Changes in Real Estate Market in Recent Years – A Study Focusing China's Real Estate Market

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Abstract. This article will take China's real estate market as an example, specifically analyze the great changes in China's real estate market during recent years. By performing data analysis of recent growth trend, the industry scale, profit growth rates and other factors reflect a downward trend in the housing industry. The reason of this market depression will be explored from four perspectives, one of the main reasons for this is the increased regulatory efforts of the Chinese government in the last two years. Several suggestions will be made based on the discussed reason of depression, which include the promotion of development of ESG, the relaxation of policy and re-employment.

Keywords: Real Estate; Land Economy; Green Finance; COVID-19.

1. Introduction

A lot of previous research found that the China's real estate market was expanding so quickly in the years before the financial crisis of 2008. Due to the concern of overheating, Chinese government introduced several restrictions, including increase the amount of down payment for property transactions and increase interest rate for five times in 2007. However, as soon as the crisis started, these regulations were rapidly dropped, the policy was no longer effective. Beijing as China's capital city also introduced a sizable stimulus program to spur the whole economy. A large portion of this stimulus eventually flooded the real estate market, raising house prices and prompting more investors to turn to foreign markets [1]. In late 2014, the International Monetary Fund (IMF) which is an agency of the United Nations, issued a warning massage that the China's economy was at risk from an oversupply of real estate, particularly in second- and third-tier towns [2]. In 2015, the market is expanding slowly compared to before, so the Chinese government had relaxed earlier regulations [3] and issued some new regulations that will be explained in detail later [4]. By early 2016, the Chinese government introduced a series of measures to stimulate the purchases of property, containing lower house sales taxes, limit land sales for new development projects, and a range of measures to reduce the down payment on mortgages [5].

In the past, many academics have published articles about the volatility of China's real estate market around 2100 years and how the government set regulations to revive the market, but very few have written about the huge change on the China's property market in recent years. Many scholars agree that the real estate industry is not as prosperous as it used to be, but very few use data to verify this trend and discuss the reason leading to it. The main purpose of this paper is to explore the causes that led to the decline of the property market, to fill an area that has not been previously studied.

This article will be separated into three parts. Firstly, the author will introduce the reader to the Chinese real estate market and how it has evolved, then will introduce the subject of the analysis in the following section regarding the last two years' developments. Secondly, the author will use data to illustrate the decline of the Chinese real estate market in the last two years and analyze the causes of the decline from four perspectives: environment, government, investors, consumers. In the end, based on the current situation of the industry and performance of the economy, the author will make suggestions for the future of the property market.

2. Case Study of Real Estate Market in China

In the past ten years, China's real estate industry has experienced unprecedented prosperity. From 2003 to 2014, China's real housing price rose by 10% every year, which was 2 to 10 times higher than the housing construction cost [6], and the growth rate of housing price has been higher than the growth rate of residents' income for a long time. However, Chinese people insist their idea that owning a house and a car are the key to maintain a standard living, even if they must loan from bank. The high housing demand determined the high housing price, therefore, developers; investors and the government saw the interest in the climbing housing price, they built 100 billion square feet of residential real estate [6]. The boom has been accompanied by a surge in the number of vacant houses held by developers and households. The boom could turn into a housing bubble and then a crash due to the large number of unsold vacant houses, but that future is far from certain. In 2015, the state has realized that there was a large amount of unsold property, so to destock these houses, the government reformed a monetary policy, they directly compensated the residents of the demolished shantytowns in the form of monetary compensation, and the residents then purchased housing in the commercial housing market [7]. Meanwhile, the Chinese government issued a policy to increase the housing price, the reason was that high prices have attracted many investors, taking advantage of their psychology of buying up rather than buying down, therefore, to achieve the purpose of de-stocking. This policy brought about a surge in the size of the industry, house prices also rose sharply, and industry profits rose sharply. However, the real estate market is not always booming. With the outbreak of COVID-19 and the increasing regulation and control policies of the Chinese government, the property sales market has entered a recession period since 2020 and has been depressed for the past two years.

2.1 Data Analysis

Real estate sector is the backbone of China's economic development, accounting for around twenty percent of GDP every year [8], so the development of real estate industry directly affects China's total output. After decades of development, it has evolved into a well-established industrial chain with countless companies connected to it. Once the real estate industry collapses, all companies in the chain will be negatively affected, which will be devastating for China's economy. For now, China's real estate industry is not as prosperous as it used to be [9], I will use following representative indicators to show this.

