

# Commercial real estate in China: overview

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## THE CORPORATE REAL ESTATE MARKET

### 1. What have been the main trends in the real estate market in your jurisdiction over the last 12 months? What have been the most significant deals?

Over the last 12 months, the Government has continued to implement a range of policies attempting to control property prices in China. These policies include:

- Tightening bank credits.
- Increasing the supply of low-cost housing.
- Imposing penalties against holders of idle land.
- Imposing restrictions on non-residents purchasing real estate.

According to data released by the National Bureau of Statistics (NBS) in January 2015, of the 70 large and medium sized cities surveyed, on a year-on-year basis, 68 cities saw new home prices decline in December 2014. Meanwhile, 67 cities reported price drops for existing home.

The NBS data showed that home price trends in first-tier cities and smaller cities diverged last month, with the nation's four biggest cities of Beijing, Shanghai, Guangzhou and Shenzhen seeing average prices rise by 0.1% and 0.4% from the previous month for new homes and existing homes, respectively.

The price rebound came amid a sales recovery in first-tier cities, all of which saw the number of homes sold surge more than 15% in December compared to a month ago. The recovery was boosted by government policy changes intended to avoid a sharp slowdown in the sector due to fear of jeopardising the broader economy. Those moves included:

- Fewer restrictions on home purchases.
- Eased mortgage rules.
- An interest rate cut in November 2014.

China's property market began a downturn in 2014 after a year-long boom that catapulted home prices to record highs. The downturn has also weighed negatively on the economy, with third-quarter growth sliding to 7.3%, which is the lowest level since the 2008-09 financial crisis.

The most significant deal over the last 12 months was the purchase of land use rights of No.13 and No.15 land plots of Dongjiadu in the southern Bund area, Huangpu District, Shanghai on 18 November 2014 for a total price of CNY24.85 billion by three joint purchasers:

- China Minsheng Investment Co. Ltd.
- Shanghai Bund Investment (Group) Co. Ltd.
- Shanghai Jiadu Properties Ltd.

They purchased the land for an average net price of CNY35,392 per square metre. The land parcel is to be developed as a project with residential, commercial and office buildings.

## REAL ESTATE INVESTMENT

### 2. What structures do investors typically use for real estate investment in your jurisdiction and what are the main advantages and disadvantages of each (for example, flexibility and tax transparency)?

The most commonly used structures for real estate investment are either through:

- Direct or indirect share or equity acquisition (including the cross-border deal) of a company holding the real estate.
- Direct assets acquisition.

Real Estate Investment Trusts (REITs) have generated a lot of interest in recent years and there has been significant development on some trial cases of REITs in 2014. "CITIC Qihang Special Asset Management Plan", the first REIT fund in China's domestic market, started trading on the Shenzhen Stock Exchange on 21 May 2014. CITIC Securities, the country's largest brokerage, issued the fund product. It was also reported in late 2014 that the Ministry of Housing and Urban-Rural Development has selected four cities to pilot the REIT program for construction of affordable houses for rent:

- Beijing.
- Shanghai.
- Guangzhou.
- Shenzhen.

Preliminary plans formulated by the four cities have already been submitted to the ministry for final deliberations.

### 3. What are the main sources of finance and types of investors for real estate investment in your jurisdiction? Does your government encourage overseas investment into real estate in your jurisdiction, for example through real estate investment legislation?

Institutional investors can participate in the real estate market in many ways, including establishing:

- A wholly-owned real estate project company.
- A joint venture project company with a partner.
- A company or limited liability partnership (LLP) to control the shares of the project company.

Private investors can invest in real estate through a company. In that way, they are no different from institutional investors.

Individuals can purchase residential property if they satisfy certain criteria.



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## Restrictions on foreign ownership or occupation

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### 4. Are there restrictions on foreign ownership or occupation of real estate (including foreign ownership of shares in companies holding real estate)? Are there restrictions on foreign guarantees or security for ownership or occupation and on lending for the purchase of real estate?

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Currently, only foreign individuals working or studying in China for a term exceeding one year can purchase a residential property in China for their own personal use. For corporations, only a foreign corporation's branch or representative office in China can purchase non-residential property for its own business use in the city where that branch or representative office is registered.

All foreign companies or individuals seeking to invest in real estate in China must establish a company in China to carry out the investment activities.

There are generally no other restrictions on foreign ownership or occupation of real estate.

The change of control of a Chinese company does not affect its title to real estate as the ownership of the real estate is vested in, and registered under, the name of the company itself and not the shareholders. However, it is important to note that in some circumstances the change of control requires the approval of the relevant government authorities (for example, the Ministry of Commerce or its local branch offices). At present, there are quite stringent approval requirements in respect of both:

- Equity transfer of a foreign invested real estate enterprise (that is, a company established in China by foreign investors engaged in real estate construction, operation and development).
- Merger and acquisition of a domestic real estate enterprise by foreign investor(s).

The Ministry of Commerce (MOFCOM) and the local commerce authorities are in charge of the incorporation approvals of foreign-invested real estate enterprises (FIREE) ([www.mofcom.gov.cn](http://www.mofcom.gov.cn)).

The National Development and Reform Commission (NDRC) and local development and reform commissions are in charge of the approval of projects invested by foreign investors ([www.sdpc.gov.cn](http://www.sdpc.gov.cn)).

The State Administration for Industry and Commerce (SAIC) and the local administrations for industry and commerce are in charge of the registration of companies (including FIREEs or domestic real estate companies) and supervision of the operation of the companies ([www.saic.gov.cn](http://www.saic.gov.cn)).

