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China Residential
When will the party end?

Contents

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Executive summary

Many have raised concerns that China's housing market is in a bubble, given the strong sales transactions, price increases and large vacant and pipeline inventory. However, we do not expect a national or devastating bubble burst in the China property market although some smaller markets may correct due to oversupply and weak demand. China is a large country with a wide degree of variance among different geographic areas. In the Tier 1 and 2 cities, prices are high due to strong demand and constraint in supply. Home ownership rate is lower than in the rural areas and there is upgrading desire with many households in poor and cramped conditions. In many Tier 3 and 4 cities, oversupply is the main problem as local governments have been selling land to developers to fund new projects and infrastructure to drive their economies.

Long-term housing demand drivers remain intact, but the momentum of growth is expected to ease after coming up from a low base in the past few decades. China's economic growth rate is slowing down as it undergoes restructuring, the population will be peaking in a few years' time with less moving into the marriageable age group and the rate of urbanisation will be more moderate after hitting over 52% in 2012. Capital controls will be slowly eased under the financial reforms, which are likely to divert more funds to overseas properties.

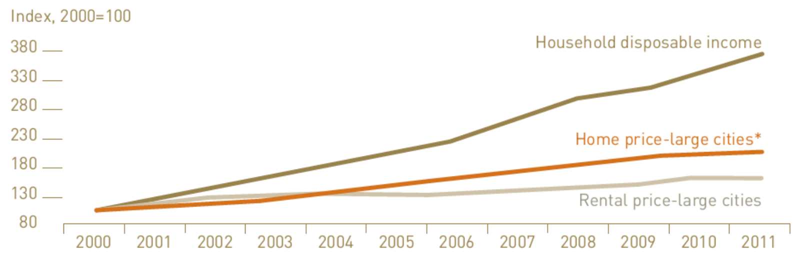
Tier 1 and 2 cities will however continue to see strong housing demand from the continuous influx of migrants, and upgrading and investment demand. Nevertheless price increases are expected to be more moderate from 2013 rates, given the slower economic growth, housing curbs, high price levels and increasing supply of affordable housing. For smaller cities with oversupply, some could see a fall in prices with weak demand but most are likely to see flat prices. Coastal Tier 3 and 4 cities are in a better position to resolve their oversupply over time, as they have stronger economic drivers to attract migrants from inland areas, aided by the recent relaxation to make it easier for migrants to obtain hukou registration.

With the property sector contributing a significant proportion to GDP growth, it is in the interest of the government to see a stabilised market. The new government has shifted focus to increasing social welfare supply instead of curbing housing demand and price increase nationwide. The major risk for the housing market is a significant economic slowdown as a result of drastic reforms or another global crisis. However, it is likely that the Chinese government will step in with some stimulus as it had done during the global financial crisis and last year's slowdown. As the housing market in China is a diverse mix and coming to a new era of slower growth momentum, investors/developers will have to carefully consider each city's economic growth drivers and housing demand and supply situation.

Introduction

Housing prices in China have risen for more than a decade, driven by strong growth in disposable income and urbanisation. 470 million people have moved from rural to urban areas over the past three decades. The share of the urban population has increased from about 17.8% in 1978 to about 52.6% in 2012. The increased demand for urban housing has helped to push home prices higher in these areas. Income has grown faster than home prices, providing fundamental support to prices (Fig 1).

Figure 1: Disposable income grows faster than home prices



Note: 36 large cities from 2000 to 2010; 70 large and medium cities after 2011
Sources: Chinese National Bureau of Statistics, DataStream

Despite three years of government measures to curb demand and price growth, new home sales volume and prices in 2013 continued to rise. Sales volume rose 18% to 1.2 billion sqm. New home prices among 70 large and medium-sized cities rose an average of 9.7%, led by Tier 1 cities which saw increases exceeding 20%[1]. The total value of new home sales in 2013 rose 27% to RMB 6.8 trillion, exceeding USD 1 trillion for the first time. This is comparable to the total value of new and existing home sales in the US, estimated to be around USD 1.1 trillion, including USD149 billion of new homes[2].

Many have raised concerns that China's housing market is in a bubble, given the strong sales transactions, price increases and large vacant and pipeline inventory. The purpose of this paper is to examine the following points of inquiry:

- Is there a price bubble?
- Is there oversupply?
- Will demand slow down?
- Will credit tightening kill the market or trigger a financial crisis similar to what happened in the US?
- What is the government policy intention?
- What is the outlook and investment strategy to be taken?

[1] National Bureau of Statistics
[2] Cushman & Wakefield

Is there a price bubble?

The price-to-income and affordability ratios, commonly used indicators to analyse housing market exuberance, showed that China's nationwide average ratios are much higher than most other countries.

However there is a degree of variance among different areas. The ratios are much higher in the Tier 1 and 2 cities where price increases have taken on a faster pace. Tier 3 cities have ratios that are comparable to other countries.

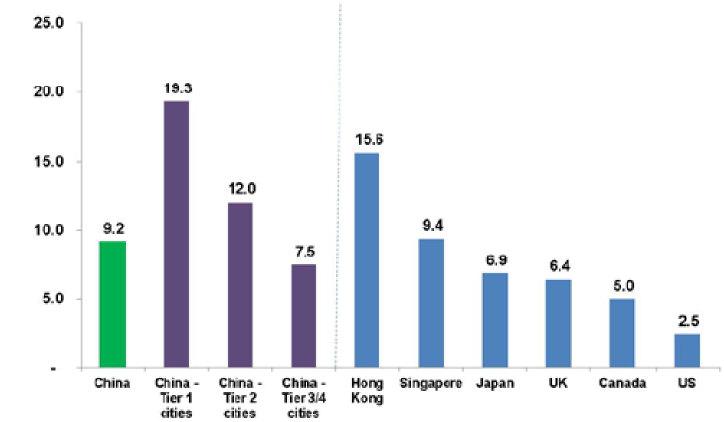
According to Citi Research[3], the price-to-income ratio in China is 9.2, higher than in most other countries with the exception of Hong Kong (15.6) and just below Singapore (9.4) (Fig 2). Similarly, the affordability ratio (monthly mortgage payment for mainstream unit size versus average household income) in China at 41.1% is higher than in most other countries except for Hong Kong (48.7%) (Fig 3). This is due to the higher mortgage rates in China, besides the high property prices.