2.1.1 Industry scale

The scale of the industry can be reflected from the sales of residential area across China. The chart below reflects the area and growth rate of residential sales area across the country from 2005 to 2021. The growth rate is represented by the red line.

Fig. 1 The sales area and its growth rate in China from 2005 to 2021 [10]

From this graph, we can see that since 2005, apart from several special years, the growth rate of the industry as a whole has been gradually slowing down, with year-on-year growth rates falling from over 40% to around 2-3% now. Among them, notice that a significant change occurred before and after 2016. The industry had compound growth rate of 9.7% before 2016, while the compound growth rate fell to 2.6% after 2016, mainly because the country opened the inventory reduction mode during 2015, especially the shanty monetization resettlement greatly stimulated the real estate market. Before 2015, scale growth rate was basically between 8-10%, due to the policy reformation, the growth rate of 2016 reached its peak at 22.4%.

We can learn that the growth rate has slowed down in the last five years, the scale of the industry was saturated, makes it difficult to have a new breakthrough.

2.1.2 Industry profit

The diagram illustrating the net profit of listed real estate company and its growth rate from 2011 to 2020. The growth rate of net profit is represented by the red curve.

Fig. 2 The net profit of China's listed real estate company and its growth rate from 2011 to 2020 [10]

The net profit of listed real estate company as an indicator examine the net profit of whole industry, from the chart, we can see the overall profit of the industry is increasing slowly and even falling in 2020. In fact, the industry profit growth rate has begun to slow down since 2014, the noticeable 38% growth rate in 2016, is due to the de-stocking policy and higher housing price level. the implementation of this policy directly brought the industry scale surge, at the same time housing prices rose sharply, the industry's profits also rose sharply. After 2016, industry profits were starting to return to normal. Not surprisingly, the industry's profits grew negatively for the first time in 2020 because of the epidemic.

2.1.3 Sales volume

According to the data of accumulated sales of top30 China's real estate company in 2021.1-2 and 2022.1-2[10], with the year-on-year sales for 2021.1-2 and 2022.1-2, the sales trend of real estate is going down from 2021 to 2022. Cumulative sales of top30 real estate enterprises fell 40% year-on-year in January to February, with most down between 40-50%. When we look at the data for top10 real estate company [10], the market concentration further increased, with sales of 399.1 billion by the top10 real estate enterprises, accounting for 38.7% of the total sales of the top100 real estate enterprises. The market concentration increased by 4.7% from 2021 to 2022. A higher market concentration indicates that more sales or other economic activities are controlled by a smaller number of firms, so that this small group of firms has considerable market power, especially price power, making the market less competitive. A higher degree of concentration is more conducive to the control of capital, but not to the economic development of the industry. Therefore, from the perspective of industry scale, industry profit and sales volume, we can see China's real estate industry is not as prosperous as it was before. After we see the deterioration of the market, we will explore the reason behind it. The analysis will be carried from four perspectives: environment, government, investor, and consumer.

2.2 Underlying Reasons Analysis

2.2.1 Environment

In late 2019, the Coronavirus disease (COVID-19) was first discovered in the Wuhan seafood market in China. Until now, the global pandemic is still running strong because of its propagation [11]. Governments across the world issued national or local area lockdown in order to halt commercial activities, and demanded that people "remain at home" in order to reduce social connections and stop the virus's spread. The pandemic is affecting nations in a way that has never happened. Although the outbreak in China is not that serious at the moment, Chinese government insist their clearance plan, residents still need to have frequent nucleic acid tests. Once an infection case is detected in any city, the area will be quickly locked down.

During the period of locked down, the urban area, in accordance with the requirements of the epidemic prevention and control command, issued a "suspension of operations" notice to all housing development sales offices in the area, which means all housing companies need to halt their current work and production. Then an emergent way of online housing sales has been carried out as an alternative for those house purchaser, but since property transactions are more than just transactions, they require both buyers and sellers to conduct on-site inspections of the specific location of the property being traded, the current state of the property and other factors. Therefore, housing sales were almost at a standstill during locked down, only a small number of houses were successfully traded. As a result, some real estate companies were exposed to the risk of cash flow disruption and business closure.

