

# The System of Land-use rights in Chinese Real Estate Law

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## I. Introduction

The real estate business in China is booming. Especially in Shanghai, new skyscrapers are built everywhere thanks to huge investment.<sup>1</sup> But China is – at least on paper – still a communist country with no private property of land. How does that fit together? Why do private investors invest so much money in real estate if they cannot even own the land they are building on? What seems to be a contradiction is made possible by a system of so-called land-use rights, which have been established in China in the past few decades.

This essay will explain this system of land-use rights in Chinese real estate law. In order to do so it will begin with an overview over the land-use right system (II). It will then explain the various ways to obtain land-use rights in the so-called primary market and the ways these land-use rights can be lost (III). Afterwards the focus will shift to the possibilities to further trade land-use rights in the secondary market (IV). This includes the transfer, lease, mortgage of land-use rights and the pre-development sale of properties. After a brief description of the legal structure of housing units (V), the special rules for foreign investment enterprises with regards to land-use rights will be explained (VI). This essay will finish with concluding remarks and an outlook (VII).

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<sup>1</sup> See Shanghai's Social & Economic Development in Relation to China's Accession to the WTO (2004) – Chapter 17: The Construction and Real Estate Industry, [www.sccwto.net:7001/wto/english/shanghai2004\\_17.htm](http://www.sccwto.net:7001/wto/english/shanghai2004_17.htm) (visited May 24<sup>th</sup>, 2005).

## II. Overview: The Land-use Right System

Unlike in many western countries there is no private property of land in China. All urban land is owned by the State and rural land is owned by the collectives.<sup>2</sup> Since the collectives are in turn administered by the local and central governments, it can therefore be said that all land is in the end controlled by the State.<sup>3</sup> In order to allow some privatisation and encourage foreign investment<sup>4</sup>, China has introduced a system of land-use rights, which are divisible from land ownership.<sup>5</sup> Due to this system it is possible for individuals (including foreigners) to hold a long-term lease for land use.<sup>6</sup> Individuals are also entitled to own buildings and apartments on land.<sup>7</sup> This system is significantly

<sup>2</sup> Art. 10 “Constitution of the People’s Republic of China” (Zhonghua Renmin Gongheguo xianfa), December 4<sup>th</sup>, 1982, latest amendment March 14<sup>th</sup>, 2004, Chinese-English in: CCH Asia Pacific (Editor): CCH China Laws for Foreign Business – Business Regulation, Volume 1-5, Hong Kong 1985 et seq. (CCH Business Regulation) ¶4-500. Art. 8 “Law of the People’s Republic of China on Land Management” (Land Management Law) (Zhonghua Renmin Gongheguo tudi guanli fa), June 25<sup>th</sup>, 1986, re-promulgated August 24<sup>th</sup>, 2004, Chinese-English in: CCH Business Regulation ¶14-701.

<sup>3</sup> Xiannian Ye, China Real Estate Market – Laws and Regulations Concerning Land and Real Estate, [www.china-window.com/china\\_market/china\\_real\\_estate/china-real-estate-market-7.shtml](http://www.china-window.com/china_market/china_real_estate/china-real-estate-market-7.shtml) (visited May 24<sup>th</sup>, 2005), p. 1.

<sup>4</sup> CHAN Nelson, Land-use Rights in Mainland China: Problems and Recommendations for Improvement, [www.findarticles.com/p/articles/mi\\_qa3815/is\\_199901/ai\\_n8839775/pg\\_1](http://www.findarticles.com/p/articles/mi_qa3815/is_199901/ai_n8839775/pg_1) (visited May 24<sup>th</sup>, 2005); Ye (supra note 3), p. 1.

<sup>5</sup> Art. 2 para. 1 “Provisional Regulations of the People’s Republic of China concerning the Grant and Assignment of the Right to Use State Land in Urban Areas” (Land-use Right Regulations) (Zhonghua Renmin Gongheguo chengzhen guoyou tudi shiyongquan churang he zhuanrang zanzxing tiaoli ), May 19<sup>th</sup>, 1990, Chinese-English in: CCH Business Regulation ¶14-716. Ye (supra note 3), p. 1.

<sup>6</sup> Art. 3 Land-use Right Regulations; Ye (supra note 3), p. 1.