However, these do not reflect a nationwide bubble. The ratios are higher in Tier 1 and 2 cities, while Tier 3 cities exhibit ratios comparable to other countries. The ratios in Beijing and Shanghai are among the highest in the world, given their fast rates of price growth which have outpaced growth in disposable income. Price-to-income ratio and affordability ratio have reached 22.4x/95% for Beijing and 17x/78% for Shanghai (Table 1).

The root causes for the high ratios in the Tier 1 and 2 cities are ample liquidity and supply shortage. Property has become a popular vehicle to park the wealth of the rapidly growing affluent group and preserve value against inflation amidst a lack of other investment channels. The better job prospects attract a continuous growing population, including new graduates, businessmen and migrant workers. However, land resources are getting limited as these cities grow, exerting pressure on housing prices.

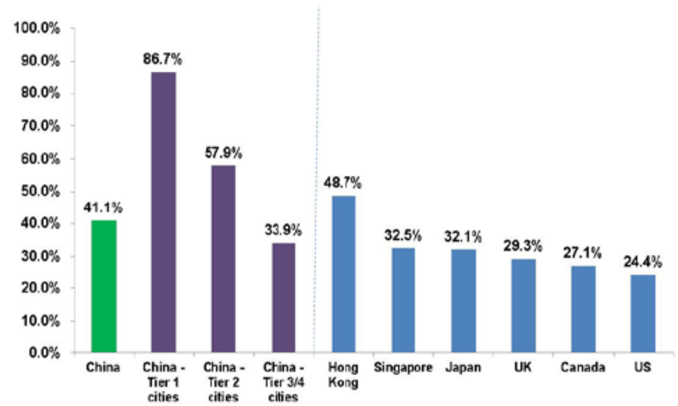
[3] Citi Research: China Property, Ghost Towns and Property Bubbles, December 2013

Figure 2: Price-to-income Ratio



Source: Citi Research; Note* assume units size of 90sqm for all countries

Figure 3: Affordability Ratio



Source: Citi Research; Note* - Mortgage payment as % of household income, taking avg living unit size/ mortgage rate in respective countries

Table 1: Price-to-income and affordability ratios of Tier 1 and selected Tier 2 cities

	Price-to-Income Ratio	Affordability (Mortgage as % of Income)
National	**9.2**	**41.1**
Tier 1 Cities	**19.3**	**86.7**
Beijing	22.4	95.4
Shenzhen	23.0	92.7
Shanghai	17.0	91.2
Guangzhou	15.6	69.4
Tier 2 Cities	**12.0**	**57.9**
Hangzhou	18.4	84.9
Tianjin	13.3	65.8
Xiamen	17.0	62.3
Chengdu	12.4	60.3
Nanjing	13.1	58.9
Chongqing	10.3	48.2
Shenyang	11.2	47.8
Wuhan	12.6	41.9

Source: Soufun, CEIC, Citi Research

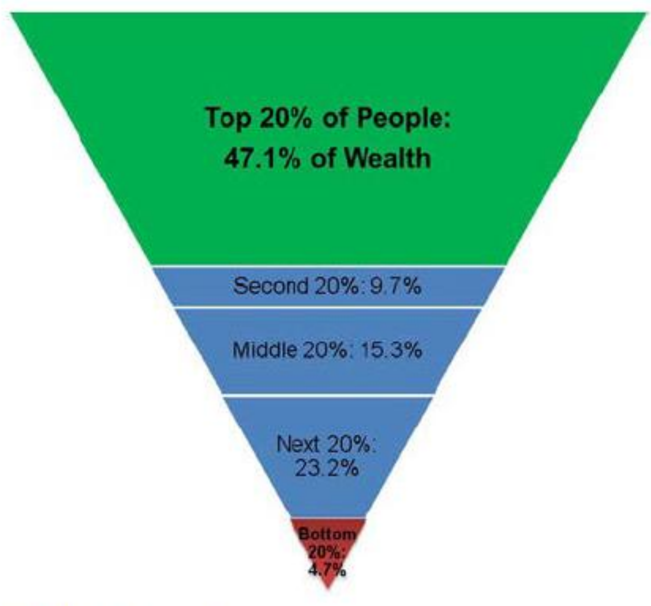
While the high prices in Tier 1 and 2 cities have a part to play in the high price-to-income ratio and affordability ratio, the huge wealth gap and under-reporting of income have also caused these ratios to be disproportionately higher.

The effective home buyers come from the affluent group which controls the majority of assets and wealth. According to a 2009 World Bank report, the top 20% of wealthy people in China controlled around 47% of assets, while the bottom 20% owned only 4.7% (Fig 4). Based on National Statistics Bureau (NBS) 2012 figures, the disposable income of the top 10% urban population is about 7.8x that of the bottom 10%[4]. Unofficial estimates said that the top 20% of earners potentially under-report incomes by 60-70%[5]. Furthermore, "grey income" is sizeable and concentrated in top-earner groups while the low-income population usually do not have "grey income". Factoring these in, the disposable income at the high end could be above10x more than the lowest income level.

