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Affordable mainland homes a long way off

The following article by Jing Ulrich appeared in the SCMP on Jun 8

China's swift exit from policies supporting the real estate market represents the most aggressive round of sector tightening in recent memory. In response to soaring housing and land prices, Beijing has tightened mortgage terms in order to restrain the purchasing power of homebuyers. Local governments, banks and regulators have released administrative measures that limit the scope for speculation and increase scrutiny of land use.

In light of the property sector's influence on demand across a host of industries, the weakness in transaction volumes in recent weeks has raised considerable concern about what further measures might be in store. Although such concerns are understandable, it is important to keep in mind that policymakers' main intent is to restrain price increases rather than engineer a sharp correction or dampen activity. More recent tightening measures at the local government level were apparently less severe than policies announced in Beijing in mid-April. Importantly, mortgage policy remains very supportive of owner-occupied home purchases.

Since mid-April, policymakers have increased the cost of property investment and restricted financing for housing not occupied by the owner. The minimum down payment on loans for second homes has been raised from 40 per cent to 50 per cent and banks now have leeway to stop lending to buyers of third homes. Mortgage rates for buyers of second homes have increased - from the previous 15-30 per cent discount on the benchmark rate - to the benchmark rate multiplied by 1.1.

Policymakers are also clamping down on developers who hoard land and intentionally keep properties off the market. Already, in the first few months of this year, regulators have fined several property developers for leaving land unoccupied. A number of local governments have also revised land auction procedures to prevent prices from spiralling.

For some years, voices from government and academia have suggested that China should introduce a recurring residential property tax. Although some local governments have submitted property tax plans for review to the State Council, the nationwide implementation of such a tax is probably still some years from becoming viable due to the complexities of establishing a national valuation system. At the onset, the government may experiment with a property tax by

targeting buyers of multiple homes, non-resident homeowners or buyers of luxury properties in select cities.

Investors' main concerns about the outlook for the sector and the broader economy centre around the extent to which a transaction slowdown may affect developers' finances and housing-related purchases, the likelihood of a slowdown in real estate investment (which would dampen demand for raw materials and hamper growth in the construction sector) and the impact of a potential price correction on the asset quality of banks.

Chinese banks extended 1.4 trillion yuan (HK\$1.6 trillion) in mortgage loans to individuals and 576.4 billion yuan in loans to real estate developers last year. Overall, the property sector accounted for almost 21 per cent of all new loans last year. Despite the rapid increase in the pace of lending last year, there seems to be no substantial risk to credit quality. The loan-to-value ratio for mortgages is low in China, and subprime loans and mortgage securitisation are not features of the mainland housing market.

The government's tightening campaign appears to be achieving its main aim of restraining property prices. There have been signs of prices softening on the secondary market and several instances of price reductions on new launches, especially outside prime areas in major cities. But property prices have corrected only modestly, by and large.

Primary sales of real estate generally lead housing starts by two to three months. The growth rate of primary sales began to slow at the end of last year, when various incentives were withdrawn, and has continued to slow this year as the credit environment tightened. If sales activity remains subdued, the growth in housing starts will probably moderate in the coming months.

If housing transactions remain subdued, property developers may feel pressure to offer bigger price cuts later this year when a substantial new increase in supply is expected. But many developers have managed to strengthen their capital base, when compared to the situation early last year, through fund-raising activities and strong sales.

The sharp increase in land supply for mass-market residential property this year should help stabilise expectations about housing prices and set a floor for real estate investment.

But authorities will need to deal with the misaligned objectives - between national policy, local government incentives and developers' preferences - that have hindered the progress of past initiatives on affordable housing.

At the root of the mainland property market's tendency to overheat is the lack of investment alternatives for the average mainlander. Investors are more inclined to channel their funds into real estate when deposit rates are at low or negative levels. While the government's administrative measures may help stabilise the sector in the short term, capital-market reforms and the broadening of

both onshore and offshore investment options are necessary preconditions for stability in the long term.

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