<sup>7</sup> Ye (supra note 3), p. 1. Art. 66 “Draft of the Law of Property of the People’s Republic of China” (Draft of Property Law) (Zhonghua Renmin Gongheguo wuquan fa), published for comments in: Legal Daily (Fazhi Ribao), July 11<sup>th</sup>, 2005, p. 3-4; German translation in: Frank Münzel (Editor), Chinas Recht, 10.7.05/1 at <http://lehrstuhl.jura.uni-goettingen.de/chinarecht/inhalt.htm> (visited August 17<sup>th</sup>, 2005).

different to the situation in many western countries, where individuals can own the land itself. There are, however, similar systems in the western world, too: Lots of property in London (England) and the United States of America (especially Hawaii) is developed on long-term ground leases.<sup>8</sup> Hong Kong has a similar leasehold system, as well.<sup>9</sup>

### 1. Granted and Allocated Land-use rights

The two kinds of land-use rights have to be distinguished: Allocated<sup>10</sup> land-use rights are given from the State indefinitely and – traditionally – without payment. These rights can only be allocated for specific purposes and are generally not transferable. Granted<sup>11</sup> land-use rights on the other hand are granted by the State for a limited time against the payment of a fee.<sup>12</sup> These rights can be transferred, leased, mortgaged and even inherited.<sup>13</sup> Nowadays, foreign investment enterprises will most often obtain granted land-use rights.<sup>14</sup> But allocated land-use rights can still be of relevance.

### 2. Urban and Rural Land

This concept of land-use rights only exists for urban land.<sup>15</sup> This is the land owned by all the people within the limits of the cities, county sites, administrative towns and industrial and mining areas.<sup>16</sup> In rural areas the land is generally owned by the collectives for agricultural purposes. To increase production the so-called household-responsibility system (or family contract system) has been introduced.<sup>17</sup> This system is, however, different from the land-use right system in urban areas and of no further relevance for the commercial real estate business.<sup>18</sup>

### 3. History and Goals

Before the founding of communist China in 1949 there was an active property market in China. It was based on the old land tenure system inherited from the Qing dynasty and land tenures that were set up by foreign powers in the occupied areas.<sup>19</sup> After 1949 all property rights were transferred into public ownership. Hence, the property market ceased to exist. Land was administratively allocated to government agencies and State enterprises and became nearly worthless.<sup>20</sup>

The situation changed in 1979, when the Chinese government introduced its open-door policy. In order to improve the economy many incentives were established for foreign investors. Incentives included: tax cuts, free or low duties on imported equipment, as well as plant and free or low-rent business accommodations.<sup>21</sup> As land is one of the most important resources for the economy,<sup>22</sup> the Chinese government realised the land-use system had to be reformed as well.<sup>23</sup> The reform started with the Equity Joint Venture Law (1979).<sup>24</sup> Foreign investors could enjoy the privilege of a land-use right that was contributed to the joint venture (JV) by the Chinese partner. For non-contributed land-use rights the State ensured revenues by raising site use fees.<sup>25</sup> This development of commercialised land was however restricted in the beginning. The JV was not allowed to further trade its land-use rights.<sup>26</sup>

Some years later, the concept of privately owned and transferable land-use rights slowly developed. It was legally recognised with the 1988 Amendment to the “Constitution of the People’s Republic of China” (Constitution).<sup>27</sup> Under this system, which is

<sup>8</sup> Patrick Randolph, Thoughts on Chinese Real Estate Law: Integration Private Property Into a Socialist Governmental Structure, [http://lawweb.usc.edu/faculty/workshops/documents/Randolph\\_000.pdf](http://lawweb.usc.edu/faculty/workshops/documents/Randolph_000.pdf) (visited May 24<sup>th</sup>, 2005), at 2.

<sup>9</sup> CHAN Nelson (supra note 4).

<sup>10</sup> In Chinese: “huabo”.

<sup>11</sup> In Chinese: “churang”.

<sup>12</sup> Ezekiel Kaufman, Effective Land Use Policy and Legislation in China: The Key to the Future of Urban Development of the World’s Most Populous Nation, [www.hklaw.com/content/newsletters/property/property0304.pdf](http://www.hklaw.com/content/newsletters/property/property0304.pdf) (visited May 24<sup>th</sup>, 2005).

<sup>13</sup> See art. 19, 28, 32 and 48 Land-use Right Regulations.

<sup>14</sup> Patrick Randolph/LOU Jianbo, Chinese Real Estate Law, The Hague 2000, p. 110.

<sup>15</sup> Tong Zhen, Das Bodenrecht der VR China, Hamburg 2004, pp. 109 – 110.

<sup>16</sup> Art. 2 para. 2 Land-use Right Regulations.

<sup>17</sup> See Randolph/LOU (supra note 14), p. 116 including footnote 120.

<sup>18</sup> Edward Lehman/Gregory Sy/John Lee, Interpretation of the Applicable Law in Hearing Cases Concerning Contractual Disputes over State-owned Land Use Rights, in: China Law and Practice, Vol. 19 (2005), No. 6, pp. 23 – 24.