Hence affordability is less of an issue for the higher income groups. The greater constraints for them are the credit tightening for second properties and ban on third property purchases.

Notwithstanding the flaws in the computation of the ratios, the rising prices in the Tier 1 and 2 cities have made housing less affordable for the lower income worker, resulting in pent-up demand in the lower end segment. In Beijing where a new type of affordable housing product for self-use with sale price 30% below surrounding properties was introduced in Oct 2013, the first project of 2,000 units attracted 148,000 applicant households.

Figure 4: China Distribution of Wealth, 2009



Source: World Bank; Citi Research

[4] NBS: Basic Conditions of Urban Households by Income Percentile (2012)
[5] Savills China: Residential Chart Book 2013

Is there oversupply?

The amount of new land supplied for residential property development hit a record high of 138,200 hectares in 2013, up 25% from the previous year. Looking at the amount of pipeline residential space nationwide, there appears to be more than sufficient supply to accommodate housing demand.

Simply by looking at the incremental supply from residential land under construction and social welfare supply for the next four years, the number is already higher than our projections of incremental demand based on migration and marriage needs (Table 2). We have not added in estimates of supply from land held by developers and the possibility of some vacant units held by multiple-home owners being put back into the market due to lack of transparent information. These would make the supply figures look even larger.

Table 2: China's incremental residential supply and demand

	GFA (sqm)	Units	No. of people[1]
Under construction by developers	4.863 billion[2]	51 million	147 million
Planned social welfare units (2014 -2017)		28 million[3]	80 million
Supply			**227 million**
Migration (2014 to 2017)[4]			72 million
Marriages (2014 to 2017)[5]			104 million
Demand			**176 million**

Source: National Bureau of Statistics

1 Assumes urban building space per capita of 32.9sqm and average household size of 2.86 based on NBS Population Census 2010
2 Source: NBS 2013
3 36 million or 7.2 million p.a. social welfare housing units were planned under the 12th Five-Year Plan (2011-2015). We assume a similar rate of 7 million to be built p.a. thereafter.
4 Migration 18 million p.a based on average of historical and future urbanisation growth rate[6]
5 Marriages 13 million p.a.[7] based on 2013 actual (Source: NBS)

[6] UNDP China and Institute for Urban and Environmental Studies, Chinese Academy of Social Sciences: China National Human Development Report 2013
[7] NBS

However, we caution against jumping to the conclusion that there is an oversupply because:

1) **Supply is inflated**

- Some construction may stop due to weak developers' financial difficulties.

- The land held by developers may not be built on anytime soon.

- Old stock that will be demolished or abandoned is not accounted for due to lack of data. Many old homes are self-built and of poor living standards. In the bigger cities, many old buildings have to be demolished to make way for new developments. Pre-reform welfare housing transferred to individuals in 1998 accounted for over 40% of residential stock in China[8]. Out of the 36 million social welfare housing units to be built the 12th Five-Year Plan (2011-2015), 41% will be for recently displaced individuals from demolished shanty towns rather than development for new migrants[9].

- It is hard to define and measure vacant units. A wide range of estimates have been reported but it is hard to verify their basis. Du Meng, chairman of the China Enterprise Capital Alliance, claimed that there were 68 million vacant houses but many think it is too high. David Li, Professor of Freeman Chair in Economics, the School of Economics and Management, Tsinghua University, has estimated 50 million. Yang Hongxu, an analyst at Shanghai E-House Real Estate Research Institute, estimated that the nation's vacancy rate is around 5% out of the total house stock of 22 billion sqm, equivalent to about 11 million vacant houses.

- We cannot assume that all vacant units can be put back into the market as some will be genuinely kept as second homes in other cities for self-use. In addition, there will always be some vacancy due to time needed to find new tenants (although the rental market is small in China) and to be fitted out for habitation as many units are delivered bare.

2) **Demand is under-estimated**

- Many homes comprise more than one household and more than one generation. 11.67% of households in China comprised three- or more generations[10]. As they become wealthier, these households can split and occupy more than one unit. This is on top of what we have accounted for in marriages.

[8] Savills China: Residential Chart Book 2013
[9] Ministry of Housing and Urban-Rural Development, Samsun Securities
[10] NBS

- As the older stock of homes are small and of poor quality, there is desire to upgrade if wealth permits. Although upgrading means letting go of the original unit to someone else and therefore there is no net increase in demand, in reality there is at least a few years of overlap if one buys an uncompleted unit.

- We cannot simply assume that each household requires only one unit of accommodation with China being so big geographically. Although we have assumed migrants would require additional accommodation on top of what they have before migration, there are others who need second homes in other cities for business, education, leisure and other purposes.

- There is a constant flow of new rich who will want to buy a second property.

- Foreigners working in China require housing too.

What is clear is that the oversupply situation is not evenly distributed. In the developed Tier 1 cities, land is more scarce and old buildings especially in the prime city centres are torn down to make way for new developments. Table 3 below shows that Tier 3 and 4 cities have a higher rate of increase in residential GFA being commenced, constructed and completed between 2008-2012, resulting in a higher inventory digestion period.

The smaller cities bear the brunt due to the large supply of land sold by local governments vis-à-vis take-up. Massive advance town planning which over-forecasted demand, and local governments' strategies of building infrastructure and selling land for housing construction to achieve their GDP-driven KPIs have resulted in excess supply in many cities. Oversupply exists not only in the units that have been completed or are under construction; it also lies in the massive landbank held by developers following the local governments' aggressive selling in the past. To make matters worse, many smaller cities do not enjoy high sustainable housing demand. As a result, a number of cities have been labeled as "ghost towns" by the media given the low occupancy of the newly completed homes.

