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China

REAL ESTATE

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This country-specific Q&A provides an overview of real estate laws and regulations applicable in China.

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CHINA REAL ESTATE



1. Overview

All land in the PRC is either state-owned or collectively-owned, depending on the location of the land. All land in urban areas of a city or town is state-owned, and all land in the rural areas of a city or town and all rural land are, unless otherwise specified by law, collectively-owned. And the state has the right to resume land in accordance with law if requires for the benefit of the public. Although all land in the PRC is owned by the state or by collectives, private individuals, enterprises and other organizations are permitted to hold, lease and develop land for which they are granted land use rights.

Land grant and land allocation are two major ways for private individuals, enterprises and other organizations to obtain the rights to use a piece of state-owned land for construction purpose from the state. For most construction projects, land grant is the way of acquiring the land use right to develop a project. Land premiums must be paid in consideration of granted land use right. Granted land use rights can be lawfully transferred, leased or mortgaged, provided that relevant legal requirements are complied with.

Property development and construction involves numerous government approvals and permits required in respect of the commencement, construction and completion of the project, the most importance of which include the project filing approval, the construction land planning permit, the construction works planning permit, the construction works commencement permit and various completion inspection and acceptance certificates.

After completion of the construction and relevant completion inspection and acceptance procedures, the project owner will apply to relevant houses administrative authority for registration of the ownership of the constructed building and issuance of a building ownership certificate, an evidence of the owner's title to the constructed building.

And after the completion of the construction project and issuance of the real estate ownership certificate thereof,

the project owner is entitled to transfer, lease or mortgage the title of the property to a third party.

2. What is the main legislation relating to real estate ownership?

Legislation in relation to real estate property rights mainly includes:

- PRC Civil Code;
- PRC Land Administration Law;
- PRC Urban Real Estate Administration Law;
- PRC Interim Regulations Concerning the Assignment and Transfer of the Right to the Use of the State-owned Land in the Urban Areas;
- Measures for Administration of the Pre-sale of Urban Commercial Properties;
- Interim Regulations on Real Estate Registration;
- Implementing Rules of the Interim Regulations on Real Estate Registration; and
- Operational Standards for Real Estate Registration.

3. Have any significant new laws which materially impact real estate investors and lenders come into force since December 2022 or are there any major anticipated new laws which are expected to materially impact them in the near future?

The following new laws and policies came into force recently and have materially impacted real estate investors and lenders:

(1) New Trial Regulation on Real Estate Equity Fund

On February 20, 2023, China Securities Regulatory Commission (CSRC) announced a pilot program for real estate private equity funds; on the same day, Asset Management Association of China (AMAC) issued the Real Estate Private Equity Investment Fund Pilot Filing

Guidelines (Trial).

Compared to the existing regulatory regime for private equity funds, the pilot program adds a new investment path to the existing real estate investment funds, by allowing qualified managers to set up funds to invest in existing residential properties, commercial properties, projects under construction and infrastructure facilities, and by encouraging foreign investors to invest in real estate funds by means of QFLP. In addition, the equity-loan ratio restrictions are loosened and the fund manager could mortgage the assets to apply for loans based on actual business conditions.

(2) 16 Articles of Financial Support on Real Estate and “Three-Arrow” Program to Stabilize the Real Estate Industry

Since late 2022, the government launched 16 articles to provide financial support on real estate and a so-called “three-arrow” program to stabilize the real estate industry, including encouraging financial institutions to offer financial support to real estate developers, promoting the disposal of non-performing assets and ensuring the delivery of pre-sold houses to purchasers.