<sup>19</sup> CHAN Nelson (supra note 4).

<sup>20</sup> CHAN Nelson (supra note 4).

<sup>21</sup> CHAN Nelson (supra note 4).

<sup>22</sup> Zhen (supra note 15), p. 19.

<sup>23</sup> CHAN Nelson (supra note 4); Martin Thümmel, Bodenordnung und Immobilienrecht in der Volksrepublik China, Hamburg 1995, p. 57.

<sup>24</sup> “Law of the People’s Republic of China on Sino-foreign Equity Joint Ventures” (EJV-Law) (Zhonghua Renmin Gongheguo zhongwai hezi jingying qiye fa), July 1<sup>st</sup>, 1979, latest amendment March 15<sup>th</sup>, 2001, Chinese-English in: CCH Business Regulation ¶6-500.

<sup>25</sup> Thümmel (supra note 23), p. 57.

<sup>26</sup> Art. 53 “Regulations for the Implementation of the Law of the People’s Republic of China on Sino-foreign Equity Joint Ventures” (EJV-Regulations) (Zhonghua Renmin Gongheguo zhongwai hezi jingying qiye fa shishi tiaoli), September 20<sup>th</sup>, 1983, revised December 21<sup>st</sup>, 1987, before the latest revision July 22<sup>nd</sup>, 2001, English in: Institute of Chinese Law (Editor), Statutes and Regulations of the People’s Republic of China, Hong Kong 1987 et seq., 830920; Thümmel (supra note 23), p. 57.

<sup>27</sup> Art. 10 para. 4 “Constitution of the People’s Republic of China” (supra note 2). Thümmel (supra note 23), pp. 57 – 58; Randolph/LOU (supra note 14), p. 19; Patrick Randolph, Ownership with Chinese Characteristics: Private Property Rights and Land Reform in the PRC, [www.cecc.gov/pages/roundtables/020303/randolph.php](http://www.cecc.gov/pages/roundtables/020303/randolph.php) (visited May 24<sup>th</sup>, 2005), at 1.1.

based on the leasehold system in Hong Kong,<sup>28</sup> land-use rights are granted for a limited time against compensation.<sup>29</sup> This allows the establishment of a real estate market with benefits for the whole economy.<sup>30</sup> The existence of land-use fees is an important source of income for the Chinese government.<sup>31</sup> Since the State remains owner of all urban land, the system also ensures the socialist public ownership<sup>32</sup> and enables the government to stay in control of the land to satisfy the social needs of the huge population.<sup>33</sup>

This development has created a dual land-use system, as free land-use rights were allocated to most Chinese organisations in the past.<sup>34</sup> The allocation of land on a free basis has, however, created a number of problems, including the inefficient use of land.<sup>35</sup> In the last decade the Chinese government has therefore tried to increase the share of compensated land use.<sup>36</sup>

#### 4. Legal Framework

The relevant rules for the land-use right system and real estate law are laid down in various pieces of legislation at a State and local level. Art. 10 para. 4 of the Constitution recognises the system of land-use rights by stating they may be transferred according to law. Although the Constitution does not have the same force of law that it does in many western countries, this is still an important sign.<sup>37</sup> While the "Law of the People's Republic of China on Land Management"<sup>38</sup> (Land Management Law - adopted on June 25<sup>th</sup>, 1986, latest revision and re-promulgation on August 24<sup>th</sup>, 2004) contains some general rules, detailed provisions about the land-use rights can be found in the "Law of the People's Republic of China on the Administration of Urban Real Estate"<sup>39</sup> (Urban Real Estate Law - adopted on July 5<sup>th</sup>, 1994) and especially in the "Provisional Regulations of the People's Republic of China concerning the Grant and Assignment of the Right

to Use State Land in Urban Areas"<sup>40</sup> (Land-Use Right Regulations - promulgated by the State Council on May 24<sup>th</sup>, 1990).

In addition to these State regulations there are local laws, which modify and specify these rules to some degree. They are in force only within their local jurisdiction. Altogether, the Chinese law on land is still in its development and contains various gaps.<sup>41</sup> So far, a complete code on the law on land does not exist. In July 2005, however, a new Draft of a Law of Property (Draft of Property Law) was released.<sup>42</sup> Where relevant, this essay will also deal with the provisions of this draft.

### III. Acquisition - The Primary Market

The primary market in the real estate business refers to the acquisition of the land-use rights by an investor to develop and use the land.<sup>43</sup> This market is ultimately controlled by a State monopoly.<sup>44</sup> There are different ways to obtain land-use rights: They may be allocated or granted by the authorities. Foreign investment enterprises can also acquire land-use rights in some other ways (see section VI below).