## TITLE TO REAL ESTATE

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### 5. What constitutes real estate in your jurisdiction? Is land and any buildings on it (owned by the same entity) registered together in the same title, or do they have separate titles set out in different registers?

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There is no legal definition of what constitutes real estate.

Land is owned either by the state or by the collectives, generally depending on its location. A collective is generally an unincorporated group of peasants in a village or town. The law allows land use rights of state-owned land to be granted through compensatory grant (that is, for a fee, known as a land grant fee) to individuals, enterprises or organisations. The compensatory grant of the land use right of a piece of state-owned land, together with any property erected on it, can be bought and sold, mortgaged or otherwise disposed of as the owner sees fit. Although there is another type of land use right (allocated land use right), since only the compensatory grant of the land use right of a piece of state-

owned land can be freely transferred in law, that land use right, together with any property erected on the land, are considered to constitute real estate from an investor's perspective.

Title to real estate is registered in different ways depending on the locality. In some places, such as Shanghai, the register for the titles of the land use right and the buildings are unified, and in other regions, such as Beijing, the registers for the titles of the land use right and the buildings are kept separately.

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### 6. How is title to real estate evidenced? What is the name of the public register of title and the authorities responsible for managing it? Is electronic access and electronic conveyancing available?

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Title to real estate is evidenced by registration, which, depending on the locality, is done either in:

- A registry that unifies both title to land and title to buildings.
- Two registries that keep separate registers for title to land and title to buildings.

The registries are under the government's control.

Title is also evidenced by title certificates issued by the relevant authority, but in the event of conflict between the contents of the register and those of the title certificate, the register prevails.

Currently, the following are in charge of the registration of titles:

- The Ministry of Housing and Urban-rural Development (MOHURD) ([www.mohurd.gov.cn](http://www.mohurd.gov.cn)) and its local counterparts are in charge of the registration of title to buildings.
- The Ministry of Land and Resources (MLR) ([www.mlr.gov.cn](http://www.mlr.gov.cn)) and its local counterparts are in charge of the registration of the title to land.

The real estate registration system is due to be significantly reformed in 2015. According to the Interim Regulations on Real Estate Registration issued by the State Council on 22 December 2014 that came into force on 1 March 2015:

- MLR will direct and supervise real estate registration across the country.
- A local people's government at, or above, the county level will designate a department as the real estate registration authority in its administrative region to register real estate.

Detailed implementation rules on the registration system will be announced by the ministry in 2015.

According to these regulations, the registration must be filed electronically or in print (print can only be used when conditions for establishing electronic registers are not fulfilled) and kept permanently. However, there is currently no national electronic access or electronic conveyancing system for the public.

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### 7. What are the main information and documents registered in the public register of title? Can confidential information or documents be protected from disclosure in the public register of title?

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The main information in the public register of title includes:

- The term or tenure of the land use right.
- The area of the building.
- The location of the land use right.
- The kind of structure of the building (for example, reinforced concrete).

- The permitted usage.
- The owner's name.
- The completion date.

In addition, the register must also contain information on any:

- Applicable mortgage.
- Applicable lease.
- Objections to the title registered.
- Restrictions applicable to the title registered.

Original transaction documents are also registered in the register but they are generally not available for inspection. In certain circumstances, the search of a public register is not permitted without the owner's consent.

Confidential information or documents can be protected from disclosure in the public register, except to the extent that disclosure is required by the title owner or the judicial institutions (including the police, the court or the procuratorate).

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**8. Is there a state guarantee of title? Is the authority that manages the public register liable to pay compensation for any errors it makes in relation to title registration? Is title insurance available and is it commonly used?**

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There is no state guarantee of title although the state can be liable for direct loss to an innocent party arising from erroneous registration or unlawful registration by a registry.

Title insurance is extremely rare, if not non-existent.

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**9. How can real estate be held (that is, what types of tenure and other main ownership rights exist over land)?**

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The land use right of state-owned land is held for the following terms of years, depending on its land usage:

- Up to 70 years for residential land use right.
- Up to 50 years for industrial, education, technology, hospital and sports land use right.
- Up to 40 years for commercial, tourism and entertainment land use right.
- Up to 50 years for mixed-use land use right.

## **SALE OF REAL ESTATE**

### **Preliminary agreements**

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**10. What types of preliminary agreements are typically used in the sale of real estate? Are they legally binding?**

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The sale of real estate generally involves three different types of transactions:

- Direct or indirect sale and purchase of equity or shares in a company holding the real estate (equity transaction).
- Direct sale and purchase of real estate before construction of the real estate is completed and an ownership certificate is issued to its developer where a pre-sale permit regarding the real estate has been issued to its developer (pre-sale transaction).
- Direct sale and purchase of real estate after construction of the real estate is completed and an ownership certificate has been

issued to its developer, or direct sale and purchase of real estate from any subsequent owner deriving title from the developer (sale transaction).

Common marketing methods either by the seller or through real estate agents include:

- Telemarketing.
- Network marketing.
- Exhibition.

Commercial negotiation is conducted throughout each stage of a sale of real estate involving non-binding documents (for example, a letter of intent), right up to the conclusion of a binding sale and purchase agreement.

Non-binding, or sometimes binding, letters of intent or memoranda of understanding are often used to set out pre-contractual arrangements, including, among other things:

- Applicable exclusivity periods.
- Confidentiality arrangements.
- Method of calculation of the purchase price.
- Due diligence arrangements.

