

An Overview of Property Development in China

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In framing the theme for this issue of the SGLA Law Journal, we overview China's legal regime on property ownership and development by outlining the following four topics: legislative and administrative system for property development in China, land use rights system, property development approvals process, and licensing requirements for enterprises involved in a development project.

The Legislative and Administrative System

The legislative pillars of China's legal system in regard to land are the *Law of the People's Republic of China on Property Rights*, enacted by the National People's Congress (NPC) and effective on 1 October 2007 ("Property Rights Law"), the *Law of the People's Republic of China on Land Administration*, adopted by the NPC and effective on 1 January 1999 ("Land Administration Law") and the *Law of the People's Republic of China on the Administration of Urban Real Estate*, enacted by the NPC and effective on 1 January 1995 ("Urban Real Estate Law").

The Property Rights Law and the *Contract Law of the People's Republic of China*, enacted by the NPC (as amended) and effective 1 October 1999 ("Contract Law"), govern contracts for transfers of buildings and other immovable property. The construction of buildings and other improvements are governed by the *Construction Law of the People's Republic of China* enacted by the NPC and effective 1 March 1998, and a slew of other administrative regulations, rules, decrees and orders issued by the relevant departments in charge of the administration of construction quality control, environmental protection, fire protection, safety, labour and health.

The Ministry of State Land and Resources is in charge of the administration of land at the national or "central" level. Provincial land authorities are commonly referred to as the Real Property and Land Resources Administration Bureaux, while district-level authorities under each Provincial Land Bureau generally are called the District Planning and Land Administration Bureaux, or the District Real Property and Land Administration Bureaux. For simplicity, we refer to each department in charge of the administration of land at the various levels in China's bureaucracy as the "Land Authority".

The Land Use Rights System

There is a fundamental distinction in China between "rights of ownership in land" and "rights to use land". All land is owned by the State or by a rural collective. Rights of ownership in land are not transferrable. By contrast, the right to use State-owned land use rights is transferrable and such land use rights can be leased or mortgaged. Provided that the land is first requisitioned by the State and, in effect, converted to state-owned land, the land use rights to collectively-owned land can be transferred, leased or mortgaged.

Land is classified in China as agricultural, construction or unused, and as a general rule only state-owned land for construction purposes may be requisitioned and used for development of commercial or profit-making real estate projects. The State Council reviews and revises the national land use plan, i.e., it alters the classification of specific parcels of land, only once every five years. Despite frequent claims to the contrary by developers and local government officials, provincial, municipal, district and county level governments are prohibited from issuing land use plans that are not in strict compliance with the State Council's plan.

Generally, land use rights can be obtained only by grant or by allocation. Allocated land use rights refer to land use rights that were allocated by the Land Authority to a State-owned enterprise or other public entity for an indefinite term and without the payment of consideration. Allocated land use rights cannot be transferred, leased or mortgaged. Granted land use rights, by contrast, involve the execution of a State-owned Land Use Rights Grant Contract (“Land Grant Contract”) between the land user and the Land Authority and the payment of a grant fee.

The grantee of properly granted State-owned land use rights to land that is properly planned for industrial or residential use (1) may enjoy an enforceable right to use the land for a fixed term of between 40 and 70 years, (2) may use the land for the purposes specified in the Land Grant Contract during such term, and (3) subject to certain restrictions, generally is free to transfer, lease or mortgage the land use rights freely.

Land Grant Contracts often form documents prepared and promulgated by the Land Authority, but should be scrutinized — they often set tight deadlines for payment of the land grant fee and the commencement and completion of construction. Penalties for non-compliance can be draconian. Land Grant Contracts also contain planning parameters for the development of land and describe the location of the land, identify the type of user (residential, commercial, industrial, comprehensive) and prescribe the grant period.

Property developers in China may choose from several options to acquire land use rights, including a grant to develop a new project, the acquisition of an existing development project, the acquisition of an equity interest in an entity that holds land use rights or a lease of land use rights.

Developers rarely lease land use rights. The State is not permitted to lease land use rights for commercial developments, though land use rights may be available for lease in the secondary market, i.e., previously granted rights. Under the Contract Law, the term of a lease is not valid for more than 20 years. Instead, the term must be renewed. In addition, lessees are seldom able to successfully negotiate for the right to assign, sublease or encumber land use rights.