(3) Adjustments in Residential Housing Loan Policies

Between July to October 2023, four first-tier cities in China, i.e., Guangzhou, Shenzhen, Beijing and Shanghai implemented the new policy of “recognizing houses instead of recognizing loans” to determine the qualification of house purchasers and their loan conditions. Previously, purchasers may be disqualified either due to historical loan records or ownership of houses, which is quite unfriendly for purchasers who seeks to buy a new house to replace its old one. Under the new policy however, regardless of the historical loan records, purchasers who do not own a house at the time of purchasing within a certain locality should be deemed purchasers who has not bought a house. Therefore, when applying for a mortgage loan from a bank to purchase a new house, such purchasers may be deemed to be purchase of house for the first time and enjoy lower interest rates.

Meanwhile, in August 2023, the People’s Bank of China and the State Administration of Foreign Exchange decided that targeted and differentiated housing loan policies should be precisely implemented according to the situation in each city, and purchasers who do not own a house shall be enabled to enjoy lower interest rates and lower percentage of down payment.

The following laws are expected to be enacted in the near future, and may have a substantial impact on the real estate sector:

(1) Real Estate Registration Law

According to the legislation plan issued by the 14th National People’s Congress, the Real Estate Registration Law is proposed to be submitted for review and discussion. This means the *Interim Regulations on Real Estate Registration*, which has been in force for nearly four years, will be upgraded and the registration process of real estate related rights will be further improved.

(2) Territorial Space Planning Law

The Territorial Space Planning Law is also listed in the legislation plan, the issuance of which will tighten the administration on the use of territorial space, refine provisions related to land expropriation, and improve the relevant compensation system.

4. How is ownership of real estate proved?

Ownership of real estate is evidenced by title certificate and real estate register. After the owner registers the title with real estate registration center, the registration center will record the title in the real estate register and issue a title certificate to the owner.

A party can verify ownership of real estate either by inspecting the title certificate or by applying to the registration center for title search. Generally, the information on the title certificate should be consistent with that on the real estate register kept by the registration center. If there is any discrepancy between the title certificate and the real estate register, the real estate register shall prevail.

5. Are there any restrictions on who can own real estate?

In China, the ownership of the land and the buildings constructed thereon are different. The land is either owned by the state on behalf of the whole people, or collectively owned by farmers. Therefore, natural persons, legal persons and other organisations cannot obtain land ownership, but only land use right. However, natural persons, legal persons and other organisations are all competent owners of buildings.

Nevertheless, there are still restrictions on foreign individuals and institutions in terms of their purchase of real estate in China:

Foreign Individuals:

- Only overseas individuals who have been working or studying in China can directly purchase onshore residential property for self-

use.

- In some cities, there are some additional local requirements. For example, in Shanghai, the local policy requires a foreign purchaser to provide an employment contract with a term of more than one year to justify the purchase.

Foreign Institutions:

1. For Self-Use Purpose

- Only Foreign institutions with branches or representative offices in China can purchase properties in cities where their branches or representative offices are registered.
- The properties can only be occupied for self-use purpose.
- The properties cannot be residential properties.

2. For Investment Purpose

- Only foreign investors which established an onshore business vehicle and conduct real estate development business (an FIEE) can purchase properties for investment purpose through the FIEE.

6. What types of proprietary interests in real estate can be created?

The following proprietary interests can be created in real estate:

Ownership

Ownership is the right of an owner pursuant to the law to possess, use, benefit from and dispose of its property. In China, the ownership of real estate can be created, proved and protected through registration of ownership at the local real estate registration center.

Usufructuary Rights

Usufructuary right is the right to possess, use and benefit from the property owned by other entities in accordance with law. A wide range of usufructuary rights can be registered at the real estate registration center, such as land use right, easement and right of residency.

Mortgage Right

Mortgage right is the right to enjoy preferred payments from the property for security when the obligator fails to pay its due debts or any circumstance of foreclosure of mortgage happens. Generally, it is common to see a mortgage over land use rights or ownership of buildings.

7. Is ownership of real estate and the buildings on it separate?

As described above in Question 5, the ownership of the land and buildings are separate, as natural persons and legal persons in China cannot obtain the ownership of land but only the land use right, but the aforementioned people or entities can obtain the ownership of buildings on the land.

