need to set up a wholly Foreign-owned Enterprise (WOFE) for the purchase of non-self use properties. Approval from Ministry of Commerce (MOC) and related government departments including State Development and Reform Commission (SDRC), Ministry of Construction, etc. are required for setting up the WOFE. It generally costs several months to obtain these approvals.

However, the approval may be avoided if the foreign investors acquire the shares of an offshore SPV. Foreign investors can acquire real estate properties in China by either asset transfer or shares transfer of company holding the assets. On shares transfer, while acquisition of shares of an onshore company can be made, a more common deal structure for foreign investors is through shares transfer of a Special Purpose Vehicle (SPV) offshore which indirectly holds the property in China. From a tax perspective, the offshore deal structure may not enjoy preferential treatment as it used to due to one tax legislation as of 2009 that impose more prohibition and supervision on tax evasion for those offshore transactions. [ii]

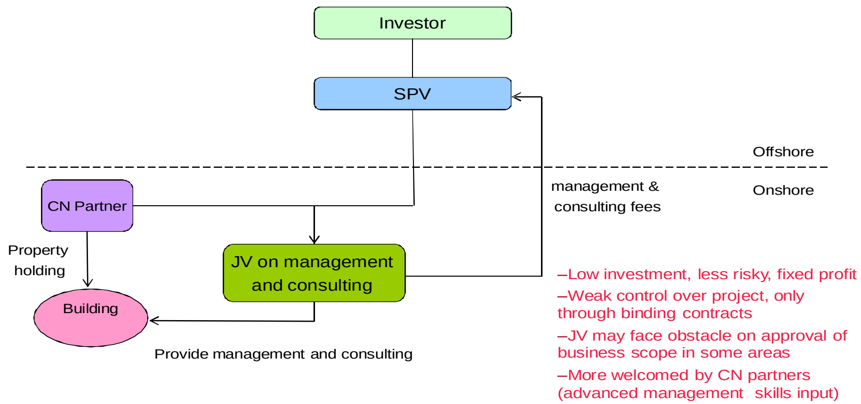
Even though investment in Chinese real estate market is still pursued by many foreigners, capitals into senior housing sector are quite limited, partially due to unclear profitable business model and regulatory environment,

partially are just waiting for a good timing. Currently, investors follow this model are mainly domestic developers and insurance companies, mostly are targeting at high-end products.

(3) <u>Investment in Management and Consulting Enterprises</u>

Aiming at exporting its expertise in senior care service, foreign investors may use this model by establishing a joint venture enterprise, to provide nursing facilities with consultation, management on operation or staff training as approved by local authorities. Since as a national strategy, home-nursing will be the dominant solution for most elderly, this model is promised to be in great demands in the future.

Model III Investment in Management Co.



What worth mention is the flexibility of this model, for example, if the investor does not want to cooperate with a local partner, they can choose to set up a WOFE to operate consulting, training service, or even render community or medical service based on the opening up policy in the abovementioned point 2.3.

For some foreign investors, this model is relatively acceptable since investment amount is low that taking one shot as a test of the Chinese market seems to be a good starting point. One recent example is an equity JV incorporated by MCS, a Japanese investor, and Sanmao Group, a SOE local partner to operate a nursing home. The MCS contributes 49% of the total investment of 3 million US dollars while its local partner contributes the other 51%. The JV is planned to provide operation and management service while the property ownership is still hold by Sanmao Group. The Japanese investor can not only charge a fixed consulting fee from the JV, but also will eventually enjoy JV's profits as a shareholder.

Among others, protecting their IP and well trained professionals are two big issues that foreign investors mostly concern about. This model is to be tested from business perspective, and we will, on the other hand, discuss legal solution for investors in another article.

(4) <u>Entering Via Financial Market of Insurance</u>

Foreign insurance investors, especially those multi-national enterprises, have already spread their business in the Chinese market years before, and now are facing fierce competition. Involving in the senior care industry seems to be not only a trend that proved to be well worked for insurance companies, but also an urgent desire for those player aiming to dominate the market by combining the senior care industry with their elderly insurance products.