Land use rights may be granted by means of negotiated agreement, public bidding, auction or listing process, though a grant by negotiated agreement is no longer permitted in relation to land intended for industrial, commerce, tourism, entertainment and residential use. Instead, pursuant to the *Provisions on the Assignment of State-owned Construction Land Use Right through Bid Invitation, Auction and Quotation*, promulgated by the Ministry of Land and Resources and effective 1 November 2007, such land, as well as land intended for more than one user, must be granted by way of public bidding, auction or listing on a land exchange. Land use rights granted by auction or public bidding may not be sold below a government specified minimum price rate.

Land use rights also may be obtained by transfer from the original land user in the secondary land market, and a transfer may be conducted by exchange or gift, subject to government supervision. Transfers of land use rights normally occur pursuant to a transfer agreement. The use term obtained by the transferee of land use rights is equivalent to the remaining term of the granted land use rights at the time of the transfer.

Though ownership rights in regard to other forms of immovable property such as buildings and other improvements are regulated separately from land use rights (and, generally, different certificates are issued to evidence the ownership rights in each), Chinese law recognizes the principle of unity of title. Hence, where land use rights are granted, transferred or bequeathed, improvements to the land are disposed together with the land use rights.

Under the Property Rights Law, the creation, modification, transfer or termination of property rights in regard to immovable property, including land use rights and buildings, is effective only upon registration. To be clear, if a transfer of land use rights occurs pursuant to an enforceable transfer contract, the parties would have enforceable rights and obligations under the contract, irrespective of a failure to register the transfer. If, however, the transferor under the land transfer contract were to again transfer the land use rights to a *bona fide* third party purchaser and the purchaser were to register the transfer, it would be the legal owner of the land and the original transferee’s only recourse would be an action for damages under its contract.

The Property Development Approvals Process

In discussing the myriad approvals required to complete a construction project in China, it is necessary to emphasize the considerable regional variation that exists. Further, we do not discuss the approvals that are or may be required to operate a specific business in China, including among others foreign investment approvals, business licenses, production permits, product safety permits, pollution discharge permits and registrations, organizational code certificates and registration certificates with the relevant departments in charge of the administration of tax, foreign exchange, customs, statistics and finance.

The document that in most cases evidences ownership of land use rights following a land grant (or a land transfer, if the land has been granted previously) is called a Land Use Rights Certificate. To obtain a Land Use Rights Certificate a land user may be required to obtain permits and approvals from as many as five administrative agencies at the local, municipal and / or provincial level.

The land user first must submit a project proposal and a feasibility study report to the relevant development and reform commission ("DRC"). Upon approval, the DRC will issue a Project Approval. The land user then must apply to the relevant department in charge of the administration of construction ("Construction Bureau") for issuance of a Land Location Selection Opinion Letter. In the next step, the land user must apply to the Land Authority for issuance of a Construction Project Land Use Pre-approval Report.

Under the *Regulations for the Administration of the Environmental Protection of Construction Projects*, promulgated by the State Environmental Protection Administration (predecessor to the Ministry of Environmental Protection) and effective 29 November 1998, a detailed environmental impact report or form, or an environmental impact registration form, must be submitted for review and approval by the relevant department in charge of the administration of environmental protection ("Local EPB") prior to the commencement of construction.

As discussed above, if collectively-owned (and suitably planned) land is involved, the Land Authority must requisition the land. The Land Authority will execute a Compensation and Resettlement Agreement with the relevant rural collective, and the Land Authority (or the land user) will compensate the collective for the land, costs of resettlement, improvements and greenage and crops, among other things. Upon proof of payment to the collective, the Land Authority will issue a Construction Use Land Permit, the collective will give up its use rights to the land, and the character of the land will be converted from collectively-owned to state-owned. Upon conversion of the land, the land user and the Land Authority will execute a Land Grant Contract.

Upon signing the Land Grant Contract, the land user may apply to the relevant department in charge of urban planning ("Planning Bureau"). Upon issuance of the Construction Land Planning Opinion Letter, the land user must return to the Land Authority and apply for issuance of the Land Use Rights Certificate.

The document that in most cases evidences legal ownership of a building is called a Property Ownership Certificate. To construct a building in China (and thus obtain a Property Ownership Certificate), the builder must obtain several basic approvals.