That being said, according to the *PRC Civil Code*, the land use right and the ownership of buildings thereon cannot be separated and shall vest in the same owner, and such rights shall be disposed of as a whole. In practice, for historical reasons, there may be individual cases of separation of land use right and building ownership, but such circumstance is quite rare.

8. What are common ownership structures for ownership of commercial real estate?

In China, real estate may be owned by one single owner or by various strata title owners. In case of strata title ownership, the owner shall have exclusive ownership to its own room, suite or floor, while it shares ownership with other strata title owners over common areas, such as elevators, passages, stairs, external walls of water tanks, main pipelines for water, electricity and gas, etc.

For the spaces exclusively owned by the strata title owner, the owner shall enjoy complete ownership, i.e., the right to possess, use, benefit from and dispose of such exclusively owned areas. For the common area and common facilities owned by all strata title owners, all owners have co-ownership and co-management rights in respect of the use, proceeds, maintenance and other matters of such properties, and shall have the corresponding obligations in respect of the management of such properties, e.g., not to discard garbage, not to build structures in violation of laws or regulations, and not to occupy passageways.

But for commercial real estate, the property is usually owned by single owner and strata title ownership is usually not permitted in practice to avoid potential management issues.

9. What is the usual legal due diligence process that is undertaken when acquiring commercial real estate?

In real estate transactions, the usual legal due diligence process is as follows:

1. Define the scope of the legal due diligence

Subject to the customized requirements and circumstances of the transaction, the scope of real estate due diligence may usually include the following aspects:

- Title and encumbrances;
- Zoning compliance;
- Construction and fitting-out;
- Leases and other major contracts;
- Property management and maintenance; and
- Environmental and energy conservation compliance.

If the transaction is an equity purchase, it is also necessary to investigate into the target company's status.

2. Prepare a legal due diligence checklist

Usually, a comprehensive due diligence request list will be provided to the owner of the property, which is tailored to the specifics of the transaction. For example, if the property is leased to third parties, the property owner should provide lease contracts and lease registration certificates.

3. Conduct an independent title search

To obtain the most updated information recorded in the real estate register, and also to verify if the title certificate provided by the owner is authentic or not, counsel usually conduct an independent title search under the authorisation of the property owner. It is a search regarding target property at the local real estate registry, by which counsel can confirm all basic information about the property, including the location, the property owner, the planned usage, the term of land use right, and any existing encumbrance registered on the property, etc. Counsel can also obtain construction archives in relation to the property through independent title search.

4. Further implement the due diligence process

Counsel will review all the due diligence materials provided by the property owner and the documents acquired in the independent title search, and may request additional documents from the property owner regarding legal issues discovered in the process. To gather more information, counsel may also conduct on-site due diligence and management interviews.

Upon the completion of the investigation above, counsel usually deliver their work products in the form of a due diligence report.

10. What legal issues (if any) cannot be covered by usual legal due diligence?

Most legal issues can be covered by routine real estate legal due diligence, subject to some unavoidable restrictions such as following:

- (1) Government information is not disclosed in a timely or complete manner (e.g., business registration information not updated in time, judicial cases not uploaded to the online judicial cases database);
- (2) The relevant information is confidential or non-public (e.g., arbitration awards not available to the public)[]
- (3) The counterparty refuses to cooperate in providing documents or authorizing independent title searches.

In light of the restrictions, counsel would usually require the counterparty to make full representations and warranties with respect to the property, especially for the information that are not available during the legal due diligence process.

11. What is the usual process for transfer of commercial real estate?

In China, the procedures for transfer of real estate are mainly as follows:

(1) Contract Signing

For residential properties, the buyer and the seller should usually sign a sale and purchase contract online, in the form recognized by local real estate administrative authorities.

For non-residential properties, the buyer and the seller may sign the sale and purchase agreement offline, the form of which is usually not restricted by the real estate administrative authorities.