#### 1. Allocated Land-use rights

The State as owner of the land can allocate land-use rights to individuals or organisations, traditionally without compensation.<sup>45</sup> Nowadays however, there usually are some costs involved. The land user has to pay a land-use tax.<sup>46</sup> Additionally, the new user has to pay compensation and expenses for resettlement for the allocated land, if the land had previously been reclaimed by the State or used by another entity.<sup>47</sup> But these payments do not equal the full market value.<sup>48</sup>

The allocation of the land-use rights is an administrative act by the State.<sup>49</sup> It requires an application by the land user and approval by the relevant authority.<sup>50</sup>

<sup>28</sup> CHAN Nelson (supra note 4).

<sup>29</sup> Xiaoyang Zhang, Real Estate Investment in China - Legal Review and Analysis of Foreign Investors' Participation, [www.murdoch.edu.au/elaw/issues/v6n2/zhang62\\_text.html](http://www.murdoch.edu.au/elaw/issues/v6n2/zhang62_text.html) (visited May 24<sup>th</sup>, 2005), at no. 5.

<sup>30</sup> Zhen (supra note 15), p. 20.

<sup>31</sup> Zhen (supra note 15), pp. 20 and 110. Also see Thümmel (supra note 23), p. 56.

<sup>32</sup> Art. 1 Land Management Law (supra note 2).

<sup>33</sup> CHAN Nelson (supra note 4).

<sup>34</sup> Zhang (supra note 29), at no. 5.

<sup>35</sup> See Thümmel (supra note 23), p. 56; Zhen (supra note 15), p. 20.

<sup>36</sup> Art. 2 para. 5 and art. 54 Land Management Law; Zhen (supra note 2), p. 116. Also see art. 126 Draft of Property Law (supra note 7).

<sup>37</sup> Randolph (supra note 27), at 1.1.

<sup>38</sup> Supra note 2.

<sup>39</sup> Zhonghua Renmin Gongheguo chengshi fangdichan guanli fa, July 5, 1994<sup>th</sup>, Chinese-English in: CCH Business Regulation ¶19-593.

<sup>40</sup> Supra note 5.

<sup>41</sup> Zhen (supra note 15), p. 22.

<sup>42</sup> Supra note 7.

<sup>43</sup> Zhang (supra note 29), at no. 1 and 4.

<sup>44</sup> Zhang (supra note 29), at no. 1.

<sup>45</sup> Art. 22 para. 1 Urban Real Estate Law and art. 43 Land-use Right Regulations.

<sup>46</sup> Art. 43 para. 2 Land-use Right Regulations.

<sup>47</sup> Art. 22 para. 1 Urban Real Estate Law.

<sup>48</sup> Zhen (supra note 15), p. 104.

<sup>49</sup> Zhen (supra note 15), p. 104.

<sup>50</sup> Zhen (supra note 15), p. 105.

### a) Purposes

The land-use purposes for which a land-use right can be allocated have been significantly restricted in the past years.<sup>51</sup> For residential purposes allocated land-use rights are still common.<sup>52</sup> For industrial and commercial purposes though, the current State policy is to use granted land-use rights.<sup>53</sup> Art. 54 Land Management Law states that construction units shall obtain land-use rights through a grant or other means of compensatory use. Exceptions exist for activities of special public significance, such as urban infrastructure projects or public facilities and certain infrastructure projects supported by the State.<sup>54</sup> Exceptions for other uses may be established by administrative acts. This can include housing and special allocations for foreign-investment enterprises.<sup>55</sup> They should however remain exceptions.<sup>56</sup>

### b) Terms

The term of allocated land-use rights is unrestricted.<sup>57</sup> The right can however be withdrawn without compensation, if the land is needed for urban construction and development or the land-use is stopped for reasons such as movement to another site or dissolution.<sup>58</sup> This has rarely happened in the past though.<sup>59</sup>

### c) Transferability

In principle allocated land-use rights may not be transferred, leased or mortgaged.<sup>60</sup> Under certain conditions, however, they can be converted into granted land-use rights for such purposes.<sup>61</sup> Art. 45 Land-use Right Regulations allows such conversation for economic organisations or individuals, if they possess the necessary certificates for the land-use right and possible buildings, a granting contract is signed and the land user pays a granting fee to the government. In addition to these requirements the transaction has to be approved by the Land Administration Department as well as the Housing Administration Department.<sup>62</sup> Obtaining these two

separate approvals can require a lot of effort.<sup>63</sup> A transfer, lease or mortgage without these approvals may be fined.<sup>64</sup>