However, not all "ghost towns" deserve the label. According to Citi Research[11], Ordos, Yingkou and Tangshan deserve the label given the massive cumulative oversupply that has been built up, virtually no rental market, resources-driven economies which have been hit by overcapacity, wide income disparity which means many locals cannot afford to buy these new homes, and declining or slow population growth.

[11] Citi Research: China Property, Ghost Towns and Property Bubbles, December 2013

Public perception of ghost towns usually comes from the impression of low occupancy such as no lights at night or little activity in the town. However there are some peculiarities in the China housing market that takes a newly completed building a longer time to reach high occupancy. The primary market is still dominant with bare-shell units and young couples tend to buy first and move in upon marriage. The physical key handover can come after 18 months or more from purchase day while often taking another two years for decoration[12]. Hence in general, it can take 3-4 years for homebuyers from buying to moving in. From Citi Research's ground checks, they noticed many projects can indeed record around 50% occupancy in around two years' time, and over 70% after 3-4 years.

Hence for the other "ghost towns", Citi Research felt that they do not deserve such labels as their oversupply is less, have more diversified economic bases and higher proportion of transient population. Their oversupply can be cleared, although it will be slow and take a number of years.

Table 3: China Property – Key Statistics by City Tier

5-year CAGR (2008 – 2012)	Tier 1	Tier 2	Tier 3/4	National
Demographic and Economic				
Population	**3.4%**	1.9%	0.1%	0.5%
Disposable income	9.2%	**12.0%**	11.5%	11.0%
Real GDP growth	10.3%	**13.3%**	11.7%	9.3%
GDP per capita	7.7%	11.8%	**13.6%**	11.7%
Property Market				
Residential property sales value	6.2%	15.4%	**18.7%**	16.1%
Average selling price	**12.4%**	10.7%	7.9%	8.8%
Residential GFA started	1.3%	10.1%	**15.8%**	13.1%
GFA starts/GFA sold	110.8%	119.6%	**160.1%**	132.0%
Residential GFA completed	-0.4%	11.9%	**16.5%**	13.4%
Residential GFA under construction	6.2%	15.6%	**22.6%**	18.6%
Inventory digestion (months)	10.4	14.9	**20.7**	17.8
Land Market				
Land sales value	0.9%	12.5%	**23.2%**	17.6%
Land price	**16.9%**	12.3%	7.5%	14.9%
Land sold in GFA/GFA sold	77.6%	135.2%	**175.2%**	151.0%

Source: CEIC, Soufun, Citi Research (November 2013)

[12] Citi Research: China Property, Ghost Towns and Property Bubbles, December 2013

Will demand slow down?

China's housing market in the last two decades has been driven by various factors – high GDP growth resulting in greater wealth, urbanisation which created new demand in the cities and lack of investment alternatives which have driven many to park their money in homes. It has been estimated that about 15% - 20% own more than one housing unit in China.

While the long-term drivers of housing remain intact, going forward we expect a slower rate of growth in housing demand given that the market has come up from a low base in the last 20 years and as the government rolls out more reforms:

1) **Slowdown in economic growth**: The economy has slowed down to 7.7% last year. With more reforms being implemented to restructure the economy, there will continue to be some pain and impact on growth. Many authorities have been reported to have lowered their GDP projections for 2014, ahead of the central government's announcement in March of its 2014 target. Bloomberg consensus forecast[13] is a slower growth rate of 7.5% for 2014 and 7.2% for 2015.

2) **Slowdown in urbanisation rate**: It grew at an annual average of 1.37 percentage points between 2005 (43.0%) and 2012 (52.6%) with an annual increase of about 21 million[14] in urban population. The urbanisation rate is predicted to increase to 70% by 2030, at a slower annual average of 0.97 percentage point. Between 2010 and 2030, the urban population is expected to rise by another 310 million, an annual average increase of 15.5 million[15]. Some of the urbanisation may also not lead to a direct increase in housing demand, as some areas may simply be re-designated from rural to urban, and people who have already been living there already owned houses. Urbanisation does not simply involve people from rural areas to the cities. China's urbanisation is focusing on the development of big city-clusters – each cluster with bigger cities (like Tier-2 and Tier-3 cities) linking with smaller cities and towns (like Tier-4 cities and institutionalised towns) via modern infrastructure (including transportation and information networks).

3) **Slowdown in marriages**: New demand from newly/soon-to-be married couples could slow down as the population ages. The main homebuyers in China tend to be in their late 20s, when couples are getting married. While in the next five years we might expect this age range to grow, after that point there is expected to be a protracted decline in new demand. The number of Chinese in the marriageable ages of 20-34 years will fall from 325 million in 2010 to 219 million in 2030 (Fig 5). It will be another 20 years before the recent easing of the one-child policy can boost the number of marriages. At the same time, lifestyle is changing. Young people are marrying at an older age as more take up higher education, and they prefer spending on entertainment and travel, or other personal interests/projects.