The preliminary designs for the construction project must be prepared by qualified design entities and approved or commented on by the departments in charge of utilities supply design, construction road access, fire-safety design, work-place safety and hygiene facilities design, as well as the Local EPB. In addition, the builder must obtain a Construction Land Planning Permit from the Planning Bureau and then must notify the Construction Bureau by completing a Construction Project Notification Form. According to the Notification Measures, the form is required to enable the builder to obtain the Commencement of Work Permit.

Prior to the commencement of construction activities, the builder must apply to the Planning Bureau and obtain a Construction Planning Permit. Before construction activities commence but after the foregoing documents are obtained and after completion of demolition and resettlement work, if any, and any pre-construction preparatory work, the builder must apply to the Construction Bureau to obtain a Commencement of Work Permit.

Finally, upon completion of the construction project, the builder and the land user must arrange for inspection and acceptance of the construction project by the Construction Bureau and the Local EPB, as well as the relevant departments in charge of fire protection, safety, labour and health. Upon completion of the inspection and acceptance procedures, the land user may apply to the Construction Bureau to obtain a Building Ownership Certificate for the building.

Licensing Requirements for Real Property Enterprises

The legal regime in China does not permit the establishment of an all purpose company. Instead, most companies operate pursuant to a specified and approved scope of business. Hence, an enterprise engaged in specific business activities within the property development industry in China must comply with one or more pieces of legislation that delineate qualifications requirements applicable to such activities.

In this section, we set forth a brief outline of the basic categories of business activities and the rules that apply to each one. We note that additional qualifications requirements that are not addressed in this overview also may apply to individuals and / or foreign invested enterprises that engage in each category of business activities. If more than one set of rules applies, each enterprise or individual must comply with all applicable rules.

Surveying Activities

Construction project surveying (“CPS”) is defined as the investigation, analysis and evaluation of the geological and geographical characteristics of a construction site. Foreign investment in CPS is not permitted under Chinese law, but a foreign invested enterprise may hire a qualified company to engage in CPS activities in China.

The *Regulations on the Administration of the Survey and Design Qualification of Construction Projects*, issued by the Ministry of Construction (MOC) and effective 1 September 2007 (“Regulation 160”), divide CPS into three qualification categories: General, Specialist and Service.

The General CPS qualification category has only one tier, Grade A. An enterprise with a General CPS qualification may perform CPS in all specialised fields, except for maritime project surveying, regardless of the scale and type of project.

The Specialist CPS qualification category has three tiers: Grade A, Grade B and Grade C. An enterprise with a Specialist CPS qualification may perform CPS for each of the corresponding tiers of construction projects if it meets certain minimum criteria related to project experience, technical and management capabilities and registered capital.

The Service CPS qualification is not tiered. An enterprise with a Service CPS qualification may undertake CPS projects involving the management of geotechnical engineering, engineering drilling, and shaft drilling and similar activities.

Design Activities

Construction project design (“CPD”) is defined as the comprehensive analysis of the technological, economic, resource and environmental conditions of, and the preparation of design documents for, a construction project. Regulation 160 divides CPD qualifications for enterprises into three categories: General, Industry-based and Specialist.

The General CPD qualification has only one tier, Grade A, which provides the right to engage in design services in all industry sectors. The minimum registered capital for a General CPD qualification is RMB60 million, and the enterprise must have 500 professionals, 200 of which must be individually qualified or have advanced degrees. Regulation 160 also sets forth detailed requirements regarding the enterprise's track record and its technical and management capabilities.

The Industry-based CPD qualification is generally divided into three tiers, Grade A, Grade B and Grade C, and covers all types of project design services within specified industry sectors.

The Specialist CPD qualification is generally divided into three tiers, Grade A, Grade B and Grade C. It covers specific types of project design services within a particular industry sector. A Grade D qualification is also available, but it is restricted to construction or building design.

Development Activities

The main piece of legislation governing the qualification requirements for developers in China is the *Provisions on the Administration of the Qualification of Real Estate Development Enterprises*, issued by the MOC and effective 29 March 2000 ("Development Qualification Provisions"), which require an entity that engages in development activities to obtain a Real Estate Development Qualification Certificate. A newly established real estate developer in China is required to apply for a temporary qualification certificate, which is valid for one year, within 30 days after it obtains a business license.

The Development Qualification Provisions define real estate development as the construction of infrastructure and buildings on state-owned land within areas subject to urban plans, the transfer of real estate development projects and the sale and lease of commodity housing. The Development Qualification Provisions divide real estate development enterprises into four tiers, Grade A, Grade B, Grade C and Grade D, based mainly on the enterprise's registered capital, operating term, project experience and professional staff.

