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Shanghai Tightens Control over the Housing Market

In order to rein in rising property prices in China's major cities, **the State Council** announced eight new steps, introduced at the end of January 2011. This is a determined move in the Central Government's fight to curb real estate speculation.

Shanghai, whose housing prices rank among the highest nationwide, disclosed further local measures, echoing the eight new steps from the central government, including an **expansion of the subsidized housing area and home buying restrictions**.

The regulatory rules are expected to **weigh down the transaction volume**. However, there are strong doubts that the **policies** will achieve what the locals want most, that is **bringing down the housing prices** to an affordable level.

1. Background Information: the History of China's Real Estate Industry

The public housing system, operated since the founding of the People's Republic of China in 1949, allocated public housing as welfare benefit to urban dwellers, which on the whole ensured accommodation for all, though with a low per-capita living space. However, the rapid growth of the urban population, the lack of urban development planning, the bias in capital investment, and, especially, the structure of the public housing system itself led to the need for reform.

In its shift from a planned to a market economy, the commercialization of housing became indispensable for China, and action was taken in 1998 with the reform of the public housing system. In 2003, when the economy suffered a slowdown, the property industry was assessed as the pillar industry which greatly contributed to the continuation in GDP growth of that year. It not only brought remarkable land transfer revenue to the government but also boosted related industries and provided job opportunities. To stimulate the public demand for housing, governments at all levels furthermore laid out incentive policies such as tax breaks and eased loan procedures. All the measures gradually drove up the housing prices, especially in first-tier cities like Beijing and Shanghai. Seen as a very profitable market, speculators poured investment into it, subsequently pushing the prices up to heights well beyond what common people can afford.

- Ø A research studying 2010 housing prices in major Chinese cities was recently released and the results show that Hangzhou, Beijing and Shanghai take the lead with an average housing price of RMB 25'000 (USD 3'900), 22'000 (USD 3'300) and 19'000 (USD 2'900) per square meter (m²) respectively.
- Ø The majority of second-hand homes sold in Shanghai cost between RMB 1'500'000 (USD 227'000) and 2'500'000 (USD 380'000).
- Ø The average yearly disposable income of Shanghai residents in 2010 was RMB 31'000 (USD 4'700).

2. Regulatory Rules and Measures

In the early 1980s, most of the basic living goods were under centralized management and commodity supplies were limited per family. The Government as such distributed various vouchers for a set amount of a specific good to each family, thus tightly controlling the supply and demand of each commodity. Due to China's exceptional development of the past decade and economic liberalization, the newest restrictions imposed upon the housing sector bears for some a stark resemblance to former times.

The State Council announced the **eight new steps at the end of January 2011**. Shanghai itself has also shown its determination to cool the local property market by introducing further local policies which are regarded as the toughest in recent years. The main policies are:

1. The **minimum down payment for second-home buyers** at commercial banks has been **raised from 50 to 60 percent**, whilst interest rates have risen by 10 percent from the standard benchmark level.
2. For **local families who already have one property and non-local families** who are able to prove their legal length of residence of minimum one year (through tax certification or social security payments) are both entitled to **buy one more property**. As such, local residents who own two or more homes and non-local home owners who fail to prove their length of residency will be banned from making additional purchases¹.
3. To accommodate more common families, Shanghai will accelerate the pace of expanding the coverage of subsidized housing, emphasized by Shanghai Mayor Han Zheng in his recent speeches. Shanghai's housing authority is developing a more accessible subsidized housing system and vows to build more low-rental homes for the low to middle income groups². It is reported that around **80'000 affordable homes with a total area of 2'000'000m²** are to be finished by the end of 2011. By that time, about 32'000 households could benefit from the policy.

Last but not least, the central bank also raised the benchmark interest rate for financial institutions twice since the end of 2010 to further control the up-rising trend of housing prices.

Furthermore, the Shanghai Provident Fund Administration Centre will only extend loans to second-home buyers if the area of their first home divided by the number of household³ members is no larger than the average per capita living area of 34m². The lending ceiling for

¹ The restrictive rules apply to 36 cities, including first-tier cities like Beijing, Shanghai, Tianjin and second- and third-tier cities whose housing prices have risen during 2010.

² A new threshold for applicants is set for those whose monthly disposable income is less than RMB 3'300 (USD 500) or average household property is worth less than RMB 130'000 (USD 19'700). People with per-capita housing area less than 15m² also qualify to apply for subsidized housing. According to the government's long-term plan, per capita floor area will reach 35m² by 2020.

³ The household registration system is one of China's basic systems in managing population information. Each household owns a residence certificate and the booklet records all members.

each household under Shanghai's public housing fund program is now RMB 400'000 (USD 60'698) for second-home buyers.

3. Launch of pilot property tax reforms

On January 28th 2011, the State Council announced that the long-awaited property tax would be introduced as a trial in Shanghai and in Chongqing, in the hope to curb housing prices (See Table 1 and 2 in the attachment).