[13] Median of several economists' forecast
[14] UNDP China and Institute for Urban and Environmental Studies, Chinese Academy of Social Sciences: China National Human Development Report 2013
[15] Based on projection by UNDP for China's population in 2026

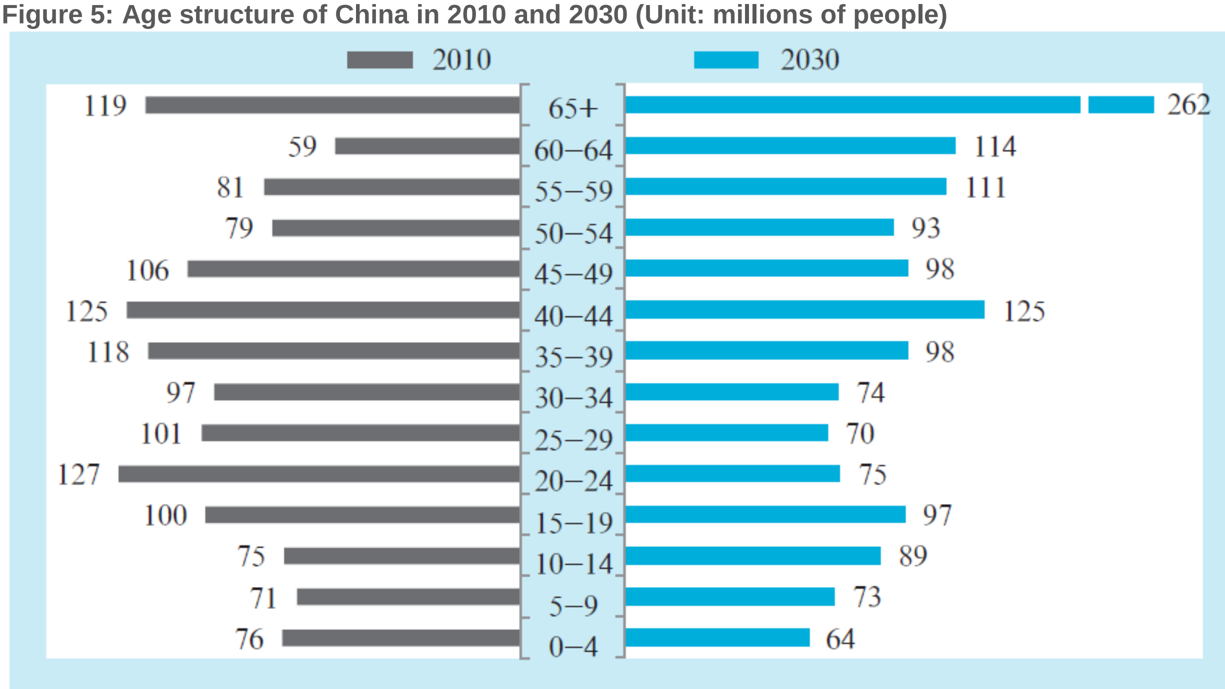
4) **Increase in overseas and alternative investments**: More Chinese are expected to divert funds to purchase properties overseas as they become more familiar with the external environment and as capital controls are gradually relaxed under the government's financial reforms. There could also be a loss of capital in the physical real estate market if more alternative investments are introduced.

5) **Increase in government supplied affordable housing**: The government is addressing social inequality issues by supplying more affordable housing which will have some effect on the lower end segment of the private market eventually. In Beijing, 70,000 self-use units with prices capped at 30% below market price are being put on the market (20,000 in 2013 and 50,000 in 2014) which is similar to the total number of units sold in Beijing in 11M2013[16].

6) **Increase in holding costs**: There is currently little holding cost in keeping a unit empty. Should holding costs increase significantly as a result of property taxation or other taxes, investors will be more inclined to rent out units or change investment class.

7) **Government regulations**: It has been reported that the government's anti-corruption campaign has caused officials to be more discreet in purchasing multiple homes and some have been divesting. It is uncertain how long and deep this campaign will last. A nationwide property database that has been proposed will increase transparency in ownership and further deter multiple home buyers.

Figure 5: Age structure of China in 2010 and 2030 (Unit: millions of people)

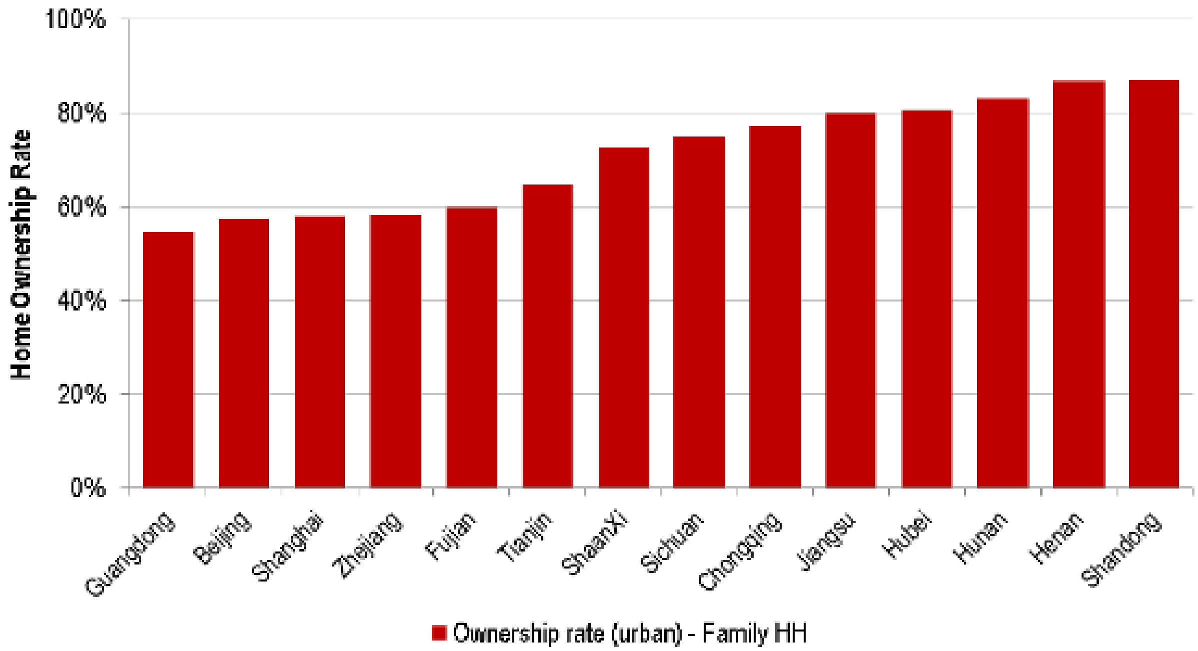


Source: UNDP China and Institute for Urban and Environmental Studies, Chinese Academy of Social Sciences