2.2.2 Government

In August 2020, the central bank, the CBRC and other agencies proposed targets for real estate companies, namely a gearing ratio of no more than 70% after excluding pre-receipts, a net debt ratio of no more than 100% and a cash-short debt ratio greater than 1, this is commonly known as ‘The three red lines of financing’ for real estate company [12]. In China, land acquisition by real estate enterprises mostly relies on financial investment, by limiting the amount of financing, the amount of land owned by real estate firm would be reduced. This new policy cut off the way for real estate enterprises to borrow new debt to pay off old debt, which led to rising debt pressure for real estate enterprises. Therefore, they would not invest in new land due to the debt pressure. Since the aggressiveness of land acquisition by real estate enterprises was controlled and the demand for land was stabilized, the land price became stable. However, with less land development, fewer houses were being built and the industry was expanding at a slower rate, led to slower growth in industry scale. This policy also limited the chance for small and medium-size firm to enlarge their operating scale, as they were not allowed to borrow money from bank for land investment. Consequently, it was difficult for them to overtake large companies, the industry would become increasingly concentrated and monopolized by a few companies which was bad for market development.

On 31 December 2020, to regulate the market, Chinese government issued a policy call ‘The two red lines’ for bank regarding the scale of housing loans. The first red line is the "proportion of real estate loans", which refers to the ratio of the balance of real estate loans to the balance of total loans of the banking financial institution. Specifically, the percentage of loans made by housing firms from large banks may not exceed 40%, medium-sized banks may not exceed 27.5% and small banks may not exceed 22.5% etc. The second red line is the "personal housing loan ratio", which is the ratio of the balance of personal housing loans to the balance of loans of financial institutions, large banks may not exceed 32.5%, medium-sized banks may not exceed 20% and small banks may not exceed 17.5% [13]. This policy aimed to tighten the funding for supply and demand side of real estate market, reducing the property sector's traction with financial resources. Consequently, total investment was tightened due to controlled loans, which indirectly led to a slowdown in front-end investment in land acquisition by real estate enterprises. Meanwhile, the proportion of personal investment on house is controlled, directly led to less demand for housing and less speculative behavior. Therefore, the property sales were lowered as a result.

In 2021, there was another restriction established regarding property market, which called ‘centralized land supply’. It said each city can only offer land for sale in a maximum of three times per year, rather than any time per year. This policy aimed to return land management authority to the government, deprive the opportunity for investors to speculate on property, therefore, stabilize housing price and housing market.

All these policies mentioned above have similar target, from supply side, reducing land investment of real estate firm, from demand side, avoiding consumer’s speculative behavior. However, on both sides, they all reduce the growth of the real estate market.

2.2.3 Investor

We discussed the ‘centralized supply policy’ on real estate market in previous paragraph, this established policy also lowered the expectations of investors. In land auctions, funding always preferring core cities for land acquisition rather than in remote area, so to sold land in remote areas, government passively adjusted land price down, which then indirectly affected market expectation as well as investor’s expectation.

When thinking about the real estate development operation cycle, from land auction, production to trading, it needs at least three months’ time to complete the cycle. However, since area were locked down during epidemic, the development of house construction was at a standstill, the period of cycle is infinitely extended. This uncertainty of delivery on schedule has led investors to become risk averse, which then led to less investment on housing.

2.2.4 Consumer

After 2015, because people must undertake the task of de-stocking and deleveraging, the house prices climbed rapidly. The house price growth outpaced resident income growth for many years, so the growth rate of daily consumption on grocery continued to decline as people had less disposable income to spend on consumption.

However, since the outbreak of COVID-19, many cities have suffered a total blockade, many industries have ceased their current production, many businesses were unable to pay salaries to their workers, therefore led to massive layoffs. During that time, people were living under high financial pressure, they were more willing to spend their income on daily consumption and had no time to think about purchasing a house. Therefore, the house did not sell well.

Meanwhile, many purchasers predict the house price will fall continuously during epidemic, so they will not buy the house at this time. When buying a house, people not only consider the comfort and convenience of living in the house, but also measure the appreciation value of the house, since many people are holding the psychology of buying up not buying down, they chose not to buy at this time. According to data released by the National Bureau of Statistics, the country's commercial housing sales in April 2022 totaled 87.22 million square meters and 813.4 billion yuan, compared with the sales area and number of sales in the same period last year, April sales continued to be down year-on-year and at a historically low level, with housing price still under downward pressure. Therefore, people were reluctant to buy the house at this moment, result in lower housing sales.