### **Sale contract**

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**11. Briefly outline the typical main provisions of a corporate real estate sale contract and main real estate provisions of a typical share purchase agreement.**

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There is set rule as to when a sale contract is executed in any equity transaction or sale transaction. In a pre-sale transaction, the contract is called a pre-sale contract, and no pre-sale contract can be signed before a pre-sale permit is issued by the relevant government authority.

Generally, both the seller and the buyer are legally bound on execution of a binding sale and purchase agreement for the target real estate.

### **Due diligence**

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**12. What real estate due diligence is typically carried out before an acquisition and what key areas does it cover? Which documents are typically reviewed? Which specialist advisers are usually involved and which reports do they typically produce?**

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In a complex real estate transaction, typical due diligence includes legal, financial and technical due diligence, which is completed by different groups of professionals with different expertise.

A property search with the competent public authorities is usually completed as a first step of the legal due diligence on title.

Due diligence generally involves the following (to a greater or lesser degree depending on the complexity of the transaction):

- Ensuring the seller has a valid and clear title to the target real estate.
- Identifying any encumbrances on the target real estate.
- Ensuring the proper construction of the target real estate.
- Investigating any environmental issues.

Where the sale and purchase is structured as an equity transaction, there will be additional due diligence on the company whose shares are the subject matter of the sale and purchase.

## Sellers' warranties

### 13. What real estate warranties are typically given by a seller to a buyer in the sale of corporate real estate and what areas do they cover? What are the main limitations on warranties, for example are they typically qualified by disclosure?

In both pre-sale transactions and sale transactions, a seller generally warrants in respect of the property itself, unless otherwise disclosed, that:

- The seller lawfully owns the target real estate.
- The target real estate is not subject to any mortgage or other encumbrance.
- The target real estate is in a good state of repair and condition.
- Either vacant possession is given on completion or the target real estate is under tenancy, in which case the particulars of the tenancy are warranted.
- Subject to negotiation, if the seller is also the developer of the target real estate, the construction of the target real estate has complied with all relevant laws and regulations of the national and local competent authorities.

In an equity transaction, these seller's general warranties are applicable as well and the usual warranties commonly found in share or equity transactions are added. The typical warranties required of the seller in an equity transaction are that:

- The seller has full capacity to enter into the sale and purchase agreement for the target shares or equity.
- The seller lawfully owns the target shares or equity.
- The target shares or equity is not subject to any undisclosed pre-emptive right, right of first refusal, encumbrance or other right or restriction.
- The property owner company whose shares or equity is to be transacted does not have undisclosed liabilities.

The precise nature of the warranties to be included ultimately depends on the relative bargaining power of the two parties.

## Liability

### 14. Does a seller have any statutory or other liability to the buyer in a disposal of real estate?

A seller is under the following main statutory obligations *vis-à-vis* a buyer:

- The seller must be the owner of the subject matter of the sale, or otherwise entitled to dispose of the subject matter.
- The subject matter of the sale must be capable of transfer. Its transfer must not be prohibited or restricted by:
  - law or any other administrative decree; or
  - any judgment, asset seizure order or other restrictive orders.
- The sale must have the consent of any co-owners (where applicable).
- The subject matter of the sale must have been duly valued and the sale approved if the subject matter is state-owned property.
- If the subject matter of the sale is under a lease, a prior notice of the sale must be served to the lessee and a waiver of the right of first refusal to purchase must be obtained from the lessee.

- If the subject matter of the sale is under a mortgage, the seller must inform the buyer of the mortgage and inform the lender of the proposed sale.

As well as the above statutory obligations, there are other contractual obligations owed to a buyer, for example:

- The full payment of management fees.
- Utility fees.

The contractual obligations vary depending on the facts of each case and the relative bargaining position of the parties.

### 15. Briefly outline the environmental legislation and potential liability for a buyer in a purchase of real estate. Is it common to carry out environmental surveys and searches and to obtain environmental insurance? How is environmental liability typically dealt with in the sale contract?

Appraisal of the environmental impact is required for every construction project. Reports on environmental impact appraisal of construction projects must be submitted by developers to the competent environmental protection authorities for their examination and approval.

To avoid potential liability, a buyer will usually check the relevant environmental documents of the target real estate project during the due diligence exercise prior to the conclusion of the sale contract.

Environmental insurance is not very common. However, some high risk enterprises (for example, heavy metal enterprises), must buy environmental pollution liability compulsory insurances (*provisions of the Ministry of Environmental Protection* ([www.zhb.gov.cn](http://www.zhb.gov.cn)))

In a sale contract, there is usually a warranty clause for the seller to:

- Comply with all applicable environmental laws and regulations.
- Obtain all applicable environmental approvals or licences.
- Maintain a valid policy on environmental insurance (if any).

### 16. Can an owner or occupier inherit liability for other matters relating to the real estate even if they occurred before it bought or occupied it? Can a seller or occupier retain any other liability relating to the real estate after it has disposed of it?

The owner or occupier of a property does not normally inherit liability for matters relating to real estate if they occurred before it bought or occupied it, although there are some exceptions to this general rule:

- **Liability in contract.** The owner or occupier of a property can, by contract, expressly assume this liability. A common example is where a new owner agrees in the sale and purchase agreement to pay all outstanding management fees incurred before they become the owner or occupier.
- **Statutory liability.** Liability can be expressly stated in statute imposing liability relating to real estate on a person notwithstanding the fact that the liability may have arisen prior to them becoming an owner or occupier. There are not many instances under law where this kind of liability arises, but two examples are where:
  - a real estate has an illegal structure. The purchaser of the real estate is liable for removing the illegal structure



notwithstanding the fact that the illegal structure was erected by their predecessor in title;

- there is hazardous material in a real estate which continues to pose a danger to the other users of the land or its neighbours. The new owner can be liable even though it was the predecessor in title who used the hazardous material.
- **Other liability in tort.** An owner or occupier is generally not liable in tort for wrongful acts committed by a previous owner before they became the owner or occupier of a real estate (unless that liability is expressly included in statute).

