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CONTENTS

China eases pressure on property sector but reform remains priority

Beijing's policy loosening to prevent collapse of industry does not represent a retreat, analysts say

Chinese regulators have eased pressure on property developers by loosening credit controls and allowing more bond issuance in recent weeks in an effort to prevent the sector from collapsing. But analysts and government advisers say the measures do not represent a retreat from President Xi Jinping's crackdown on the sector.

Real estate is estimated to account for as much as one-third of overall economic activity in the world's second-largest economy, highlighting the wider implications of any significant shift in policy. The industry has been struggling in recent weeks to deal with a liquidity crisis that has driven some of the country's biggest developers, such as Evergrande, to the brink of bankruptcy.

"There are still systemic risks posed by a real estate meltdown to the broader economy," said Deng Haozhi, a Guangzhou-based property analyst. "It is up to regulators to avoid that scenario."

"All of our previous attempts to regulate the real estate market have failed because we exited halfway through overhauls," said a Beijing-based policy adviser. "This time the central government is determined to stick to the plan."

Mortgage lending increased 1 per cent in October, ending four consecutive months of year-on-year declines, according to Wind data, after Zou Lan, head of financial markets at the People's Bank of China, said some banks had misinterpreted Beijing's real estate policies.

The objective, Zou said, was to restrict the flow of credit to overleveraged property companies rather than to stop the issuance of development loans. "We have instructed major banks to keep real estate loan issuance steady and orderly," he added.

Executives at banks in Beijing and Shanghai told the Financial Times that the review time for mortgage applications had fallen from six months in September to less than three. "We have acted too cautiously in the past," a loan officer at China Merchants Bank said. "We are now returning to normal."

Bond issuance by developers is also resuming. Since November 10, more than two dozen state-owned developers have announced plans to issue a combined Rmb28.8bn ($4.5bn) worth of relatively low-interest debt instruments on the interbank market, which developers have traditionally had difficulty accessing.

Zhejiang China Commodities City Group Co, a developer based in the eastern province of Zhejiang, took just five days last week to secure approval to sell a nine-month, Rmb1bn note this week. "In the past the process could easily take more than a month," a company executive said. "Now everything is being expedited."

Chinese cities come out with measures to support home sales

Local governments across China are trying to curb home prices from a precipitous drop, while encouraging home buyers to buy mortgaged houses to help cash-stricken property developers to quicken home sales, amid the nation's tightened regulation for the housing market.

Since the start of November, about 21 cities have published notices to prevent house prices from falling too far. Some cities have initiated talks with property developers to prevent them from undercutting the market, according to a report published by yicai.com on Saturday.

On November 1, the property bureau of Yongzhou, Central China's Hunan Province, required that property developers not to take advantage of low prices or engage in practices which would disrupt the normal order of real estate market, or they will be punished by regulators.

Except for Shenyang, capital of Northeast China's Liaoning Province, and Kunming, capital of Southwest China's Yunnan Province, these administrative actions to set minimum prices have been mainly undertaken by third- or fourth-tier cities.

Shenyang is being characterized as having two-pronged policies, setting both a ceiling and a floor price for new homes. Local residents are currently not allowed to purchase a third home in an effort to crack down on speculation. Liaoning province has also warned developers against false property advertising.

New home prices in Shenyang, a city of 9 million people, fell in September for the first time since December last year.

"Compared with first- and second-tier cities, the cooling speed of housing markets in third- and fourth-tier cities is accelerating, and at the same time real estate companies are anxious to speed up sales to recoup investment and pay back the lenders, bond-holders and other financial organizations," a real estate expert, who asked to speak on condition of anonymity, told the Global Times on Sunday.

Prices spiral down

Tian Yun, deputy director of the Beijing Economic Operation Association, told the Global Times on Sunday that the recent flare-up of COVID-19 infections in some regions of China is dealing a heavy blow on local consumption. "If home prices, which directly determine the land prices that offered a major revenue source for local governments, drops precipitously, the impact on local economy is hardly affordable," Tian noted.

