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Chinese growth and the property bubble

Shifting policy is risky, and necessary

China's residential property bubble is helping to sustain economic growth, while increasingly frustrating Chinese citizens. Reforms to taxation arrangements are required, but unlikely in the near term, Xinling Wang writes.

In the lead-up to the 19th Party Congress, the Communist Party of China has shown increased tolerance for slower economic growth. Seeking a soft landing for its over-bloated housing market, there is growing momentum against property speculation, a consistent driver of economic expansion in China.

Although doing nothing is no longer affordable, sticking this soft landing will be tricky. Miscalculation could burst the bubble, dragging down the economy. The test for the Party will likely come next year, if economic growth, as expected, continues to slow.

In December, a statement from the Central Leading Group on Finance and Economic Affairs, on which Xi Jinping sits, gave hints on policy direction: 'Houses are built for living, not for speculation.' This was the fourth time the housing bubble was mentioned by Chinese leaders in the second half of 2016. President Xi is rallying an increasingly frustrated public against speculators, developers, local governments and real estate agents, who benefit from, and contribute to, inflated residential property prices.

For the public, booming property prices are pushing a growing number of young people out of the housing market, and the cohort of first-time homeowners is growing older.

A campaign against speculation is also needed to dampen (if not reverse) the prevailing expectation that prices will always rise. This encourages speculators and desperate buyers to take out larger loans, potentially posing a threat to the banking system.

President Xi's campaigns seem to be also inspiring some reform-minded bureaucrats. A formal and long-awaited policy on housing bubbles is due out this year. While it will take time to fully develop and implement, the long-term measures of the policy will aim to find solutions to the profound problems in the financial, fiscal, legal, housing, and land institutions that influence the property market.

A number of policy options are being considered.

First, a rental market, protected by legislation, that guarantees tenants the same access to social benefits as homeowners. Access to public schools is crucial, as education of their children is the biggest concern of young urbanites. However, legislation itself is far from sufficient, as unequal access is deeply rooted in the scarcity of public education resources, which will take time and funds to improve. Another current move is developing cheaper public housing, where leases could be converted to ownership when tenants are in a position to purchase their dwellings.

At the core of the housing bubble lies 'land finance,' a system with complex and deep roots in fiscal, financial, land and rural institutions. Land finance refers to the practice where both local government and developers use land as collateral to secure loans from banks. Despite the shadowy nature of such endeavours, they have been tolerated as a reliable source of local government revenue. After all, when growth dictates all, policies that support investment will prevail.

Depending on its monopoly power, local authorities could take land from peasants then sell to developers. Charging developers a land transfer fee, a major component of land finance, local governments would then pocket the value added to land following development. Developers would take land to banks to borrow money to build homes, only paying back debts when homes are sold. Behind the decades-long housing boom in China, this simple formula has rarely failed. Developers and banks know homes would be sold, with buyers willing to pay inflated costs, expecting prices to rise further.

An option to replace land finance with a property tax, paid by homeowners, is also being considered. While easy to collect on developers, the land transfer fee is eventually passed down to buyers, twisting tax incentives.

However, with home prices already so high, many homeowners are against a property tax. The Property Tax Law has been repeatedly delayed, with 2020 being the earliest expectation for implementation.
Despite the difficulties, a practical approach is needed, allowing the government to impose a property tax without causing sell-offs and thus sharp corrections. Yet because of these difficulties, a transitional plan from land transfer fees to property tax is not in sight.

The unexpected growth rate in the first half of 2017 is mostly supported by a continued housing boom. As the government continues to clamp down on real estate in overheated cities, the delayed economic slowdown effect may emerge in late 2017 and early 2018.

By then, government action on the housing bubble would send an assuring message that it prefers healthier, albeit slower, economic growth.

It's the Great Chinese Property Pullback

That whoosh you just heard? It's Chinese money pulling back from property in London to Sydney to New York.

Capital centres globally should brace for tumbling real-estate prices as Beijing manages to do what Brexit and higher interest rates haven't.

This is why Australia is heading towards a crisis.

It is almost exactly 10 years since the financial world began a wobble that would swing into what we now know as the global financial crisis.

Reflecting tighter regulations, China overseas direct property investment could drop 84 per cent to $US1.7 billion ($2.15 billion) this year and about another 15 per cent to $US1.4 billion in 2018, according to Morgan Stanley.

Mainland money began piling into offshore commercial property in 2013. Land prices were expensive at home, and investors wanted to find a hedge against a weakening yuan.

Another draw was the prospect of higher returns in cities such as Sydney where yield spreads - the difference between rental yields and what government bonds pay - are higher. A slumping British pound post June 2016's Brexit vote helped, too.

While some marquee transactions are still being inked - think the purchase earlier this year of London's "Cheesegrater" tower by Chongqing-based, Hong Kong-listed CC Land Holdings - their numbers are dwindling.

A strengthening yuan, along with China's One Belt One Road initiative that needs funding, will see many property deals dry up.

Over the past few months, Beijing has made it tougher to get money out, clamped down on more fanciful transactions such as the buying of football clubs and luxury hotels, and is now going after some of the country's most prolific acquirers.

Dalian Wanda Group, Anbang Insurance Group, HNA Group and Fosun International have all included real estate in their global buying binges.

Against that backdrop, and with increasing foreign-government scrutiny thrown into the mix, it's hard to see how Chinese offshore real estate acquisitions can continue at such a pace. Domestic developers are already finding it harder to tap international debt markets, and have been resorting to short-term securities instead.

This matters because Chinese capital accounted for one-quarter of commercial property transactions in central London last year, up from 1 per cent a decade ago.

China is now the second-largest foreign investor in the US after Canada, and is responsible for between 12 and 25 per cent of all office transactions by value in Australia over the past two to three years.

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In Hong Kong, Chinese firms have bought about 80 per cent of the residential land sold so far in 2017, and have spent around $US6.5 billion on office space from 2012 through 2016.

One sliver of good news - some Chinese companies have capital already stashed offshore with which they can keep buying, plus there are other interested Asian parties around.

London's "Walkie Talkie" tower was sold last month to Hong Kong's LKK Health Products Group. And Sunac China Holdings, now the most indebted developer after buying assets from Dalian Wanda Group, last week issued $US1 billion of US dollar bonds.

Whether that's enough to offset the amount of money going the other way, however, is questionable. Investors would be wise to stand well back.