As an exception<sup>65</sup> allocated land-use rights can also be transferred without prior conversation, if approved by the relevant people's government (art. 39 para. 2 Urban Real Estate Law). This allows the land-user to transfer the land-use right without any commercial risk. He does not have to sign a granting contract or pay a granting fee.<sup>66</sup> He is only obliged to pass on to the government any profits made from the transfer of the land-use right. Profits from the sale of the buildings owned by the land-user, on the other hand, remain with the land user.<sup>67</sup>

Some uncertainties exist as to whether land-use rights transferred according to art. 39 para. 2 Urban Real Estate Law are further transferable and unrestricted in their duration. On the one hand, it could be stressed that they have not been formally converted into granted land-use rights. Since the seller can generally not sell more than he possesses, they could therefore not be further transferred without approval.<sup>68</sup> This reasoning is however not cogent. It could also be argued that in approving the first transfer without prior conversation the relevant authorities have waived the formalities of the conversation.<sup>69</sup> Art. 39 para. 2 Urban Real Estate Law seems to be designed to reduce formalities to the benefit of the land user and not to restrict his legal ability to further transfer the land-use right. Land-use rights transferred according to art. 39 para. 2 Urban Real Estate Law should therefore be further transferable as well.

Overall, these provisions have made the transfer of allocated land-use rights much easier.<sup>70</sup> In fact, most land-use rights sold on the property market are former allocated land-use rights.<sup>71</sup> Converted allocated land-use rights are often used in the real estate market, when building offices or condominiums.<sup>72</sup>

<sup>51</sup> This trend would be acknowledged by art. 142 para. 3 Draft of Property Law.

<sup>52</sup> *Randolph/LOU* (supra note 14), p. 93.

<sup>53</sup> *Randolph/LOU* (supra note 14), p. 93.

<sup>54</sup> Art. 54 Land Management Law and art. 23 Urban Real Estate Law; *Randolph/LOU* (supra note 14), p. 93.

<sup>55</sup> *Randolph/LOU* (supra note 14), p. 94.

<sup>56</sup> *Randolph/LOU* (supra note 14), p. 94.

<sup>57</sup> Art. 22 para. 2 Urban Real Estate Law.

<sup>58</sup> Art. 47 para. 1 and para. 2 Land-use Right Regulations.

<sup>59</sup> *Zhen* (supra note 15), p. 105.

<sup>60</sup> Art. 44 Land-use Right Regulations.

<sup>61</sup> Art. 39 Urban Real Estate Law and art. 45 Land-use Right Regulations; *Randolph/LOU* (supra note 14), p. 98.

<sup>62</sup> Art. 45 Land-use Right Regulations.

<sup>63</sup> *Zhen* (supra note 15), p. 107.

<sup>64</sup> Art. 46 Land-use Right Regulations.

<sup>65</sup> See *Randolph/LOU* (supra note 14), p. 100.

<sup>66</sup> *Zhen* (supra note 15), p. 107.

<sup>67</sup> *Zhen* (supra note 15), p. 107 including footnote 288.

<sup>68</sup> *Zhen* (supra note 15), p. 108.

<sup>69</sup> See art. 39 para. 2 Urban Real Estate Law.

<sup>70</sup> *Zhen* (supra note 15), pp. 107 - 108.

<sup>71</sup> *Zhen* (supra note 15), p. 108.

<sup>72</sup> *Zhen* (supra note 15), p. 108.

## 2. Granted Land-use rights

The State as owner of the land can also grant the right to use the land for a certain number of years against payment of a corresponding fee.<sup>73</sup>

### a) Civil Act of the State

The State is not only owner of the land, but also controls and supervises the use of land with his authority as a State. It could therefore be argued that the granting process and the granting contract shall be qualified as administrative acts.<sup>74</sup> It has however to be seen that while granting the land the State only acts in his role as landowner.<sup>75</sup> Furthermore, the granting contract is based on the principles of equality, voluntariness and compensation for use,<sup>76</sup> which are typical for acts of civil law.<sup>77</sup> The granting process and the granting contract should therefore be qualified as civil acts of the State.<sup>78</sup>

### b) Ways to obtain Granted Land-use rights

Granted land-use rights can be obtained in three different ways: negotiated agreement, public tender or auction.<sup>79</sup>

#### aa) Negotiated Agreement

The negotiations can be initiated by an application of the potential land user. Alternatively, the relevant department can choose a potential land user taking into account the purpose and function of the land-use as well as land development considerations. If the parties agree about the particular land, purpose, duration and compensation for the land use, the granting contract is signed.<sup>80</sup>