Project Management Activities

The activities associated with project management are governed by the *Provisional Measures on Management of Construction Project*, promulgated by MOC and effective 1 December 2004, which define construction engineering project management as specialised management services provided by an enterprise engaging in project management for all or part of the development process on behalf of a project owner. Enterprises that carry out project management activities must hold qualifications in one or more of the following fields: surveying, design, construction, supervision, construction, tendering agency and cost consulting, though in certain cases, surveying, design or supervision activities must be subcontracted to qualified third parties.

Construction Activities

Under the *Regulations on the Administration of the Qualification of Construction Enterprise*, issued by MOC and effective 1 September 2007 ("Regulation 159"), a construction enterprise is defined as an enterprise that engages in the new construction, expansion, restructuring, rebuilding and / or renovation of civil works, wire-carrying and pipeline equipment projects and other construction projects.

Regulation 159 divides qualification requirements for construction enterprises into three categories: General Construction Contractor, Specialist Construction Contractor and Services Sub-contractor. General Construction Contractors may undertake all types of construction projects and also may subcontract portions of their projects to qualified sub-contractors or service providers. Specialist Construction Contractors may undertake specialised projects subcontracted by general construction contractors and developers or on their own account. Services Sub-contractors may undertake services projects subcontracted to them by general construction contractors or specialist construction contractors.

Supervision Activities

A project supervisory enterprise generally represents a developer in supervising a contractor in regard to quality of construction work, timing for completion of various milestones and use of construction funds. Supervisory enterprises must comply with applicable laws and regulations, technical standards and design documents, as well as terms and conditions of the construction contract, and must assume legal liability for its conduct.

The Provisions on the Administration of Construction Supervision Enterprises Qualification, issued by MOC and effective 1 August 2007, divide construction supervision qualifications into three categories: General, Specialist and Firm.

The General qualification does not have a grading system. Instead, qualified general supervisory enterprises are permitted to engage in supervision activities in regard to all types of construction engineering projects.

The Specialist qualification is generally divided into Grades A and B and, for building construction, Grade C, depending upon whether the enterprise meets certain minimum criteria related to its track record, its technical and management capabilities and its registered capital.

The Firm qualification does not have a grading system and subjects supervisory enterprises to significantly lower registered capital, staffing and technical capabilities requirements and no track record requirement.

Tendering Agency

Under the *Measures for Recognising the Qualifications of Construction Project Tendering Agencies*, issued by MOC and effective 1 March 2007, a construction tendering agency acts as an intermediary on behalf of its principal in preparing tender documents and assessing tenders in regard to surveying, design, construction and supervision of construction projects, as well as the procurement and tendering of equipment and materials associated with construction projects.

Qualification requirements are divided into three tiers: Grade A, Grade B and Provisional Grade. Enterprises in each tier are required to maintain workplace conditions suited to their business activities, a sound management system and a pool of technical, financial and other specialists sufficient to prepare tender documents and carry out the tender assessment process. A tendering agency holding a Grade A qualification may undertake agency work for any size or scale of project. A tendering agency with a Grade B qualification may only engage in tendering activities with a total investment below RMB 100 million. A tendering agency with a Provisional Grade qualification may only engage in tendering projects with a total investment of below RMB60 million.

Project Cost Consultancy

The *Measures for the Administration of Project Cost Consultancy Enterprises*, promulgated by MOC and effective 22 March 2006, define a project cost consultancy as an enterprise that provides professional consultancy services with respect to the determination and control of project costs and investments in construction projects.

Qualification requirements are two tiered: Grade A and Grade B, depending on the amount of registered capital, experience and business turnover of the enterprise, and number of staff and experience of senior personnel.

A newly-established enterprise can obtain no higher than a Grade B qualification for the first year, and an enterprise holding a Grade B qualification is restricted to projects value at less than RMB50 million.

Conclusion

These are just some of the current rules affecting real estate industry in China. Due to considerable divergence between legal principles and market practice however, any discussion of the regulatory regime alone is inadequate to describe the full picture in China. The choice between regulatory compliance and commercial practicality poses an ongoing dilemma for domestic and foreign investors alike as they attempt to navigate through an era of rapid change. In such an environment, it is always prudent to seek advice from experienced professionals.

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