China's overall property and construction sector contracted in the third quarter for the first time since the start of the coronavirus pandemic, hamstrung by the slump in urban real estate sector.

The growth rate of China's property development investments slowed to 8.8 percent in the January-September from 10.9 percent in the first eight months of the year, data from the National Bureau of Statistics (NBS) showed.

China's new home prices dropped or remained flat across major cities in September from previous month, amid government measures aimed at stabilizing property prices. The price slide compared to a 0.3 percent rise in August. Meanwhile, home prices at the secondhand homes market dropped 0.4 percent, compared with 0.2 percent growth in August, according to data from NBS.

Cash flow crunch

As China has ratcheted up efforts to wean property developers off excess debt levels to ensure a healthy growth of the real estate sector in the coming years, home builders are feeling growing pain of tightened bank lending policy as well as land-buying restrictions.

To ease the crunch of cash shortages, the developers have been on a selling spree of their newly built homes. Some developers are doling out generous discount rates so that they could recoup their investment more quickly, which will help them pay back loans or bonds on time.

Apart from third- and fourth-tier cities, discounts on mortgaged homes have mushroomed in some first- and second-tier cities including Guangzhou, capital of South China's Guangdong Province and Chengdu, capital of Southwest China's Sichuan Province.

In Guangzhou, launches of mortgage-related house projects totaled more than a dozen, according to the yicai.com report. In terms of prices, the discount ranges from hundreds of thousands of yuan to millions of yuan.

Zhang Dawei, chief analyst with the real estate agency Centaline Property, said that many developers are using this scheme to quicken home sales. The move could ease the financial pressure faced by real estate developers to a certain extent.

"Quickening these projects could proportionately alleviate developers' tight cash flow, but it seems to me is not a long-term measure to push the nation's property reform," said Tian.

China's GDP growth this year, which has been widely forecast to reach 8 percent, has created enough room for further deleveraging measures in the real estate sector. "But we need to heed the speed and strength, preventing the tightened regulation measures from squeezing the developers too much so that they can maneuver," Tian said.

Chinese Vice Premier Liu He said in October at 2021 Annual Financial Street Forum that the trend toward a sustainable development of the real estate market will not change with controllable risks, and that property developers will be given access to bank loans.

Meanwhile, long-term property sector operational mechanisms will get scrutinized, Tian said.

Policymakers have decided to pilot property tax levies in selected cities during the coming five years, to evaluate impact of the new policy before proceeding with formal legislation. The new levies could be tested at the end of this year in selected first- and second-tier cities that have hot real estate markets, most likely in Guangdong's Shenzhen, Hangzhou, capital of East China's Zhejiang Province, and the southern island province of Hainan.

Beijing should tread softly in experiment with property tax

It's dangerous to burst the market bubble with a heavy tool, which is why the authorities are moving ahead cautiously

Beijing is set to experiment again with a property tax. First tried in 2011 in Shanghai and Chongqing, where the tax remains, the new trial period will last for five years. The tax did not make much difference in those cities, which saw prices soar; a nationwide roll-out was subsequently postponed. The central government no doubt expects a better outcome this time.

When the scheme will start and which cities and regions will be targeted have yet to be announced. However, the mere announcement of such a plan is likely to cause some of the desired effects on China's inflated property market. Those holding multiple properties in tier-one cities may be most worried and tempted to offload some investments before the new tax kicks in.

Along with excessive corporate debt, power shortages and the pandemic threat to public health, high property prices are among the 10 challenges named by Beijing that the nation must face. The listing of the challenges comes at a time when there is a frequent narrative building up in Western countries about China's economy reaching the end of the rope. It's likely to be intended to show that the central government is well aware of the main problems but with great confidence, is in a position to address and resolve them.

As such, it will help set the tone and policy direction of the sixth plenary session of the 19th Central Committee and the Central Economic Work Conference, which will start on Monday. Affordable housing is key to what President Xi Jinping calls "common prosperity", a programmatic mission statement for the nation to become more equitable and just. Homes, he famously said, were not for speculation, but for living in. But in recent years, Beijing has had little success reining in runaway prices in the property market.