(2) Tax Payment

The buyer and the seller pay their taxes respectively for the title transfer and obtain certificates of tax payment from local tax authorities.

(3) Registration Application

The buyer and the seller apply to the real estate registration center for registration of title transfer and submit application materials which mainly include: (i) real estate registration application form, (ii) applicant's ID cards/business licenses, (iii) original real estate title certificate(s), (iv) sale and purchase agreement(s), (v) plans of the land and the buildings, and (v) tax payment

certificate(s).

For industrial properties, subject to local regulations and policies, the following application materials may be additionally required for submission: (i) written confirmation from the management committee of the industrial park where the project is located; (ii) resolution of the shareholders' meeting of the seller; and (iii) appraisal report on the value of the properties, etc.

(4) Certificate Issuance

The real estate registration center shall complete the registration process within 30 working days (national level time limit, city level may have shorter time limit) from the date of accepting the application materials. After the application is approved, the buyer will be issued a new real estate title certificate by the registration center.

12. Is it common for real estate transfers to be effected by way of share transfer as well as asset transfer?

Transfer of real property is usually effected by means of equity transfer or asset transfer. In practice, equity transfer is usually more preferable to institutional investors due to the following reasons:

(1) Free from restrictions on asset transfer

Asset transfer will be subject to some statutory restrictions, such as the purchasers' qualification and the 25% development progress requirement. In addition, there may be also contractual restrictions on asset transfer stipulated under the land grant contracts or investment agreements with the government, for example, the land grantee shall keep a portion of the buildings for self-use and cannot sell or transfer them to third parties, the land grantee shall obtain the local government/management committee's written approval prior to its asset transfer, etc.

The abovementioned restrictions are normally applicable to asset transfer only, and equity transfer may circumvent the restrictions.

(2) Tax advantage

In respect of asset transfer, taxes payable include land appreciation tax, value added tax, enterprise income tax, deed tax and stamp duty, among which the land appreciation tax is usually quite burdensome for seller. As for equity transfer however, taxes payable include only enterprise income tax and stamp duty, which are relatively lower than those asset transfer taxes; and if

the equity transfer occurs at offshore level in tax-free states, the taxes payable may be further reduced.

Although institutional investors prefer equity transfer, if the financial status of the asset owner is not in good order, asset transfer will be a more appropriate option.

13. On the sale of freehold interests in land does the benefit of any occupational leases and income automatically transfer?

As mentioned above in Question 5, natural persons, legal persons and other organisations can only obtain land use rights of land in China.

According to the *PRC Civil Code*, when the land use right is transferred, exchanged, contributed or donated, the ownership of the buildings, structures and other appurtenances attached to the land shall be disposed together, and vice versa.

If there is any existing lease on the site or the buildings thereon, with transfer of land use right as well as the ownership of the buildings, the rights and obligations under the lease will automatically transfer, unless the parties have agreed otherwise. That being said, it is always recommended that the original owner, the new owner and the tenant enter into agreements to make clear how the deposit, prepaid rent and fees should be settled upon the transfer, absence of which would likely cause disputes in the future.

14. What common rights, interests and burdens can be created or attach over real estate and how are these protected?

Usufructuary rights and mortgages can be created over real estate.

(1) Usufructuary right is the exclusive right of possession, use and benefit from the property of others, including land use right, land contractual management right, easement, right of residency etc.

(2) Mortgage is the right created for the purpose of ensuring the performance of debts.

In order to protect and realize usufructuary right and mortgage rights over real estate, a contract is necessary to record detailed arrangements of such rights. Further, such right shall be registered at the real estate registration center. In China, most usufructuary rights (e.g., land use right, easement and right of residency) and mortgage will become effective and enforceable upon registration.

15. Are split legal and beneficial ownership of real estate (i.e. trust structures) recognised

Under the PRC law, the split of legal and beneficial ownership of the real estate (i.e. trust structures) is generally not recognised. Under PRC law, once a property is transferred to a trust, the trust shall be the legal and beneficial owner of the real estate.

