Overview on Real Estate Investment in China for Foreigners

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Introduction

This report aims to give a brief observation on real estate sector investment environment in China through initial research. In the first part, a brief introduction to current real estate investment environment will be provided. Then it will be followed by a general real estate investment analysis by regions which are Beijing, Shanghai , Chengdu , Guangdong and Shenzhen in the second part. Last but not least, it will indicate the regulations on real estate industry for foreign investment nowadays to make investors have a clear picture for their investing activities. Finally, a document of Real Right Law of the People's Republic of China will be attached in appendix as a reference for foreign investors.

Current Real Estate Investment Environment

Foreign investment in the Chinese real estate sector soared to US$1.44 billion in the first half year of 2006. This figure mainly refers to money was used to purchase buildings and does not include purchases of land for real estate development. Beijing and Shanghai remain the priority choices of foreign real estate investors.

Currently, Industry insiders and analysts have said the rise in property prices has slowed (with only a few exceptions). According to Jones Lang LaSalle's Global Capital Flow report, China's direct real estate investment reached USD 9.91 billion in 2006, up 70% over 2005. In an effort to cool down the overheated real estate market, the Chinese government introduced new measures in July of 2006 aimed at curbing rampant growth in the sector. These measures have had some impact on the real estate market – in terms of strengthening market controls and promoting healthy, sustainable development. Measures vary from city to city and include a capital gains tax, depending on the length of a buyer's holding period, and the tightening of land transactions and pre-completion sales.

Scores of Chinese cities are being rebuilt .China has issued a new policy restricting foreign investment in real estate in a bid to cool overseas investment in the domestic market. The move aims to regulate the real estate market, as well as halt overseas investors' frenzied and speculative trading in the property market. The new rules stipulate that foreigners have to live in China for at least a year before they can purchase a home to live in. They will also need to secure government approval to buy property they don't intend to use themselves. The restrictions don't apply to overseas Chinese or compatriots from Hong Kong, Macao and Taiwan who want to buy property for personal use. Overseas real-estate developers will also have to register more than 50% of the capital for all projects worth more than 10 million US dollars.

However, some foreign investors continue to be optimistic with Chinese real estate market as they express confidence of a strong economic growth for China in the long-term. For the whole year of 2006, there were numerous new players enter the market while investors with existing projects in China continued to

Real Estate Investment Market Analysis by Regions

Beijing

Early this year, a new rule was announced requiring foreigners living in Beijing to get certificates from the Beijing Municipal Public Security Bureau to prove they have been in China for at least one year for work or study before buying property. The Beijing investment market is increasingly becoming attractive to foreign institutional investors with a growing number of en bloc sales recorded and numerous projects' financed by foreign investors due to the continued loan tightening by local financial institutions.

High quality investment grade properties will continue to remain the target of foreign investors. Single ownership assets with stable income remain the most attractive investment even if such opportunities are hard to come by in the Beijing market at this stage, but clearly structured development companies are also targeted as development partners.

Beijing witnessed more than ten en bloc transactions in 2006, five of which were concluded by foreign investors. With nearly 2 million sqm of new office supply coming into the market in 2007 and 2008, there will be more investment grade properties available to investors, especially in the Beijing CBD. Since the market will need some time to absorb this massive adjunction, it is likely that capital values for commercial properties will not run away in the next few years while residential properties are still seeing good potential upside for well-located properties.

Shanghai

Following the pace of 2005, the year 2006 saw an increased level of en bloc investment transactions in the Shanghai property market. Global sources of capital were particularly active in the Shanghai market.

In particular, residential investments became a favored sector for institutional investors followed by the office sector as the next most popular choice. Given the lack of investment grade opportunities in the commercial market as well as the competition that drove down commercial yields, institutional investors started to find residential investment opportunities attractive, where they can find better deal flows as well as higher yields. Towards the end of 2006, there is strong evidence of yield compression in Shanghai commercial properties. Average gross investment yields in Shanghai now fall in the 7–8% range. With the transaction of core investment assets such as Ocean Tower and Platinum Tower, we believe that Shanghai is beginning to take shape in developing a core market for more risk-averse institutional investors such as pension funds.

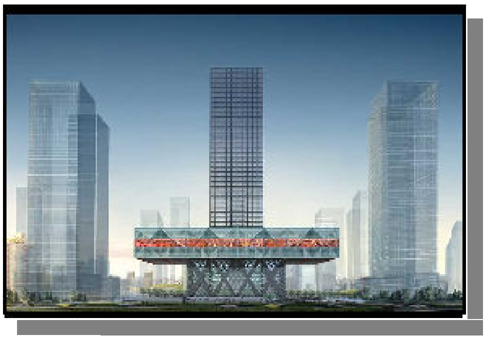
More importantly, the emergence of a core investment market and signs of a secondary market being developed signal the improved maturity of the real estate capital market in Shanghai. Developers, opportunistic investors, and core investors each play a different role in the development of a real estate market. With the real estate capital market maturing in Shanghai, we expect the development of a secondary investment market that will attract more capital.