[16] CBRE Marketview November 2013

The demand is assessed to be higher in the Tier 1 cities where homeownership rate is estimated to be below 60% given their higher number of migrants (Fig 6). This is below the nationwide homeownership rate of 85%[17], as close to 50% of the households surveyed lived in the rural area, whose close-to-100% home ownership (95% of which are self-built housing) skewed the overall number significantly[18].

Figure 6: Home Ownership Rate (Urban), Select Provinces, 2010



Source: NBS 2010 Population Census, JLL

[17] Based on National Bureau of Statistics, Census Population 2010. Peking University's Institute of Social Sciences survey in mid-2013 showed that 87.4% of Chinese families either fully or partially own their homes. In another survey by PBOC, China Household Finance Survey, the national homeownership rate was found to be 89.68%; cities have a lower rate of 85.39%. In a December 2013 report by Citi Research, it estimated homeownership rate to be around 65% after adjusting for multiple home ownership as it believed that the national statistics were based on the number of homes that are owned rather than number of households which owned homes. Milken Institute, a non-profit, non-partisan think tank based in the US, also noted the same view on the definition. However, we have not been able to verify it from the NBS website.

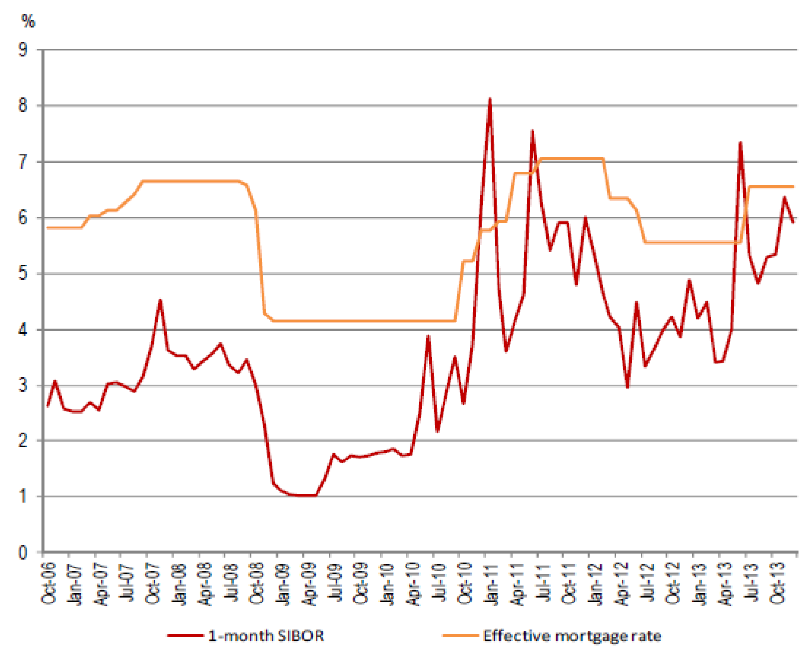
[18] Jones Lang LaSalle

Impact of tightening credit

China experienced two credit crunches last year, a strong sign that the central bank is keen to wean banks off cheap credit. JP Morgan[19] calls it credit tapering, and not tightening. Credit growth still outpaced nominal GDP growth as the government does not want to trigger a forced deleveraging. Credit slowing is accompanied by an effort to shift credit components – credit that supports real activity (medium and long term loans) continues to grow at a stable pace, but parts of shadow banking activities more likely to be involved in speculative financial activities are contained. The aim is to mitigate the negative impact on the real economy. The continued credit tapering has nevertheless caused liquidity tightening – interbank rates and long-term bond yields have risen. **Interest rates on home mortgages have increased by over two percentage points from 2009 to 2013 (Fig 7)**.

However, mortgage rate adjustments in China have less of an impact on the housing market than restricting credit availability and prohibiting purchases. The property market has very low levels of leverage (Fig 8); down-payment rates are high for second properties and no mortgage is allowed for third properties. Many buyers pay in cash or do not leverage the full amount, especially in the smaller cities. In the larger cities where prices are higher and there is a greater need to borrow, it is the credit availability rather than mortgage rates that is hindering purchases. In addition to banks, employees can apply for loans from Housing Provident Funds (HPF) at significantly lower rates and better terms.