16. Is public disclosure of the ultimate beneficial owners of real estate required?

In China, although the split of legal and beneficial ownership of real estate is not recognised by law, in practice, there are cases where the actual owner of the house is not the legal owner, i.e. the real estate is registered in the name of another person or entity acting on behalf of the actual owner. Under the PRC law, the ownership of a real estate may be held on behalf of another person or entity and there is no prohibition on the registered owner holding the property under an entrustment agreement. But this entrustment arrangement is not required to be publicly disclosed and the actual owner is not shown on the title certificate of the real property.

17. What are the main taxes associated with commercial real estate ownership and transfer of commercial real estate?

Main taxes associated with real estate ownership are:

Real Estate Tax:

Owner of commercial property is liable for real estate tax calculated either on the residual value of the property at an annual rate of 1.2%, or on the rental income from the property at an annual rate of 12%.

Land Use Tax

Individuals and enterprises who use land in urban area shall pay land use tax, which is calculated on the basis of the areas of land actually occupied by taxpayers, multiplied by a standard rate stipulated by each city ranging from RMB 0.6 to RMB 30 per sqm.

Main taxes associated with real estate transfer are:

Value Added Tax

In real estate transactions, the seller is usually responsible for paying value-added tax charged at 11% under the general tax calculation method, or charged at

5% under the simplified tax calculation method.

Land Appreciation Tax

The seller is also responsible for paying land appreciation tax, which is charged in four progressive levels from 30% to 60%, depending on the difference between the appreciation amount and the deductibles.

Enterprise Income Tax

For the income from real estate transactions, the seller is responsible for paying enterprise income tax, which is usually charged at 25% of taxable income.

Deed Tax

Generally, the buyer is responsible for paying deed tax, unless otherwise agreed. The rate of deed tax ranges from 3% to 5%, depending on local tax policies.

Stamp Duty

Both the buyer and the seller shall pay a stamp duty charged at 0.05% of the total amount of the contract price.

18. What are common terms of commercial leases and are there regulatory controls on the terms of leases?

In accordance with Article 704 of the *PRC Civil Code*, a lease contract shall contain terms such as the landlord, tenant, leased premises, purpose and usage, lease term, rent and method of rent payment, as well as maintenance and repair of the leased property, etc.

Moreover, based on our experiences, commercial property lease contracts usually also contain clauses such as delivery and acceptance conditions of the premises, security deposit, fitting-out and approval, right of first refusal to purchase the property, taxes, insurance, liability for breach of contract and property management, which can be adjusted depending on the commercial arrangements of the contracting parties.

As for the lease term, the maximum lease term allowed in China is 20 years. If it is agreed in the lease contract that the lease term shall be automatically renewed for another 20 years upon expiration thereof, such renewal agreement shall be invalid.

19. How are use, planning and zoning restrictions on real estate regulated?

In China, the use, planning and zoning of real estate is

regulated throughout the whole life cycle of a real property.

(1) Stage of Planning

Usually, the government will formulate general land use plans in accordance with local urban development scheme. Based on the general land use plans, local planning authorities will formulate detailed regulatory regional plans, which precisely control the use of each plot of land located within the area, as well as their planning conditions (e.g., plot ratio, green ratio, etc.).

(2) Stage of Land Grant

In land grant contracts and supervision agreements (if any), the government will explicitly emphasize the land use term, the planned usage and planning conditions of the land. If the grantee violates the terms, it

may face a range of liabilities, such as the land being reclaimed by the government, or liquidated damages to be paid, etc.

(3) Stage of Construction

To construct buildings on the land, the land use right holder shall apply for certificates issued by local planning authority, such as land planning permits and construction works planning permits. Upon completion of construction, the project shall be thoroughly inspected and accepted by the planning authority. If the buildings constructed do not comply with the approved planning conditions, they may be recognized as unauthorized constructions and be demolished.