A seller or occupier's liability concerning the real estate usually ceases after the seller has transferred title of the property, or the occupier has vacated the property, except in the following situations:

- **Liability in contract.** There can be contractual obligations imposed on the seller or occupier that survive the transfer of title or vacation of the property. A good example is a breach of warranties in a pre-sale agreement or a sale and purchase agreement, where the seller remains liable even though title has been transferred. The limitation period for breach of contract is two years from the day the innocent party becomes aware of the breach. For the occupier, a tenant's breach of the terms of its tenancy agreement will survive despite the fact that the tenant has vacated the property under the tenancy.
- Where the seller is not a developer, it remains liable for any latent defects in the property if they have knowledge of the defects but have failed to make proper disclosure to the purchaser.
- **Statutory liability.** This liability is expressly stated in statute and imposes liability relating to real estate on a person after they cease to be an owner or occupier. For example, where a property contains hazardous material, the person who put in that hazardous material is liable despite the fact that it has transferred its title (as owner) or vacated the property (as occupier).
- Where the seller is a developer, it remains liable at law for the construction defects of the property after the transfer of title.
- **Other liability in tort.** Any liability in tort (that is not specifically contained in a statute) already incurred before the transfer of title or vacation of the property will still be borne by the seller or occupier after the transfer of title or vacation of the property. The applicable statute of limitations differs depending on the tortious acts.

### Completion arrangements

#### 17. What are the typical arrangements and main documents required for completion of the sale? When does title transfer and what are the formal legal requirements to execute the sale documents, transfer the real estate and register the change of title? Is notarisation required?

The sale of real estate generally involves three different types of transactions:

- Equity transaction.
- Pre-sale transaction.
- Sale transaction.

For completion of the sale, an equity or share transfer agreement, a pre-sale agreement and a sale agreement must be acquired.

If the deal is structured as an equity transaction, the parties are not required to register the transfer of the equity or shares in China if the subject matter is equity or shares in a foreign company. For a transfer of equity or shares in a Chinese company, the parties must

register the change of ownership of the equity or shares within 30 days of the transfer with the local Administration of Industry and Commerce.

In a pre-sale transaction, an application for registration must be submitted within 90 days after the developer delivers possession to the buyer.

In a sale transaction, no time limit is set for the registration of the transfer of title if the seller is not a developer, although in practice, a time limit is often agreed in the sale and purchase agreement. Where the seller is a developer, registration of the transfer of title must be submitted within 90 days after the signing of the sale and purchase agreement.

In an equity transaction, the moment at which the title of the shares is transferred is governed by the law of the place of incorporation of the company whose shares are being transferred. With a transfer of equity or shares in a Chinese company, the transfer is effective on completion of the sale and purchase of the shares. Failure to register the transfer with the local Administration of Industry and Commerce does not render the transfer void, but the transfer is not binding on any bona fide third party.

In both the pre-sale transaction and sale transaction, title transfer is legally completed only by entering the transfer on the register in the relevant registry. The parties must submit, among other things, the pre-sale agreement or the sale and purchase duly signed by both the seller and the buyer.

For the formal legal requirements on the transfer of real estate the following issues should be noted:

- **Requirements on transfer of compensatory land use right.** Only compensatory land use rights may be transferred (allocated land use rights are non-transferable), subject to the statutory requirements below, from one owner to its transferee by entering into a transfer contract. On a transfer of compensatory land use rights, all the rights and obligations of the transferor in relation to the land are transferred to the transferee including those set out in the land use rights grant contract. Compensatory land use rights may not be transferred unless the following statutory requirements are satisfied:
  - at least 25% of the total investment for the relevant construction project, excluding the land premium, have been expended;
  - the land premium must have been paid in full;
  - the transferor has already obtained a land use rights certificate of the land.
- **Requirement on entering into a pre-sale contract.** Prior to the completion of construction, a developer may be allowed to "pre-sell" its incomplete properties through a process called "pre-sale" by obtaining a pre-sale permit and entering into pre-sale contracts with purchasers. In order to obtain a pre-sale permit, the following conditions must be met;
  - the land premium has been paid in full and the relevant land use rights certificate has been obtained;
  - the Construction Works Planning Permit and the Work Commencement Permit have been issued;
  - as far as the development to be put on pre-sale is concerned, no less than 25% of the total investment of the development project has already been expended, and the construction schedule and completion date have been confirmed.

The above conditions can vary from place to place as local government authorities can impose more stringent conditions for a pre-sale permit.

- **Requirement on entering into a sale contract.** After the completion of construction and with the issuance of the land and property ownership certificate relating to the entire

development, a developer sells its development without further restriction by entering into sale and purchase contracts with purchasers.

If one or both parties to an agreement are foreign individuals or entities, notarisation and legalisation (a special attestation procedure required in China) can also be required for other relevant documents, for example, the corporate documents of the foreign party.

## REAL ESTATE TAX

### 18. Is stamp duty/transfer tax (or equivalent) payable on the purchase of real estate? Who pays, what are the rates and are there any exemptions? Does it apply to the transfer of shares in a company holding real estate and at what rate?