The property tax debate has been going on for a decade. It's both complicated and controversial to impose because many local governments earn big chunks of revenue from land sales; many are already in deep debt. Developers are unlikely to pay top prices now, as many face scrutiny from regulators. The debt crisis of Evergrande, which at one point roiled world markets, has been a result of the new regulatory stance. Central authorities must therefore walk a fine line in introducing a nationwide property tax.

Like their counterparts in Hong Kong, many young mainlanders cannot afford to buy their own homes without help from their parents. Beijing has made it an official policy to help them. That's easier said than done, though, as the property market has taken up a disproportionately large share of the Chinese economy. It's dangerous to burst the market bubble with a heavy tool such as a property tax. That's why the authorities are moving ahead cautiously.

Speculation nation: Can Xi Jinping's property tax deflate China's housing bubble?

Xi Jinping's to-do list has seen a lot of ticks in recent months: more flights into Taiwan's defence zone; suppressing dissenting voices in Hong Kong; clipping the wings of tech barons; outlawing the out-of-school tutoring industry. The list goes on.

However, one key initiative – introducing a local property tax – has attracted fewer headlines but is apparently so controversial within China's ruling Communist party that even Xi is still only able to deal in trial schemes rather than wholesale change.

The decision to pilot the tax on all types of property in selected regions for five years – most likely important cities such as Shenzhen and Hangzhou – was taken last month. It is seen as vital to reforming the country's bloated property sector, a concrete-and-glass divide between China's haves and have-nots which has been personified by the woes of the heavily indebted developer China Evergrande.

The property tax is controversial because local governments rely on land sales for at least 40% of their revenues. This has encouraged an aggressive sales policy, aided and abetted by property developers happy to take on massive debts to buy the land and build ever more apartment blocks for buyers convinced the market is a one-way bet.

This decades-long party saw China's property developers build a debt mountain of around $5tn, according to analysts at Nomura, before Beijing called time by restricting what they could borrow. When the music stopped, Evergrande was stranded on the dancefloor with $300bn of debt, and it faces its latest pay-up-or-default deadline on 10 November.

Evergrande is just the tip of the iceberg though. Developers have to repay around $92bn in the next year, and analysts at S&P have estimated that more than a third could experience difficulties meeting those obligations.

Kaisa Group, second only to Evergrande in terms of risky borrowing in US dollar bonds, became the latest focus for concern when its shares were suspended in Hong Kong on Friday morning because of cash flow problems.

Xi has clearly had enough of the sector's excesses. But the question is whether the president's property tax experiment to bring the housing market under control is too little, too late.

Real estate investment accounted for 12-15% of GDP in China between 2011 and 2018, the Harvard economists Kenneth Rogoff and Yuanchen Yang estimate. This compares with a 7% share of GDP in the

US at the peak of the housing boom in 2005. Once related property market activity is added to the Chinese numbers, the proportion of GDP is more like 30%.

Such a large property market does not necessarily create a problem. After all, China has a population of 1.4 billion and needed to build millions of new homes because hundreds of millions of people have moved to urban areas in the past 30 to 40 years.

Speculation nation

The notion that prices can only go up has made buying a house in China enormously expensive, with a house price-to-household income ratio of 19 in the biggest “tier-one” cities such as Beijing or Shanghai, 10 in tier-two and seven in tier-three cities, Canada-based BCA Research says. The average ratio in the UK is about 10 and in the US it is four, although mortgage rates are much lower in those countries, making it easier for households to manage the debt.

However, the speculative nature of the market is what really makes China stand apart. Between 2008-10, the proportion of people buying homes in China who were first-time buyers was 70%, according to the Survey and Research Center for China Household Finance. By 2018, after the property and construction sectors were jet-propelled by the 4tn yuan of post-financial crisis stimulus, that figure had dropped to 11.5%.