#### bb) Public Tender

In the case of a public tender, the relevant department publishes a bid invitation, which contains the main contents of the contract. Within a determined period of time interested parties can make written offers that contain the necessary documents. The department then chooses between the offers, considering not only the amount of the

compensation offered, but other factors. Finally, the granting contract is signed by the parties.<sup>81</sup>

#### cc) Auction

The relevant department can also publicly announce the auction of a land-use right for a particular piece of land. During the public auction the interested parties can bid and the bidder with the highest bid wins. Afterwards the granting contract is signed.<sup>82</sup>

#### dd) Choice Restrictions

The choice between these three methods is, however, not unrestricted. The method is determined by regulations and the relevant authorities according to the land-use purpose, the quality of the property and the development of the land market.<sup>83</sup>

Legally, the acquisition by negotiated agreement is often limited to certain privileged land-use purposes.<sup>84</sup> But in practice, it has been the most popular method in the past.<sup>85</sup> This method has however shown a number of disadvantages. Although the granting fees cannot be lower than a certain minimum fee,<sup>86</sup> the revenue for the State is relatively small.<sup>87</sup> There is usually no competition between potential land users.<sup>88</sup> Furthermore, many local Chinese entities have competed to attract foreign investment by reducing the price for the land-use rights.<sup>89</sup> There have also been many under-the-table transactions with local entities.<sup>90</sup> Because of this, State coffers have suffered significantly.<sup>91</sup>

The role of auction and public tender has therefore been significantly strengthened in recent years. They have been made obligatory for commercial, tourism, recreation and luxury housing purposes.<sup>92</sup> Only if the conditions do not permit and it is impossible to adopt these methods, the mode of negotiated agreement may be used. This requires determining if the market is already developed to such a degree, that more than one interested party exists and is willing to participate in the auction.<sup>93</sup>

<sup>73</sup> Art. 8 Land-use Right Regulations and art. 7 Urban Real Estate Law.

<sup>74</sup> See *Zhen* (supra note 15), p. 110 with further references.

<sup>75</sup> Art. 8 Land-use Right Regulations.

<sup>76</sup> Art. 11 Land-use Right Regulations.

<sup>77</sup> See art. 3, 4 "General Principles of Civil Law of the People's Republic of China" (*Zhonghua Renmin Gongheguo minfa tongze*), April 12<sup>th</sup>, 1986, Chinese-English in: CCH Business Regulation ¶19-150; *Zhen* (supra note 15), p. 111.

<sup>78</sup> *Zhen* (supra note 15), p. 111.

<sup>79</sup> Art. 13 Land-use Right Regulations and art. 12 Urban Real Estate Law; *Zhang* (supra note 29), at no. 9.

<sup>80</sup> *Zhen* (supra note 15), p. 111.

<sup>81</sup> *Zhen* (supra note 15), pp. 111 - 112; *Randolph/LOU* (supra note 14), p. 149.

<sup>82</sup> *Zhen* (supra note 15), p. 112.

<sup>83</sup> *Zhen* (supra note 15), p. 112.

<sup>84</sup> See *Zhen* (supra note 15), pp. 112 - 113 with further references.

<sup>85</sup> *Zhang* (supra note 29), at no. 10; *Zhen* (supra note 15), pp. 113 - 114.

<sup>86</sup> Art. 12 para. 3 Urban Real Estate Law.

<sup>87</sup> *Zhen* (supra note 15), p. 112.

<sup>88</sup> *Zhen* (supra note 15), p. 112.

<sup>89</sup> *Zhang* (supra note 29), at no. 11.

<sup>90</sup> *Liu Jie*, New Rules influence Real Estate, [www.chinadaily.com.cn/english/doc/2004-08/25/content\\_368735.htm](http://www.chinadaily.com.cn/english/doc/2004-08/25/content_368735.htm) (visited May 24<sup>th</sup>, 2005).

<sup>91</sup> *Jie* (supra note 90); *Zhang* (supra note 29), at no. 12.

<sup>92</sup> Art. 12 para. 2 Urban Real Estate Law.

<sup>93</sup> *Zhen* (supra note 15), p. 113 footnote 306.