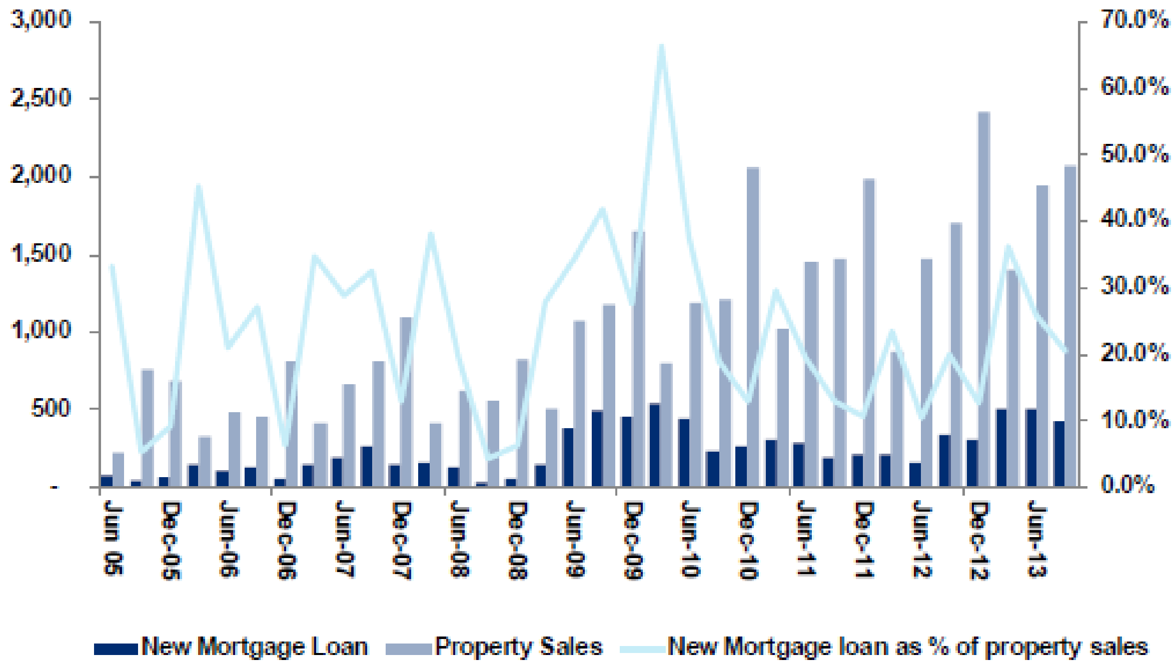
Figure 7: 1-month SIBOR[20] versus effective mortgage rate in China



Source: CEIC; Deutsche Bank

[19] JP Morgan, Ten Questions about China, December 2013
[20] SIBOR refers to Shanghai Interbank Offered Rate

Figure 8: China new mortgage loans versus transaction value



Source: CEIC, Citi Research

Due to the extent of informal or shadow banking for which no reliable statistics are available, another concern is the impact on the property market and banking sector should some developers become insolvent. We think the impact will be limited and not spread nationwide. China has accumulated a large cushion against the possibility of a housing crash. The government debt level, although rising in recent years, is still fairly low at approximately 40% of GDP compared with 92% in the United States, 80% in Germany and 220% in Japan. Furthermore, China has $3 trillion in foreign exchange reserves, and the People's Bank of China holds nearly $700 billion in required reserves. Chinese banks depend on deposits as a major source of funding. Consequently, they are less vulnerable to a liquidity crunch than U.S. banks, which are more reliant on short-term borrowed funds.

Demand and supply conditions in each city and segment are still the main drivers.

Implications of government policies

The new government's speech in the Third Plenum last year underscored that its policy is for stabilization in the property market, given the significant contribution of the sector to the economy and the impact to domestic consumption (which the government is encouraging as an engine of growth) if asset wealth is eroded. In the past five years, the real estate sector's direct and indirect contribution to China's total GDP is estimated to be about 20-25%[21].

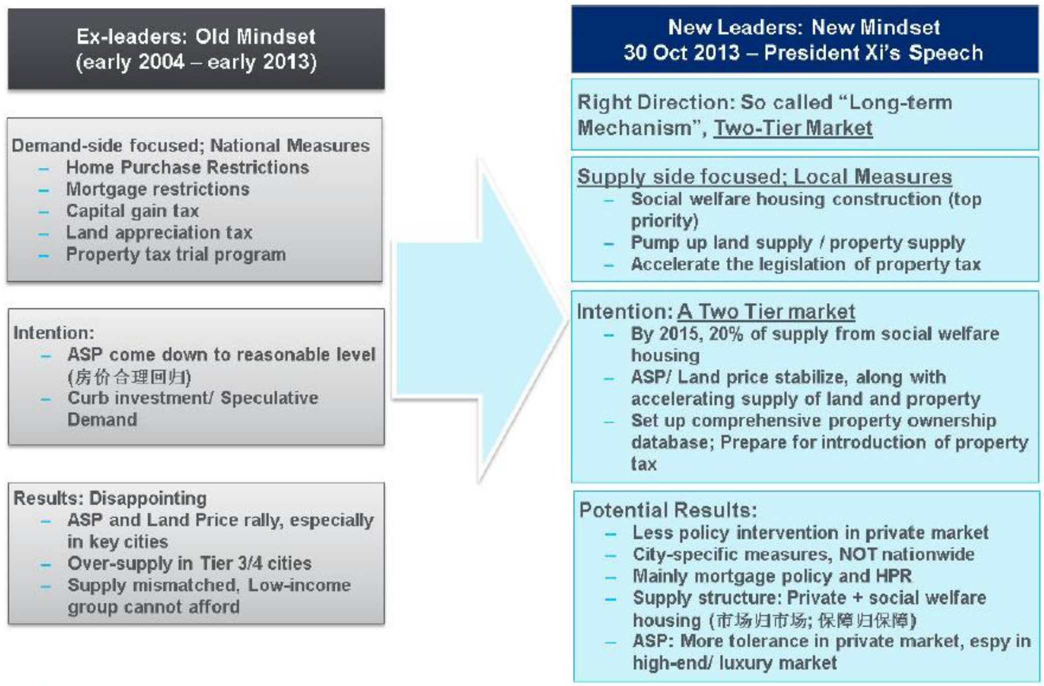
Instead of focusing on curbing demand and price increase, it has shifted focus to increasing the supply of land and social welfare housing to 20% by 2015 (Figs 9 & 10). This may imply more tolerance for the upper-end segment in future but for now, existing policies such as the Home Purchase Restriction (HPR) are likely to continue. China's housing minister said in December that the government would maintain controls on the property market in 2014 while increasing land and housing supply in cities facing big home-price increases. At least 17 major cities have introduced further cooling measures in the last quarter of 2013, mainly focusing on further tightening HPR for non-locals, raising down-payment ratio for second-home buyers and increasing land supply in the coming year[22].