The same survey shows that first-time buyers were being replaced at a rapid rate by investors. In 2018, 22.5% of homebuyers already owned two or more dwellings, while 66% owned one. No wonder that Xi had said the year before that houses should be for “living in, not for speculating”.

Because these investors rarely rent out their properties, one-fifth of China’s housing – or at least 65m homes – lie empty. Rental yields are typically about 2% in China, which is way below the typical mortgage rate of 5.4%. In other words, the buy-to-let strategy that has proved popular for wealthy people in western countries such as the UK doesn’t make sense in China. Investors are instead buying the properties solely because they expect the value to keep going up.

“Clearly, housing in China has become an object of speculation which has made it unattainable for first-time homebuyers,” analysts at BCA Research wrote recently.

“Property developers have been building the wrong type of housing at the wrong prices and for the wrong type of buyers,” they said. “They have been building high-end houses and selling them at very high prices to high-income households who have been buying multiple properties as investments.”

The massive speculative bubble – China’s household debt is about 100%, or about the same as that of the US – has been magnified by property developers doing the same on an even bigger scale. While the cost of borrowing remained lower than the rate of house price growth, developers simply took on more debt to build ever more properties selling at ever higher prices while pocketing ever higher profits.

The catch is that with demand falling thanks to a declining population, fewer people starting families, and prices also tumbling, those profits have disappeared and may soon turn into massive losses.

‘The music has stopped’

It remains to be seen whether Beijing will allow Evergrande or any other large developer to fail. Most observers expect it to be a “controlled demolition” – in other words restructured in an orderly manner – and debts distributed via state-owned banks and institutions. Containing the impact of falling house prices in the wake of such restructuring and the introduction of a property tax could be more difficult.

Lower prices might be good for some people not yet on the property ladder, but with more than 90% of the urban population owning property and 40% of household wealth tied up in property, any disorderly collapse in values could trigger social unrest such as that seen during past downturns.

This is what Anne Stevenson Yang, co-founder of Connecticut-based J Capital Research and a China specialist, fears. She says the Communist party supported free market activity as long as it unlocked value for the state. Now it wants to rein in the excess but the process of deflating the market is freighted with risk for Xi and his government.

“The buying of new apartments has got to be coming to an end,” she said. “The music has stopped and all these people can’t find a chair. Then what?”

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The strongest weapon in Xi Jinping's common prosperity armoury is a property tax

The recent publication of a speech by president Xi Jinping saw the leader detail in public for the first time how he plans to curb excessive wealth and achieve his goal of "common prosperity" for China. But it was his mention of a property tax, which has been much-discussed in China over the last two decades, that carried the most significant implications.

A few days after excerpts of the speech were published, the country's top legislative body announced that it will roll out a five-year pilot scheme for the property tax in some regions, despite steep resistance from the middle class and political elites, many of whom own a vast number of properties.

Aside from the fact that it would exclude rural households, the announcement lacked specifics, including the location of the trials and the range of the tax rate. But it represents China's biggest step towards having a nationwide property tax on homes, which has been discussed since at least 2003.

Xi, whose heightened power is compared often to that of chairman Mao Zedong, seems determined to push through the tax, despite its unpopularity. With around 70% of Chinese families' wealth parked in properties, it could be his most powerful tool in adjusting the "overly high incomes" targeted by his common prosperity campaign. "In the past years, the value of residential housing has been skyrocketing due to its rising prices, which helped many families to accumulate their wealth, making properties an important element in creating wealth gaps," wrote Economic Daily, a state-owned media outlet this week. "A property tax will focus on adding taxation for owning the asset to enhance the regulation and adjustment of high income."

It is too early to say definitively how the property tax could affect China's economy and society. It may not bring down housing prices substantially, as that will still depend on supply and demand. But the consensus among analysts is that the taxation will finally alter the habit of citizens, developed since the country allowed private home ownership in 1998, of holding on to properties.