Stamp duty is payable on a sale and purchase agreement. The rate is 0.05% of the contract price, payable by each party. Taxpayers are required to calculate the amount of stamp duty and to purchase and attach duty stamps to the taxable document. Duty stamps should be attached to taxable documents when they are drawn up or received. If a contract is signed outside of China then the stamp duty should be paid when it is implemented in China.

Business tax and a surcharge are payable on the sale of real estate. The transferor pays and the combined rate is 5.5% of the transfer price. Where a transferor contributes real estate in exchange for equity interest, that capital contribution is not subject to business tax.

Land appreciation tax (also called land VAT) is also payable by the transferor for sale proceeds, at a tiered rate from 30% to 60% of the gain depending on the quantum of gain.

Where the transferor is a body corporate, corporate income tax at the rate of 25% of profit is also payable for profit from the sale of the real estate, although the actual corporate income tax payable ultimately depends on the profit or loss level of the body corporate from other business activities in the same fiscal year. Where a corporate transferor is not resident for Chinese tax purposes, a deemed corporate income tax of 10% of the gain on sale of the real estate is imposed.

Deed tax is payable on the sale of real estate. It is paid by the buyer, and the rate is 3% to 5% depending on the location of the property. Deed tax is exempted in mergers and demergers.

Where the sale is of the company holding the real estate asset, the above transfer taxes do not apply. The transferor pays the stamp duty and the income tax (individual or corporate, as applicable) and the Transferee pays only stamp duty. This accounts for the preference for transfer of equity of the holding company over the asset itself.

Offshore purchase of the equity of an offshore vehicle holding the ultimate Chinese real estate asset triggers an obligation on the part of the buyer to report the details of the transaction to the tax authority. In the absence of any commercial purpose of the offshore vehicle, it may be deemed to be an acquisition of the equity of a Chinese company holding the asset, therefore, subjecting the seller to stamp duty and corporate income tax. A recent notice issued by the tax authority even imposes an obligation on the buyer to withhold such taxes when paying the sale consideration.

### 19. Are any methods commonly used to mitigate real estate tax liability on acquisitions of large real estate portfolios? What is the general approach of the tax authorities in your jurisdiction to such schemes?

Some developers have tried to retain a portion of the property so that they do not have to make a final settlement of land VAT. Some

developers have tried to pay land VAT according to a deemed rate that they negotiated with the tax bureau. However, the enforcement of land VAT has become increasingly strict.

### 20. Is value added tax (VAT) (or equivalent) payable on the sale or purchase of real estate? Who pays? What are the rates? Are there any exemptions?

Land VAT is payable on the sale of real estate. It is also sometimes referred to as the "land appreciation tax". It is payable by the seller.

Land VAT is levied on the value added through the sale of real estate. Value added is calculated as the difference between the amount of the income derived from the sale and the amount of certain deductible items.

The rates of land VAT are progressive, depending on the extent of the value added:

- For the portion of the value added amount that is no more than 50% of the amount of the deductible items, the rate is 30%.
- For the portion of the value added amount that is more than 50% of the amount of the deductible items but no more than 100% of the amount of the deductible items, the rate is 40%.
- For the portion of the value added amount that is more than 100% of the amount of the deductible items but no more than 200% of the amount of the deductible items, the rate is 50%.
- For the portion of the value added amount that is more than 200% of the amount of the deductible items, the rate is 60%.

There are certain exemptions from land VAT, and the common ones are:

- Transfers of ordinary standard residential buildings (excluding luxury apartments, villas and holiday resorts) if the value added is less than 20% of total deductions.
- Where, as part of a merger between two or more enterprises, one enterprise assigns real estate to another enterprise participating in that merger (this is a temporary exemption from land VAT).
- Where one party contributes land, another party contributes funds and the two parties co-operate in the construction of buildings, there is a temporary exemption from land VAT where the completed buildings are allocated between the two parties for self-use.

When real estate is used as capital contribution into a real estate enterprise or contributed by a real estate enterprise, no exemption applies. Otherwise, an exemption may apply.

### 21. Are municipal taxes paid on the occupation of business premises? Are there any exemptions?

There are generally no municipal taxes paid on the occupation of business premises.

## CLIMATE CHANGE ISSUES

### 22. Are there targets or incentives to reduce greenhouse gas emissions from buildings in your jurisdiction? Is there legislation requiring buildings to meet certain minimum energy efficiency criteria?

There are not any specific targets to reduce greenhouse gas emissions from buildings. But the Energy Construction Design Standards for Civil Buildings (Heating Residential Buildings)

released by the Ministry of Housing and Urban-Rural Development of China, which came into force on 1 July 1996, stipulates the relevant minimum energy efficiency criteria for certain buildings.

### 23. Are provisions relating to the energy efficiency of buildings commonly included in contracts for the sale of real estate or in leases (for example, green leases)?

Regulations on Energy Conservation in Civil Buildings issued by the State Council in 2008 provide that real estate development enterprises, when selling real estate, must clearly state to the buyers:

- Energy consumption indicators.
- Energy conservation measures and protection requirements.
- Insulation warranty periods.

These must be stated in the:

- Real estate sale and purchase contract.
- Residential quality assurance certificate.
- Residential user manual.

Also, under the 2014 version of the Template Contract for the Sale of Commercial Premises jointly issued by Ministry of Housing and Urban-Rural Development (MOHURD) ([www.mohurd.gov.cn](http://www.mohurd.gov.cn)) and State Administration for Industry and Commerce (SAIC) ([www.saic.gov.cn](http://www.saic.gov.cn)), commercial premises must comply with all relevant requirements of mandatory standards on energy conservation for civil buildings. Where there is a failure to comply with the regulations, the seller must make up the energy conservation procedures according to the relevant requirements and bear all the costs incurred.