As the latest development, all land used for real estate development now has to be sold through auction or public tender. Under Document No. 11 of the Ministry of Land and Resources, promulgated on May 9<sup>th</sup>, 2002, the transfer of State-owned land by agreement has been forbidden from July 1<sup>st</sup>, 2002, on.<sup>94</sup> To ensure the effectiveness of this policy and strengthen supervision the ministry has issued Document No. 71, the so-called August 31<sup>st</sup> regulation, in 2004.<sup>95</sup> It obliges all land users, who obtained land by agreement, to get land-use certificates and development licenses by August 31<sup>st</sup>. It also requires development to be started within the first two years after trading. Otherwise, the land will be taken back by the government and put on the market for auction and public tender.<sup>96</sup> This policy allows the government to take a firm grip on land supply and trading. It is also designed to enhance transparency on the land market and prevent repetitive trading of land, a possible cause of real estate market bubbles.<sup>97</sup> As a result, State-owned land-use rights are now most extensively sold by public bidding.<sup>98</sup> This trend would be confirmed by art. 142 para. 2 of the Draft of Property Law. It stipulates that all commercial property has to be sold by auction or public tender.

### c) Purchasing Contract

For all the above methods a granting contract has to be signed at the end of the granting process.<sup>99</sup> The contract is concluded between the investor and the local branch of the Land Administration Department of a municipal or county people's government.<sup>100</sup> It has to include the duration of the

grant, the payable fee as well as the purpose of use for which the right is granted. The contract also has to comply with the State's overall urban development and construction plan.<sup>101</sup> The contract itself is valid when signed by the parties.<sup>102</sup> The assignment of the land-use right, however, also requires the registration of the right with the relevant Land Administration Department.<sup>103</sup>

### aa) Duration of the Grant

The maximum durations for the grant are set out in art. 12 Land-use Right Regulations and depend on the land-use purpose: 70 years for residential purposes, 50 years for industrial purposes, 50 years for the purpose of education, science, technology, culture, public health and physical education, 40 years for commercial, tourist and recreational purposes and 50 years for comprehensive utilisation or other purposes. However, in practice these terms are only used as general guidelines and many local authorities have laid down different rules within their jurisdiction.<sup>104</sup>

### bb) Payment of Fee

The fee for the land-use right has to be paid in full within 60 days of the completion of the contract,<sup>105</sup> unless stipulated otherwise by local regulation.<sup>106</sup> Any delay may lead to a cancellation of the contract.<sup>107</sup> The payment of the fee has to be made up front, which is different from a renting or leasing situation in many western countries.<sup>108</sup> The amount of the fee depends on various factors like location, lines of business, proposed investment volumes and the term of the grant. But so far no clear legal standards have been set up for the calculation of the fee.<sup>109</sup>

<sup>94</sup> See art. 24 "Provision on the Grant of State-Owned Land-use Rights through Tender, Auction and Listing" (Zhaobiao paimai guapai churang guoyou tudi shiyongquan guiding), May 9<sup>th</sup>, 2002, <http://www.cas.ac.cn/html/Dir/2002/05/09/6300.htm> (visited August 19<sup>th</sup>, 2005). *Xiao Tang*, Hungry for Land - Will new Property Transaction Policy push sizzling Property Prices to a new High?, [www.bjreview.com.cn/200439/Business-200439\(A\).htm](http://www.bjreview.com.cn/200439/Business-200439(A).htm) (visited May 24<sup>th</sup>, 2005); *Jie* (supra note 90).

<sup>95</sup> *Jie* (supra note 90); *Tang* (supra note 94) with reference to the "Circular on the Supervisory Work Regarding the Circumstances by Implementing the Continuing Development of the Grant of Land-use Rights for Commercial Purposes through Tender, Auction and Listing" (Guanyu jixu kaizhan jingying xing tudi shiyongquan zhao pai gua churang qingkuang zhifa jiancha gongzuo de tongzhi), dated March 18<sup>th</sup>, 2004, [http://www.bjtd.com/article\\_view.asp?article\\_id=332](http://www.bjtd.com/article_view.asp?article_id=332) (visited August 19<sup>th</sup>, 2005).

<sup>96</sup> *Jie* (supra note 90); *Tang* (supra note 94).

<sup>97</sup> *Jie* (supra note 90).

<sup>98</sup> Lehman, Lee & Xu, Real Property - Frequently Asked Questions, [www.lehmanlaw.com/FAQ/faq/RP.htm#14](http://www.lehmanlaw.com/FAQ/faq/RP.htm#14) (visited May 24<sup>th</sup>, 2005).

<sup>99</sup> *Zhen* (supra note 15), p. 114. This would be clarified by art. 144 Draft of Property Law.

<sup>100</sup> Art. 8 para. 2 Land-use Right Regulations and art. 14 Urban Real Estate Law; *Zhang* (supra note 29), at no. 13. Contracts concluded by development zone management committees are invalid, but may become valid upon ratification by the Land Administration Department of a municipal or county people's government; see art. 2 "Issues

Concerning the Application of the Law in Trials of State-owned Leasehold Contract Disputes Interpretations" (Guanyu shenli sheji guoyou tudi shiyong quan hetong jiu fen anjian shiyong falü wenti de jieshi), June 18<sup>th</sup>, 2005, Chinese-English in: *China Law and Practice*, Vol. 19 (2005), No. 6, p. 51.