(4) Stage of Daily Use

The land use right holder must use the land in accordance with the planned usage and other planning conditions documented on the real estate certificates and in the land grant contracts. If the land use right holder intends to alter the planned usage, it must obtain prior approval from the competent land authority.

20. Who can be liable for environmental contamination on real estate?

In China, polluters shall bear the ultimate liability for environmental pollution, and local governments are responsible for supervision and administration of environmental protection compliance.

When the environment is polluted, the local governments will identify the party that causes environmental pollution, which will be liable for all expenses incurred in the process of investigation of

pollution, pollution risk assessment, risk control or remediation, risk control effect assessment or remediation effect assessment, etc.

In case where the parties liable for pollution cannot be identified, the land use right holder shall assume the responsibilities for risk control and remediation. If necessary, local government may organize and implement such pollution risk control and remediation work. And the land use right holder or the local government may claim against the actual polluter later.

21. Are buildings legally required to have their energy performance assessed and in what (if any) situations do minimum energy performance levels need to be met?

Generally, buildings shall have their energy performance assessed before the commencement of construction. However, according to *Measures for the Energy Conservation Examination of Fixed-Asset Investment Projects*, for the following fixed-asset investment projects, the requirement to assess energy performance is exempted:

- (i) Projects of which the annual comprehensive energy consumption is less than 1,000 tons of standard coal and annual power consumption is less than 5,000,000 kilowatt hours;
- (ii) Projects which involve state secrets; and
- (iii) Projects in industries with simple energy use technology and limited energy-saving potential (subject to industry catalogues updated by NDRC from time to time).

22. Is expropriation of real estate possible?

Both land ownership and building ownership can be expropriated. However, land ownership expropriation and building ownership expropriation are subject to different rules respectively.

With respect to land ownership, as the owners of the land in China can only be the state and the collectives, there is only one situation for expropriation of land ownership, which is the state expropriates the collective land for the purpose of public interest. Under such circumstance, the government shall compensate the owners of the land, the plant and the attachments thereon, and pay subsidies for resettlement.

With respect to building ownership, the government may initiate an expropriation if it deems it necessary for

public interest, but it shall solicit opinions from the public before making the decision of expropriation, and shall make reasonable compensation to the owners of buildings. Meanwhile, as mentioned in Question 7, the ownership of buildings and the land use right cannot be separated. Therefore, when buildings are expropriated by the government, the right to use the land thereunder will be reclaimed simultaneously, and the building owner/land use right owner may receive compensation corresponding to the remaining land use term as well.

23. Is it possible to create mortgages over real estate and how are these protected and enforced?

A mortgage can be created over land use rights and ownership of buildings, except for the following properties:

- (1) The right to use the collectively owned land, unless provided by law that such land can be mortgaged;
- (2) Educational, medical and health facilities established for public welfare purposes;
- (3) Properties of which the ownership or right of use is unknown or disputed; and
- (4) Properties that have been seized, detained or placed under supervision in accordance with the law.

Under the *PRC Civil Code*, the mortgage right is created upon and protected by registration. For the registered

mortgagee, there are two ways to enforce the mortgage right:

- (1) To agree with the mortgagor to receive priority compensation from the auction or sale of the mortgaged property; or
- (2) To file a lawsuit requesting the court to auction or sell the mortgaged property.

24. Are there material registration costs associated with the creation of mortgages over real estate?

In China, the fee for mortgage registration is currently set at RMB80 per unit of residential property and RMB550 per unit of non-residential property. The mortgage fee is usually borne by the mortgagor.

25. Is it possible to create a trust structure for mortgage security over real estate?

There is commercial mortgage-backed securities ("CMBS") in China. The underlying assets of CMBS are loans secured by mortgage over commercial properties. The originator of CMBS is usually the creditor of the property owner, and the property owner mortgage the commercial properties to secure its loan. The rental and operating income from the commercial properties are usually the major sources of funds for repayment of principal and interest of the loan.

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