Therefore, the provisions in relation to energy efficiency of buildings should be included in the pre-sale agreement or sale agreement where the seller is the developer.

## REAL ESTATE FINANCE

### Secured lending involving real estate

### 24. Briefly outline the typical security package required by lenders in relation to real estate lending. How are the most common forms of security interest relating to real estate created and perfected (that is, made valid and enforceable)?

In an equity transaction involving either equity or shares in a foreign company or a Chinese domestic company (Target Company), there is very little limitation, as far as the law is concerned, as to how a foreign investor must finance that purchase. The investor may finance it using equity financing, debt financing or both.

For debt financing, the following should be noted:

- Any assets owned by either the Target Company (in the event that it is a Chinese company), or any of its Chinese subsidiaries cannot generally be used as security under the law because of the foreign exchange control rules currently in place.
- The equity in the Target Company if it is a Chinese company can be pledged as security under the law.

The usual way of financing an asset acquisition is by bank financing supported by a mortgage on the asset and, if required, further security, for example:

- A pledge of the equity or shares in the purchaser.
- A guarantee provided by its parent company.

A mortgage over real estate (including the land or buildings) is the most commonly used collateral in raising finance for real estate. The proceeds generated from real estate (for example, rental and sale proceeds) can also be pledged to a lender to secure debt financing. Both a mortgage and a pledge can be created by a contract in writing and perfected through registration with the appropriate land or property registry (for a mortgage) or with the credit reference centre of the People's Bank of China (for a pledge of rental and sale proceeds in the form of account receivables) subject to payment of certain registration fees. However, mortgage tax is not required under the law.

A charge over an account and an assignment of insurance by way of security are commonly used in financing in common law jurisdictions but are not recognised under Chinese law and therefore are rarely used. Instead, a lender can opt for a pledge over deposit or becoming the first beneficiary of an insurance policy.

### 25. What other real estate related measures do lenders typically take to protect themselves against default by the borrower?

To prevent the borrower's default, it is customary for a lender to:

- Conduct due diligence against the borrower and the project before making a loan.
- Set conditions precedent for drawdown.
- Impose property, project completion and funding and financial covenants on the borrower.
- Take collaterals and guarantees for the loan.
- Set the loan to value ratio of the property.
- Become the first beneficiary of the insurances for the property.

### 26. Can lenders incur environmental liability? What measures do lenders typically take to manage potential environmental liability?

Generally, a lender does not incur environmental liability for real estate financing. For compliance purposes, it has been a customary practice for the lender to require the borrower to provide all necessary environment permits for the project before making a loan.

### 27. Briefly outline the main remedies for lenders in relation to the secured real estate if the borrower defaults on the loan. What is the effect of the borrower's insolvency on the lender's remedies?

A lender can realise the property mortgage based on an agreement reached between the borrower and the lender to:

- Assign the ownership of the mortgaged property to the lender thereby satisfying the loans.
- Sell the mortgaged property privately to a third party thereby satisfying the loans using the sale proceeds.
- Sell the mortgaged property through auction to the general public thereby satisfying the loans using the sale proceeds.

Where there is a failure to reach any agreement between the borrower and the lender, the lender can bring legal proceedings against the borrower in court to enforce the property mortgage. The court can sell the mortgaged property to the general public

through a public auction based on a judgment in favour of the lender thereby satisfying the loans using the sale proceeds.

Under the law, a mortgaged property does not fall within a bankruptcy estate and therefore the lender has a right of priority to receive the enforcement proceeds of the mortgaged property even if the borrower goes bankrupt. The right of the lender to enforce the mortgage is subject to the limitation period imposed by the law.

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## **28. Briefly outline key additional issues for lenders in relation to construction and development projects.**

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A lender should look at various things to make sure the project can be constructed and completed in a diligently and timely manner, including:

- Construction progress.
- Construction cost-overflow.
- Completion date.
- Construction contracts.
- Official permits or certificates for project construction or development.

### ***Other real estate financing techniques***

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## **29. Are other real estate finance techniques commonly used in your jurisdiction? For example, real estate securitisation and sale and leasebacks.**

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There have been only a few instances of mortgage-backed security (MBS) relating to home mortgage loans on a trial basis. Real estate securitisation has not developed in China. Another popular form of securitisation, real estate investment trusts (REITs), have been debated for a long time, but have yet to be approved by the Government, except in a few isolated trial cases.

## **REAL ESTATE LEASES**

### ***Negotiation and execution of leases***

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## **30. Are contractual lease provisions regulated or freely negotiable? Which legislation applies?**

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Contractual lease provisions are freely negotiable, unless those provisions are provided for by law. For example, the maximum duration of a lease is 20 years. A landlord must ensure the safety of the leased premises and the facilities inside it provided by the landlord.

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## **31. What are the formal legal requirements to execute a lease? Does the lease have to be executed by certain parties or as a deed? How do the formalities differ for a company, partnership and for individuals?**

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There are no special legal requirements on the format of a lease, which is usually in writing and signed by the landlord and the tenant. An oral lease is also legally permitted, although this is not common. In some cities, a standard form lease in writing prescribed by the local authority must be adopted when the lease is submitted to the relevant local authority for lease registration, but the landlord and tenant are allowed to amend the provisions of that standard form lease.

## ***Rent payments***

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## **32. How are rent levels usually reviewed and are there restrictions on this? Is stamp duty and VAT (or equivalent) payable on rent? Is a rent security deposit required and does it have to be managed in a certain way?**

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There are no restrictions on the rent level or on the way in which the rent level is reviewed. Rent levels are usually determined by the landlord and the tenant by agreement based on market price. The landlord and the tenant can agree the rent review mechanism in the lease. In some cases, a third party may be brought in to help determine the rent level.