3. Suggestion

According to the analysis performed above, we can make some suggestions from these four aspects to help the growth of real estate market.

3.1 Environment

During the serious epidemic, the company gradually developed a working mode of remote online and switched most of their task from offline to online. Recently, the epidemic is not serious as before, most workers return to offline office. While the author suggests the real estate company to keep the online working mode, operate under a combined mode of online and offline, which will increase the working efficiency [14]. For instance, there was a house selling APP which was developed during COVID-19, buyers can find all relevant property information they interested in the APP and view picture of interior decoration of the house before they decide to visit on-site. They can even chat with sellers online for any enquiry and receive instant respond. Online viewing is much more convenient and quicker, this channel makes it possible for people to find out basic information about house even if they are not local. Therefore, people become more efficient in buying, company workers become more efficient in selling, the housing transactions will increase.

3.2 Government

The condition of real estate market largely determines the gross domestic output of China. Therefore, the government should appropriately relax some policies when the market is significantly affected by the epidemic. Firstly, Chinese government should further increase its credit support for basic needs and improvement needs of housing company, to accelerate the recovery of housing demand and stabilize market expectations [12]. Secondly, the government should further increase its financial support to real estate development enterprises to smooth the upstream and downstream industrial capital chains and stabilize producer's confidence [13]. Lastly, Chinese government should insist on the transition from high quantity of production to high quality of production, strengthen the confidence of housing buyers [15].

3.3 Investor

In recent years, green finance is a hot discussion topic, against the backdrop of China's clear targets of "carbon peaking" by 2030 and "carbon neutrality" by 2060 [16], green finance is becoming increasingly prominent in corporate financing channels, which also brings new opportunities for real estate enterprises to raise capital.

ESG is the capital letter of Environmental; Social Responsibility and Governance, it measures the company's sustainability. The concept of ESG has its roots in the awareness of corporate social responsibility. At the end of the last century, environmental and other social problems caused by rapid economic development gradually increased, lead to a prevalence of environmental and other socially responsible activities in Western developed countries. After that, companies and investors gradually began to take environmental and social responsibility into account in their decision-making process [17]. Today, Green finance is also booming in China, Chinese investors not only assess the profitability of a firm, but also emphasis on the ESG performance of the firm. As a suggestion, China's real estate companies should always raise their awareness of environmental protection and setting ESG target before the firm making strategic plans annually. For example, 'Alibaba' has a very famous environmental project called 'Ant Forest', once you make a payment through 'Alipay', the Ant Forest will receive planting energy. When enough energy has been collected in Ant Forest, the energy will be transformed into a tree. In real world, 'Alibaba' will plant this tree in the desert instead of you, and the tree will have your unique number on it. Therefore, as more and more people making payments through 'Alipay' and plant trees in the Ant Forest, there will be more and more trees planted in the desert in reality [18].

3.4 Consumer

As the epidemic recovers, people gradually return to offline office. As a suggestion, employers can create new job opportunities for people, when the condition of selling is getting better [19]. Therefore, many previously unemployed people can be re-employed, receive regular wages, and regain their need to buy a house.

4. Conclusion

In conclusion, after experiencing a burst in the China's real estate market in 2016, the pace of development of property industry was slow down, which was due to the combined influence of environment, government, investors, and consumers. Among them, the changing regulations regarding debtors and bank, and the outbreak of COVID-19 play an influential part, which affect the growth of market significantly. Meanwhile, people's changing lifestyle due to epidemic and investor's risk adverse behavior should also be considered as underlying factors.

This is followed by some targeted suggestions on the factors influencing real estate, from author's point of view, these advises could be made to help the growth of the industry. Firstly, the external environment is uncontrollable, but company can change their own plans, the authors suggest the company to develop a new working model that combines online and offline. Next, in line with the new government policies that are being implemented for property development in the past two years, the authors propose that the regulatory effort could be suitably relaxed, while insisting on a shift from high quantity to high quality and consolidating market confidence. For investors, due to the hot wind of environmental protection, investors' concern for environmental protection can urge companies to take better care and clarify of their ESG goal. The author lastly advises the company to create job opportunities for these unemployed, so to recover their housing demand. Hopefully, the author's recommendations will help or even accelerate the recovery of the property market.

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