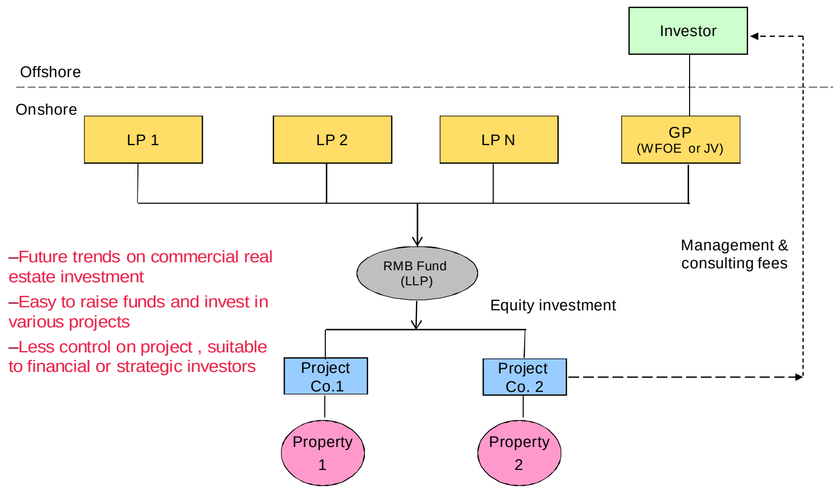
The good news is Chinese authority has already relaxed the investment to senior care institutions and real estate by insurance companies as of year 2009. While imposing a series of restriction on insurance funds that invested in the real estate, such as a investment caps of 10% of the company's total assets, and forbid insurance companies to directly invest in real estate projects, the regulators really turn "green light" for insurance companies to invest in senior care housing, and thereby creating a potentially new, large and influential institutional player in the Chinese senior care landscape. By far, most related investment is conducted via equity investment, financing structure and property purchasing.

(5) <u>Through PE Fund Investment</u>

Private equity fund investment is a luring and heating market in China recent years, and "gold rush" in the senior care industry is no exception. Strategic investment in mature projects or directly developing projects through RMB fund vehicle can meet the capital needs of local market players, and in return the investors can enjoy the benefit once the projects start to profit. By far, quit solutions applicable for these funds in commercial real estate are still limited, however, we believe once the REITs legislation in china is clear, a huge

amount of fund investment in this sector will be seen. We will discuss the RMB fund and REITs regulatory environment in another article.

Model IV Fund Investment



Two symbolic investments can illustrate the heat of the market. Within a couple of months at the end of last year, Trust Bridge Partner signed a RMB100m investment with Cherish-Yearn, a Shanghai senior care company; and Fortrees Investment, a leading hedge-fund investor announced to seek senior care projects in China with a planned investment of 1 billion US dollars. Both the investments are believed to be only tip of the iceberg, and most spectators are now rushing into the market.

4、Conclusion

We believe investors will find its own way to fit the Chinese demand, most importantly cater for Chinese tradition towards elderly care. In the senior housing sector, as long as reverse-mortgage is far from legalized, and most seniors traditionally hope to leave assets to their next generation, proven business models for most developers are still under market testing.

Finally, let's take a glance at the draft of China Elderly Law as a conclusion of this article. In this draft, elderly care is defined by legislation and responsibilities for elderly nursing and care are allocated to different levels, while home-nursing service, community elderly care facilities and elderly care institutions (nursing homes) are the three major resources to the elderly nursing market demands.

Serving China's growth in elderly population promises to be a very attractive proposition in the coming years. Now it is the time for foreign investors with a long-term vision to build their foothold in the Chinese market. Given the limitation of this article, some legal issues cannot be touched upon, such as the social welfare system for elderly people and the role the government is about to play in the process. We will continue to focus on the senior housing & care market and provide our firsthand expertise to the market players.

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[i] **To understand China land system, please refer to the article "Chinese land system and the basic principle and practice for foreign investors on real estate" on our website http://www.lawviewer.com/index.php/English/View/infoid/6653**

[ii] **For more information regarding restriction on foreign investment in real estate, please visit our website for relevant article http://www.lawviewer.com/index.php/English/View/infoid/6211**

[iii] **To understand foreign investment vehicles, please refer to the article "Introduction of Business Structure for Foreign Investors" on our website http://www.lawviewer.com/index.php/English/View/infoid/6729**

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