A business tax and a surcharge are payable by the landlord on rental income, and the combined rate is generally 5.5%.

## ***Length of term and security of occupation***

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## **33. Is there a typical length of lease term and are there restrictions on it? Do tenants of business premises have security of occupation or rights to renew the lease at the end of the contractual lease term?**

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There is no typical length of lease term but the term of a lease cannot exceed 20 years. There is no security of tenure for a tenant of business premises.

National law does not grant a tenant the right to renew the lease at the end of the contractual lease term. However, some local regulations (for example, in Shanghai and Zhejiang) provide that a tenant has a pre-emptive right to renew the lease on the same conditions that the landlord is offering to other potential tenants, which applies to both business premises and residential premises.

## ***Disposal***

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## **34. What restrictions typically apply to the disposal of the lease by the tenant? Can the tenant assign or sublet the lease with the landlord's consent? Can tenants share their premises with companies in the same group? What is the effect of a legal reorganisation or transfer/sale of the tenant on the lease and on a guarantee of the lease?**

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A tenant has no right to assign or sublet the lease without the landlord's express consent, unless there are provisions contained in the lease that allow the tenant to do so.

A tenant cannot share its leased business premises with companies in the same group without the landlord's consent. Further, under the rule that each company must have its own address, which cannot be shared with another company, where premises are shared between several companies, they must be physically demarcated into separate addresses for each company.

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## **35. Does a landlord or tenant retain any liability under the lease after the lease is assigned?**

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In a transfer of all the rights and obligations under the lease from a landlord to a third party, or from a tenant to a third party (except if there are provisions in the relevant transfer agreement) the original landlord or tenant will not bear any liability under the lease except that:

- The obligations that belong exclusively to the original landlord or tenant are assumed to be continuous.



- The original landlord or tenant must, within 30 days, handle the cancellation registration formalities with the lease registration authority where the lease has been originally registered.

### Repair and insurance

#### 36. Who is usually responsible for keeping the leased premises in good repair and for insuring the leased premises? Are there provisions for the ownership of lease improvements?

The landlord must keep the leased premises in good repair unless the lease provides otherwise. In practice, the repair obligation is set out in the lease and provides which party has the responsibility to keep the premises in good repair.

### Landlord's remedies and termination

#### 37. What remedies are available to a landlord for a breach of the lease by the tenant? On what grounds can the landlord usually terminate the lease and what restrictions and procedures apply? What is the effect of the tenant's insolvency under general contract terms and insolvency legislation?

The law does not expressly provide who is responsible for insuring the leased premises. In practice, the landlord insures the building and structure and the tenant insures the tenant-installed fixtures and movables inside the premises.

A landlord has the right to terminate the lease in the following circumstances:

- An event of *force majeure* occurs that renders the lease incapable of being realised.
- The tenant unilaterally changes the main structure of the building or exceeds the loading limits of the leased premises and fails to reinstate the premises to its original state within a reasonable notice period given by the landlord.
- The tenant sublets the lease without the landlord's consent.
- The tenant fails to pay, or delays in paying, any rent due without reasonable grounds after the landlord has given a reasonable notice period.
- The tenant uses the leased premises for purposes not agreed in the lease or causes damage to the leased premises.

The parties can also agree other circumstances that would trigger termination in the lease agreement.

Under general contract terms, the tenant's insolvency usually leads to the termination of the lease, with the forfeiture of the tenant's security deposit that is paid as liquidated damages.

After a petition for a debtor's bankruptcy is accepted by a court, the bankruptcy administrator can decide whether to terminate or continue to perform a contract entered into before bankruptcy, where performance of that contract has not yet been completed (*Enterprise Bankruptcy Law issued by the Standing Committee of the National People's Congress, which came into force on 1 June 2007*). The bankruptcy administrator can therefore exercise its right to terminate a lease in the event of the tenant's bankruptcy.

#### 38. Can the tenant withhold rent payments in certain circumstances, for example for serious damage to the leased premises? Can the tenant terminate the lease in certain circumstances?

A tenant has the right to terminate the lease in the following circumstances:

- An event of *force majeure* occurs that renders the lease incapable of being realised.
- The landlord fails to deliver the leased premises to the tenant as agreed after the tenant has given a reasonable notice period.
- All or part of the leased premises are damaged or lost due to a reason not attributable to the tenant that renders the lease incapable of being realised.
- The leased premises become dangerous to the safety or health of the tenant.
- Any of the following which renders the leased premises incapable of use by the tenant:
  - the leased premises are seized by the authorities;
  - there is a dispute over the title of the leased premises;
  - the leasing of the premises is in violation of mandatory legal provisions.

The parties can also agree other circumstances that would trigger termination in the lease agreement.

### PLANNING AND DEVELOPMENT CONTROLS

#### 39. In what circumstances can local or state authorities purchase business premises compulsorily? Is the purchase price market value?

For public interest purposes, the municipal or county authorities can expropriate business premises on state-owned land and the owner of the premises will be compensated fairly (*Regulations on the Expropriation of and Compensation for Premises on State-owned Land (Regulations) issued by the State Council, which came into force on 21 January 2011*).

The Regulations do not clearly define the term public interest but only set out a non-exhaustive list of the circumstances that constitute public interest:

- The needs of national defence and diplomacy.
- The needs of infrastructure organised and carried out by the government.
- The needs of public utilities organised and carried out by the government.
- The needs of the construction of low income housing projects organised and carried out by the government.
- The needs of reconstruction of an old town organised and carried out by the government under the Law of Urban and Rural Planning.
- Other circumstances constituting public interest provided for by law and administrative regulations.

