

Legal Aspects of Real Estate Development in China

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The Basics.

- All Land Owned by State
 - Urban: State
 - Rural: Collectives (generally)
- Land Use Rights
 - Allocation
 - Grant

Allocated Land Use Rights

- Usually Given For Free And Without Time Limit
- Can Be Used Only For A Specific Purpose
- Cannot Be Assigned
- Can Be Expropriated Under Certain Circumstances
- Generally No Longer Directly Available To Foreign Investors

Granted Land Use Rights

- Limited In Time (40 to 70 years) Against Payment
- Protected From Expropriation
 - Property Right? “Civil” Right?
- Alienable
 - Transfer
 - Lease
 - Mortgage

Granted Land Use Rights

- Direct Grant By State: “First-Class” Market
 - Auction, Bidding, Listing
- Land Use Right Grant Contract
 - Developer Must Develop Within Defined Time Period (2 years max)
 - Uses Must Conform to Land Use Regulations
 - Similar to Zoning

Transferring Granted Land Use Rights

- Subsequent Grants by Right Holders (“Second-Class” Market)
 - Written transfer contract must be prepared & filed w/authorities
 - Can’t be assigned if land hasn’t been developed per original grant contract
 - Right to use land and title to improvements are separate...need to transfer simultaneously
 - Transferee receives time remaining under original grant contract

Leasing Granted Land Use Rights

- Leasing Practices Quite Similar to Western Style
- Civil Law Framework -- Less Detail in the Lease...Law Oriented to a “Fair” Construction
- Can Lease Both (Granted) Land Use Rights and Buildings...Max. Term 20 Years (Can Be Renewed)
- Leases Must be Registered to be Valid
- Leasehold Mortgages Not Possible; Leases are a “Credit Right” not a Property Interest *per se*

Mortgaging Granted Land Use Rights

- Until Recently, Most Prevalent Method of Financing – 80% of Projects
- Lending Requirements Have Been Tightened – “Bubble” Worries
- Mortgages Freely Transferable Under Certain Conditions; Can be Alienable From Land
- Securitization Still Uncommon
- Questions Regarding Priority of Leases, Contractor Claims

Other Methods of Financing, Transferring Projects

- Buy Into an Existing Project
- Offshore Company
- Pre-Sale (e.g., Housing)
- Land Trusts (REITs Still Uncommon)
- IPOs – Still Uncommon

Vehicles for Investment

- Cooperative JV
- Equity JV
- WFOE

Equity Joint Ventures

- Advantages
 - No maximum term
 - Government's preferred investment vehicle
 - Detailed rules available
 - Can have branches or subsidiaries outside of China.

Equity Joint Ventures, ct'd

- Disadvantages
 - Inflexible structure
 - Types of capital contribution limited
 - Long time to negotiate & set up
 - Can't withdraw initial capital investment during life of JV contract
 - Consensus-style management
 - Winding up unsuccessful EJV can be difficult

Cooperative Joint Ventures

- Advantages
 - Subject to negotiation, the foreign party can control the management completely
 - Can be either a partnership or a (Chinese) limited liability company
 - Profit/loss allocation can be different from % of capital contributed
 - “Cooperative terms & conditions” (e.g., technology transfer) can be an acceptable contribution
 - Can withdraw initial investment before termination of JV (assuming agreement provides for this)
 - MAY be able to avoid creating a permanent establishment for the investor in PRC for tax purposes
 - No minimum investment by the investor required, except 25% needed if the JV will be a limited liability company.

Cooperative Joint Ventures, ct'd

- Disadvantages
 - Not very popular ... the “road less traveled” .
 - Contract must provide for a fixed term for the JV (can be extended by agreement and with regulatory approval)
 - Unless the foreign investor is willing to put up 25% needed to create a limited liability company, the JV will have to be a partnership.

WFOEs

- Advantages
 - No partner to bother you
- Disadvantages
 - No partner to help you
 - Can't own certain types of real estate
 - Must acquire the land on your own

Recent Developments

- Land Use Right Grants Now Required to be Auctioned, Bid, or Listed
- E&A Authority Now at Provincial Level
- Developer Must Obtain Pre-Sale Permit Before Marketing Housing
- Disclosure Requirements In Pre-Sale Contracts
- Capital to Be At Least 35% Before Loan
- Property Management Regulations



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