In Shanghai, buyers will pay between **0.4% and 0.6% tax** on their new second homes⁴, if the floor area of their first home divided by the number of household members is larger than the average per-capita area of 60m². The same tax will also be valid for non-local buyers when they sell a house, as the funds probably come from speculative capital.

In a country where it is common to buy property when getting married, the city has made an exception for newly-weds, allowing them to purchase one house upon marriage. However, the new owners will not escape from paying the property tax.

4. Impact and Future Prospective

4.1 Impact

The transaction volume of homes, both new and existing, dropped following the implementation of the new eight rules⁵. Despite this fall in transaction volume, prices showed an insignificant fluctuation.

Furthermore, the rules will obviously **lead to a jump in the rental market**. With those affected by the new regulations, the demand for rentals will naturally increase along with the price of rent, with landlords eager to make up for the property tax.

Moreover, **ways and loopholes** will most certainly be found to **cheat the system and the new rules**. Therefore, the detailed interpretation of the regulatory policies needs to be improved at the operational level.

The reason that some people show persistent interest in buying housing is that there are **quite limited investment channels in China**. The **property and stock market** are commonly believed as the most traditional and profitable channels to put the spare capital. Unless other proper channels are created, the restriction policies will struggle to put out public enthusiasm in the housing market and thus the housing prices will unlikely fall greatly.

4.2 Future Prospective

The housing problems will not be fundamentally solved unless **the gap of supply and demand is narrowed** in the market, which demands for more investment from the government in subsidized housing projects. Otherwise, the housing prices will stay well beyond people's purchasing capability and thus might cause social instability. On the other hand, the risk of the property bubble bursting still exists, which would lead to catastrophic consequences for the national economy if the country doesn't reassess its reliance on the industry as an economic growth factor.

⁴ The tax varies at the watershed point of RMB 28'426 (USD 4'300) per square meters. The houses with an average unit price over RMB 28'426 will be charged at a rate of 0.6% and houses with cheaper unit prices at 0.4%.

⁵ The trade volume of Shanghai's housing market slumped 40 percent on the first day of the new property tax, and transaction volumes fell further in the following days, according to figures from the Shanghai Real Estate Trade Centre.

While the issued rules are comprehensive, the extent of their implementation by local governments is questionable. This could be in part due to the revenue created by the property industry as is, with the income earned by governments though **land transfer ever growing** (see Table 3 in the attachment). Furthermore, it is worth noting that the recent regulatory policies have not been given a time frame, meaning that the length of their implementation is still undetermined.

In addition, 2011 marks the beginning of Shanghai's 12th Five Year plan, which has the target of maintaining a **yearly GDP growth of 8% from 2011 to 2015**. The economic restructuring involved requires constant investment and will not be able to produce notable returns in a short period. The local government will thus be under pressure to balance the improvement of people's livelihood with the economic performance, if contribution from the property industry was reduced.

A big question mark still remains regarding whether or not the prices will drop to a level affordable by average residents. This situation seems highly improbable unless the demands of more citizens are met with a wider coverage of subsidized and low-rental houses.

Ms. Min XU
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Attachment

Table 1 Numbers of houses sold in 4 cities during the past six months

City	Aug. 2010 (unit)	Sep. 2010 (unit)	Oct. 2010 (unit)	Nov. 2010 (unit)	Dec. 2010 (unit)	Jan. 2011 (unit)
Beijing	6579	12179	7655	11215	15753	11527
Shanghai	13592	17486	15327	15881	17596	16294
Hangzhou	3001	4428	2463	2470	3963	2575
Chongqing	21076	28343	29601	20605	21375	18260

Source: Soufun.com (one of China's most comprehensive websites focusing on housing industry analysis and information)

Table 2 Turnover of houses sold in 4 cities during the past six months

City	Aug. 2010 (billion)	Sep. 2010 (billion)	Oct. 2010 (billion)	Nov. 2010 (billion)	Dec. 2010 (billion)	Jan. 2011 (billion)
Beijing	14.4	24.4	13.5	20	31.7	24.8
Shanghai	18.3	23	23	22.2	28.9	26.4
Hangzhou	7.1	12.4	6.8	6.6	9.8	6.8
Chongqing	11.1	16.7	17.5	12.3	14.2	11.7

Source: Soufun.com

Table 3 Comparison of land transfer revenue and fiscal revenue in 4 cities in 2009 & 2010

	Land Transfer Revenue 2009 (billion)	Fiscal Revenue 2009 (billion)	Land Transfer Revenue/ Fiscal Revenue (%)	Land Transfer Revenue 2010 (billion)	Fiscal Revenue 2010 (billion)	Land Transfer Revenue/ Fiscal Revenue (%)
Beijing	93	200	46.5	160	236	67.8
Shanghai	100	250	40	148	287	51.6
Hangzhou	105	102*	-	50	125	40
Chongqing	37	116	31.9	40	102	39.2

Source: local authorities' website

* The data provided by Hangzhou official websites is inconsistent, showing that the numbers have been tempered with.