For the lower mid-end private segment, there will be competition from the new self-use commodity housing that will be priced 30% below market price. There could be more land supply constraint in the higher end segment in future as more land will be used for social welfare housing. This would squeeze profit margins with purchase restrictions still in place or tightened.

Property tax trials may be extended into several new cities and a nationwide property registry database is proposed to be set up. With the registry, the government can grasp and understand better the current state of the market and adopt more effective measures if necessary. This may lead to multiple homeowners reducing their property holdings if the tax rates are high enough to make it painful to keep vacant units, or if they do not wish to show up too often in the registry database. Progress is however uncertain given strong objections.

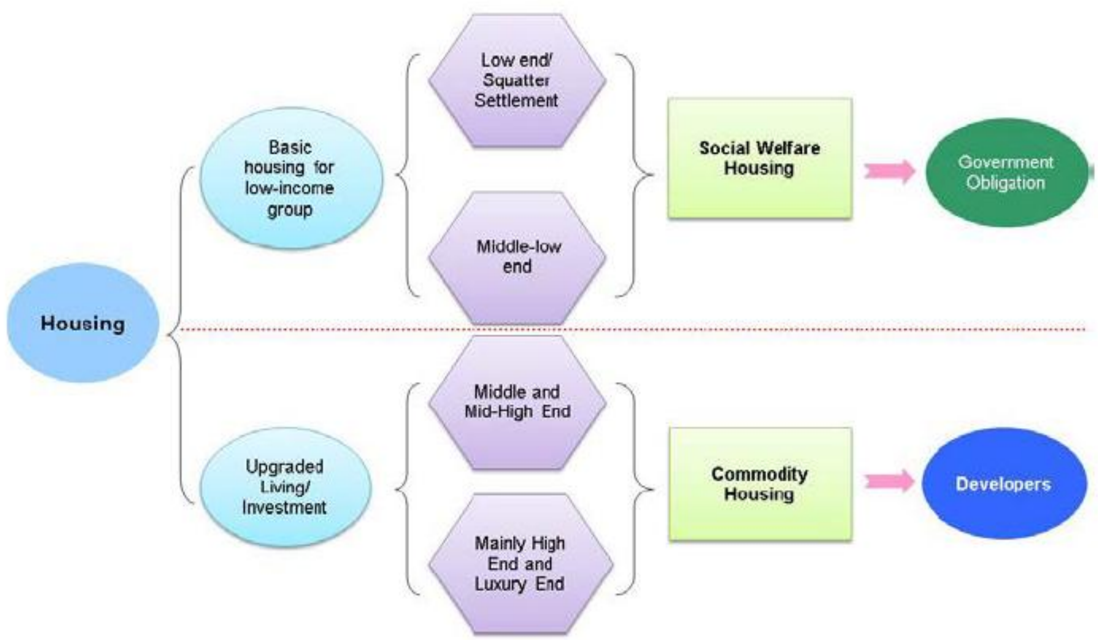
[21] Citi Research: China Property, Ghost Towns and Property Bubbles, December 2013. Direct contribution 8-10% and indirect contribution is 13-18%.
[22] CBRE China Residential Monthly Index November 2013

Figure 9: Property Policy – New Leaders, New Mindset



Source: Citi Research

Figure 10: "Two-Tier"Market – Private + Social Welfare Housing



Source: Citi Research

Outlook

We do not expect a national or devastating bubble burst in the China property market although some smaller markets may correct due to oversupply and weak demand. Among 70 large and medium-sized cities tracked by the National Bureau of Statistics, Wenzhou registered a fall in prices last year.

The pace of price increase in Tier 1 and 2 cities is forecast to moderate from the 2013 levels, given the slower economic growth, high price levels, and curbs on property purchase. The strong land sales in 2013 and increased supply of affordable housing could also translate into a surge in home supply this year and slow down home price gains.

For the Tier 3 and 4 cities with oversupply, some could see a fall in prices with weak demand. However, prices could generally remain flattish as developers hold back on construction and sale. Those at the eastern coast will fare better than inland cities as they have stronger economic drivers to draw migrants from the western and central regions. The relaxation of hukou registration for migrants as announced in the Third Plenum, which will start with smaller cities, will help to draw more migrants to the coastal Tier 3 and 4 cities. Coupled with less housing purchase curbs than in the Tier 1 and 2 cities, the non-local population can bring significant incremental demand for housing and help to resolve the oversupply gradually.

A major risk for the entire Chinese housing market is a significant slowdown in the economy as a result of drastic reforms or another global crisis. This could lead to a loss of confidence in the property market. However, the Chinese government had stepped in with a major stimulus in the aftermath of the global financial crisis and a mini one in 2013 when economic growth waned. History is likely to repeat itself.

As the housing market in China is a diverse mix and China is coming to a new era of slower growth momentum, investors/developers would have to consider each city’s economic growth drivers, and housing demand and supply situation.

Alpha Investment Partners

Alpha Investment Partners (AIP) is a real estate investment advisory firm managed by a team of established professionals with proven fiduciary experience.

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