"Recent events likely mark the start of a new paradigm for China's growth and its property sector," said Bruce Pang, head of macro and strategy research at China Renaissance Securities. "One featuring greater state involvement with less policy support, lower investment and slower activity for the sector, reduced real-estate lending concentration, and less household allocation in property assets."

In short, the tax could send China onto a different path of development.

Why does China want a property tax?

Despite its hesitation over enacting a property tax, China has long felt the acute need for it.

China's existing property-related taxes mainly target commercial real estate, and the construction and transaction processes of residential properties. Taxes like the one being piloted by Xi are the largest revenue source for local governments in many US states.

The country's leaders believe there's too much speculation in the sector, which they say has pushed up housing prices, widened the wealth gap, and suppressed residents' desire to spend money elsewhere. "Houses are for living, not for speculation," Xi famously said in 2017, sending a strong signal of his discontent about the sector.

Prior to the announcement of the tax, property developers had already faced a squeeze. China has pushed real estate firms to deleverage in an effort to deal with their rising debt levels. This has made it harder for giant companies like Evergrande to raise funding, and has led developers to grab land at a slower pace.

This has in turn put pressure on local governments. China only allows the private ownership of properties, whereas land must be leased long-term from local authorities or village collectives. Land sales to property developers account for a third of their revenue. In August and September, the value of land sales in China decreased by double digits, according to Reuters.

This is lending an urgency to the launch of the property tax, which will expand local governments' fiscal revenues, wrote analysts from Dongfang Securities.

What could the property tax look like?

Two of China's largest cities, Chongqing and Shanghai have trialed property taxes between 0.4% and 1.2% since 2011, mainly targeting second homes, luxury properties, and purchases by non-residents. The new tax is expected to cover a much wider range of properties.

An important issue is whether the pilot tax will be applied to existing properties or ones purchased going forward, said Zoe Yang, assistant professor at the School of Hotel and Tourism Management at Hong Kong-based CUHK Business School. " If the tax is imposed on existing properties that will be a huge burden for residents, who would have to deal with both the tax and mortgages," she said. The disposable income of Shanghai residents per capita is around 70,000 yuan ($10,951). For a 10 million yuan house—a common price tag in an affluent city—even a 0.5% tax rate would cost 50,000 yuan a year, adding pressure to families, she said.

Many analysts expect the central government to focus on taxing all houses. "If the property tax only covers newly purchased homes it will have a small scale, which means it can hardly achieve the purposes of boosting fairness and contributing more fiscal revenues," said analysts from Dongfang Securities. It is likely the government will give a rough guideline on the tax rate for local authorities to use as a guideline, they wrote. Shenzhen, Hangzhou, Guangzhou, and Nanjing, some of the country's most developed cities, could also be possible candidates for the pilot scheme, according to Pang at China Renaissance Securities.

A delicate balance

Although the property tax may help reduce the wealth gap in the long run, it will be an immediate sharp shock. The government will need to carefully calculate the range of the tax rate to avoid hurting citizens and the economy too much. The increased thriftiness and reduced spending of consumers is already a concern for China's economy, which has relied on exports and investment for its fast growth.

For example, retired people who rely on their pensions as a major source of income would struggle to pay the new tax, especially if the value of their home has risen significantly over the years, said Yang, the professor. Rent in first-tier cities which have seen large influxes of people could also rise if the tax comes through, as landlords would want to transfer part of their burden to tenants. Eventually, however, the rich would still be taxed the most, especially if China adopts a progressive model, applying a higher tax rate to individuals holding many properties, she said.

That's small consolation for prospective home owners. "I am just about to be able to pay mortgage together with my partner, and we have already used up savings from ourselves and parents for buying the house. I don't know how can people like me survive after the property tax?'" asked a Chinese internet user after news of the pilot tax emerged.

The property tax risks "accelerating the outflow of people and leading to a plunge in property prices," wrote Chinese finance columnist Shinian Kancha on social media platform Weibo. For underdeveloped, smaller inland cities, it is equal to "drinking poison to quench thirst," the columnist wrote.