Guangzhou and Shenzhen

Guangzhou and Shenzhen have become increasingly important targets after Shanghai and Beijing for institutional investors. In July 2006, Pramerica signed an agreement with a Shenzhen local developer to pay USD 118 million for a 50% interest in Central Walk Shopping Mall, an under construction shopping center. In the same year, Ping An Insurance kicked off the largest acquisition in the Guangzhou and Shenzhen market by buying CITIC City Plaza in Shenzhen for RMB 2 billion. These deals and others under negotiation indicate a strong interest on both cities' offices and retail sectors from core investors. Opportunistic funds are looking into residential development projects in cities across Pearl River Delta while others adopt a repositioning strategy in converting residential developments into serviced apartments.

Investment activities should be increased in 2007 due to favorable market fundamentals. Investors are encouraged by the expansion and upgrade demands from both MNCs and domestic firms in the region, the higher-than-national-level disposable income, and more experienced developers supplying higher quality properties. The relatively modest capital value is another incentive, and the recent record high land transaction price in Pazhou area indicates investors' confidence on potential price appreciation.

Most buyers have already worked out their new deal structure in response to the new government measures. Yields will continue to come under pressure given the lack of good opportunities.



Chengdu

Chengdu's investment market started to draw attention from foreign investors. The main focus was on distressed assets, with approximately 200,000 sqm of gross floor area transacted. Besides being well located within major business districts, these distressed assets are popular with investors because they offer single ownership opportunities whereas most properties in Chengdu are strata titled with multiple-ownership. Given that there are now more high-quality office buildings with single ownership being developed and probably be made available to institutional investors in the near future, we foresee Chengdu's investment market to grow.

Current Policies for Foreign Investment in Real Estate Industry

China's Ministry of Commerce listed a number of measures to ensure control over direct investment of foreign fund in the real estate sector, as the country strives to avoid international speculative money to create bubbles in the sector. The government will get tough on those involved in illegal activities and speculation to cool the country's booming property market

Local commerce departments should strictly limit foreign investment in luxury real estate. It reiterated foreign investors need to establish a real estate company before they can invest in real estate projects, and they should also get approvals from relevant department to expand their business scope in order to invest in new real estate projects. The ministry required local departments to report their approval of the establishment of foreign-funded real estate companies to the ministry. The ministry would investigate into the cases and deal with irregular cases.

The country has been trying to provide proper housing for the public by building more economically affordable apartments and curbing the rapidly rising housing prices.

Conclusion

Investors are also widening their geographical spread within China. While foreign investors account for a tiny proportion of the total capital spent on real estate in China every year, they make up a large part of the market in big cities like Beijing and Shanghai. Foreign investment has added fuel to the overheated domestic property market. To some extent, the influx of foreign investment has helped to drive property prices to new heights in the cities. The measures will restrict but not discourage property investments by institutional investors. The capital flow into the Chinese real estate market is still growing and more investors will continue to look for quality assets to acquire. We expect to see a more developed real estate investment market in the New Year.

Price Indices of Real Estate in quoted cities (Quarter III, 2007) (Unit: %)

Region		*Beijing*	*Shanghai*	*Guangzhou*	*Shenzhen*	Chengdu
Real Estate Selling Price Index		11.9	3.9	6.5	20.2	7.6
	Newly built residential buildings	13.5	4.0	7.7	16.7	8.9
	Secondhand residential buildings	10.1	4.3	5.5	21.8	4.7
Land Transactions Price Index		9.0	8.9	0.0	0.1	12.3
	Land for Residential buildings	--	5.6	0.0	--	13.9
Real estate Rent and leasing Price Index		2.9	5.0	3.0	6.4	1.0
	Residential Buildings Leasing	3.7	9.1	3.8	4.7	2.9
Price Indices of Real Estate Management		0.0	0.0	4.7	0.1	0.1

(Note: The number above indicated increased percentages compared to the same period of p receding year)
(Resource: China Monthly Economic Indicators)

2007 Average Price for Modern Real Estate in quoted cities

Region	*Beijing*	*Shanghai*	*Guangzhou*	*Shenzhen*	*Chengdu*
Average Price (yuan/square meter)	11377	8253	6545	9384	7974

(Resource from: Internet data collection)

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