Slowing the Rush of Overseas Capital

[22th Feb. 2008 Issues 5]

China Measures in the Real Estate Sector

During the fiscal year ending 31 December 2007, foreign direct investment in China has risen 13.8 per cent last year to USD 82.7 billion, as reported by the Ministry of Commerce (MOFCOM) on 21 January 2008. This growth was particularly impressive as Beijing authorities have executed certain measures to cool down the booming economy, particularly spending on real estate and other assets.

Foreign Direct Investment

The growth of foreign direct investment in the real estate sector has been tremendous and is expected to continue. In 2006, foreign direct investment in real estate in China was USD 8.2 billion – compared with USD 5.4 billion in 2005. This was contributed mainly by overseas property funds, REITs, and 'hot money' in the region. It is also estimated that the 'hot money,' which is known as "Money that flows regularly between financial markets in search for the highest short term interest rates possible" by Investopedia, made up more than USD 7 billion of investment in the real estate sector in China in 2006.

Property prices are hot in the first-tier cities and some second-tier cities. Property prices in Guangzhou and Shenzhen rose more than 50 per cent in the first half of 2007. Local and overseas investors are snapping up residential properties, grade-A office buildings and shopping plazas all over China.

Government Strategies

The Chinese government's current strategy to slow overheating growth in the real estate sector is threefold: restricted property lending; capital adequacy ratios; and increased interest rates. However, the Beijing authorities have had only moderate success in cooling down the tremendous growth of the real estate sector in China.

The growing trend of foreign direct investment in China's real estate sector is expected to continue. The Beijing authorities are concerned about foreign direct investment entering into the real estate sector to the fact that foreign direct investments would enter into the property market after the China measures taking effects in the past few years. This effectively mitigates the effects of China measures on the real estate sector.

To cope with the China measures in the real estate sector, the Beijing authorities have introduced some further policies to deal with the expanding inflow of overseas capital or 'hot money into the real estate sector.

New Policies

On 23 May 2007, the MOFCOM and the State Administration of Foreign Exchange (SAFE) jointly issued Circular 50 regarding the "Reinforcement and Regulation of Approval and Supervision of Foreign Direct Investments in the Real Estate Sector".

On 10 July 2007, the SAFE issued the "Circular of the Comprehensive Affairs Department of the SAFE on Issuing the List of the First Batch of Real Estate Foreign-invested Projects Already filed with the MOFCOM." Circular 130, governs the foreign debt and foreign exchange registration of foreign investment enterprises in the real estate sector ('Real Estate FIEs') established on or after 1 June 2007.

From 1 June 2007, foreign investors must first obtain a target, or land-use rights and property rights, or agreements to transfer or purchase of land-use rights or property rights before setting up Real Estate FIEs.

The SAFE will not approve any foreign debt registration or any foreign debt conversion into RMB of any Real Estate FIEs, even if Real Estate FIEs have obtained approval from the local MOFCOM and completed all the filing procedures with the central MOFCOM on or after 1 June 2007. These apply to the newly established Real Estate FIEs, and extend to Real Estate FIEs established before 1 June 2007, which are undergoing an increase in their approved registered capital. This measure effectively prohibits any Real Estate FIEs from raising funds, including shareholders' loans, from overseas debt markets. The major implication is that foreign investors may enter the real estate sector or establish Real Estate FIEs by injecting registered capital into the enterprises.

When Real Estate FIEs obtain approvals from the local MOFCOM but fail to complete the filing procedures with the central MOFCOM in Beijing, the SAFE will not process any foreign exchange registration or settlement and conversion of foreign currency under their capital account (nor process any foreign debt registration or any foreign debt conversion).

Summary

In a nutshell, the Beijing authorities have introduced some measures to cool down the booming in the real estate sector, but the growing trend of foreign direct investment is expected to continue. Foreign investors may enter the Chinese real estate sector by way of registered capital, with filing procedures with the central MOFCOM properly completed. No overseas debt financing is allowed.