Under the Regulations, compensation for the value of the premises to be expropriated must not be lower than the market price of premises similar to those to be expropriated.

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#### 40. What authorities regulate planning control and which legislation applies? Is there specific protection for special categories of buildings such as historic buildings?

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Generally, the central and local planning authorities supervise and regulate planning control, and the Urban and Rural Planning Law, which came into force on 1 January 2008, applies.

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#### 41. What planning consents are required for building works and the use of a building?

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The following planning consents apply to all types of real estate development:

- Development Land Planning Permit (*jian she yong di gui hua xu ke zheng*) is granted to the land use right owner after the compensatory grant is signed, which sets out the details of the planning requirements for the land lot under the compensatory grant.
- Development Project Planning Permit (*jian she gong cheng gui hua xu ke zheng*) is granted to the land use right owner after the owner has submitted the detailed architect designs.

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#### 42. What are the main authorisation and consultation procedures in relation to planning consents?

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##### Initial consents

There is generally no initial consent. The competent department of urban and rural planning under the people's government of a city or county grants the Construction Land Planning Permit and the Construction Project Planning Permit.

The decision to issue the permits should be made within 20 days, or no more than 45 days (depending on which approval procedures and methods are adopted by the authority) after receipt of the application, though this time period can be extended by the authority for another ten days or 15 days, as the case may be.

##### Third party rights and appeals

Third parties can object to the issuance of either type of permit.

Where the issuance of the Construction Land Planning Permit and the Construction Project Planning Permit may have a significant impact on the interests of a third party, before the permits are issued the authorities must inform the third party of its right to request a hearing, which must be held in public in accordance with the relevant regulations.

Also, after permits have been issued, if a third party believes that its rights have been infringed, it can seek an administrative reconsideration of the decision to issue the permits, or issue administrative proceedings against the issuing authorities.

Where the rights of a third party have been infringed and a hearing is requested, that hearing must be held in public. However, there are no detailed rules governing the conduct of public inquiries.

There is a right of appeal against planning consents. The relevant parties can seek an administrative reconsideration of the decision to issue the permits or issue administrative proceedings against the issuing authorities.

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##### REFORM

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#### 43. Are there proposals to reform real estate law and are they likely to come into force and, if so, when?

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The Urban Real Estate Administration Law (revised in 2009) and the Land Administration Law (revised in 2004) are being reviewed and are likely to be amended in due course.

It was reported that a draft amendment to the Land Administration Law had been submitted to the bi-monthly session of the Standing Committee of the National People's Congress (China's top legislature) for its first reading on 24 December 2012.

As the drafts of the proposed amendments have not been published, the extent to which these laws will be revised is unknown. However, it is envisaged that there will be provisions to strengthen both tenant protection and the protection of the rights and interests of those who own land collectively in the event that it is expropriated by the government.

## ONLINE RESOURCES

### National People's Congress database of laws and regulations

**W** [www.npc.gov.cn/englishnpc/Law/Integrated\\_index.html](http://www.npc.gov.cn/englishnpc/Law/Integrated_index.html) ( English)

**W** <http://law.npc.gov.cn:87/home/begin1.cbs> (Chinese)

**Description.** The Standing Committee of the National People's Congress (the legislative body of China) maintains the above website that is a database providing the laws and regulations at state or local level. The English database provides the English version of some of the major laws promulgated by the National People's Congress or its standing committee and some administrative regulations by the State Council. Since standardised Chinese characters are used by state organs as the official language, English translations provided are for reference only and are non-binding. The information provided should be up-to-date.

### The Central People's Government of the People's Republic of China

**W** <http://www.gov.cn/flfg/index.htm>

**Description.** The Central People's Government (the State Council) of China maintains the website, which provides the laws and regulations in the state or local level in Chinese. The information provided should be up-to-date.

### The China Court

**W** [www.chinacourt.org/law.shtml](http://www.chinacourt.org/law.shtml)

**Description.** The Supreme Court of China maintains the website, which provides the laws and regulations in the state or local level in Chinese. The information provided should be up-to-date.

## Practical Law Contributor profiles



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**Professional qualifications.** Hong Kong, Lawyer, 1996; California, US, Lawyer, 1988; California (Federal District), US, Lawyer, 1993; Singapore, Lawyer, 1984

**Areas of practice.** Real estate; mergers and acquisitions; employment

#### Recent transactions

- Advised a US PE Fund on the acquisition of a completed shopping mall in Beijing from a European developer and an Asian based PE fund.
- Advised on the acquisition of a majority interest in a shopping mall and office development site in Shanghai.
- Advised on the development of the TaiKoo Hui Project in Guangzhou, a comprehensive development comprising over 441,000 square metres with a shopping mall, two office towers, a cultural centre and a five-star hotel.

**Professional qualifications.** Hong Kong, Lawyer, 1996

**Areas of practice.** Banking; financing

#### Recent transactions

- Advised various syndicates of banks on financing the development of various phases of the Xintiandi project in Shanghai, China.
- Advised various lenders on financing various property development projects in other cities in China including Beijing, Chengdu, Chongqing, Dalian, Dongguan, Guangzhou, Hangzhou, Nanjing, Shenzhen and Tianjin.
- Advised the lender on extending a standby letter of credit facility for securing Renminbi loans to the four Chinese joint venture companies operating the Hefei-Yeji Highway in Hubei Province, China.