<sup>101</sup> *Zhang* (supra note 29), at no. 13. Also see art. 59 Land Management Law and art. 93 Draft of Property Law.

<sup>102</sup> *Zhen* (supra note 15), p. 115. Art. 15 Draft of Property Law.

<sup>103</sup> Art. 16 Land-use Right Regulations; *Zhen* (supra note 15), p. 115. Art. 9 para. 1 and art. 14 Draft of Property Law.

<sup>104</sup> *Zhang* (supra note 29), at no. 14.

<sup>105</sup> Art. 14 Land-use Right Regulations.

<sup>106</sup> *Randolph/LOU* (supra note 14), p. 152.

<sup>107</sup> Art. 14 Land-use Right Regulations.

<sup>108</sup> *Randolph* (supra note 8), at 2.

<sup>109</sup> *Zhang* (supra note 29), at no. 16. Also see *Randolph/LOU* (supra note 14), pp. 152 - 153 footnote 118.

### cc) Registration

After the fee is paid the land user shall begin with the registration process.<sup>110</sup> The land-use right has to be registered with the relevant Land Administration Department. The department in turn issues the land-use certificate.<sup>111</sup> Only after this certificate is issued, the land user is entitled to use the land and can further trade his right on the secondary market.<sup>112</sup>

### a) Expiry of the Grant

Land-use rights are only granted for a certain period of time. Upon expiration of the term the land-use right is automatically acquired by the State without compensation (art. 40 Land-use Right Regulations).<sup>113</sup> This raises the question what happens to the above-ground buildings and other attached objects. They are legally separate objects typically owned by the land user. Nevertheless, their ownership is automatically acquired by the State without compensation, as well.<sup>114</sup> It would, however, be legally possible that their ownership remains with the old land user.<sup>115</sup> Although the buildings cannot be separated from the land in reality, they are separate legal entities under Chinese law. This would, however, lead to practical problems. The value of the land would be significantly reduced, since the buildings on the land restrict the State as owner in its freedom to use the land. To prevent this, and a complex legal situation, the State automatically acquires the buildings, too.<sup>116</sup> Thus, the land-use right and the ownership of the buildings stay with the same person – in this case the State.

It is, nevertheless, a significant infringement of property rights,<sup>117</sup> which does not necessarily have to happen without compensation. The protection of the property of citizens and corporations is guaranteed in art. 13 of the Constitution and art. 75, 77 “General Principles of Civil Law of the People’s Republic of China”.<sup>118</sup> Since the land user is the owner of the buildings, it can very well be argued

that he should be entitled to compensation.<sup>119</sup> On the other hand, the property of the buildings can also be seen as only temporary in the first place.<sup>120</sup> By the time the buildings are constructed it is already clear for everyone that the ownership of the buildings will be lost upon expiry of the land-use right. Therefore, the owner cannot have reasonably relied on acquiring unlimited property, if he obtained the land-use right and constructed the buildings after art. 40 Land-use Right Regulations came into force in 1990. It seems unlikely that this situation would change under a new Law of Property, even though art. 68 para. 2 of the draft stipulates that there has to be appropriate compensation if immovable property is demolished or expropriated. First of all, it can be argued that acquiring the building upon expiry of the grant is no case of expropriation, since the property of the buildings was only temporarily from the beginning. Secondly, art. 40 Land-use Right Regulations very clearly excludes compensation. Despite not being a proper law, art. 40 Land-use Right Regulations is therefore likely to stay in force as a more specific provision.

Another question that arises is whether the land user is entitled to take away the building or parts of it just before the grant expires. Since at that time it is still his property and the State acquires the building mainly to prevent a complex legal situation,<sup>121</sup> such a right seems appropriate.

It is also questionable who has to pay for a possible demolition of the building. In case it can still be used it would seem unreasonable should the land user not only lose his property without compensation, but also have to pay for its destruction. However, if the building has to be demolished anyway (because it is hazardous for example), the land user should not be released from his responsibility. In Guangzhou, disputes about the dismantling and moving of buildings which do not conform to universal standards are supposed to be handled through consultation, unless there is a specific provision in the contract.<sup>122</sup>

All these problems are practically reduced to some degree, as land-use rights can be extended

<sup>110</sup> Art. 16 Land-use Right Regulations.

<sup>111</sup> Art. 16 Land-use Right Regulations; *Zhang* (supra note 29), at no. 8. Also see art. 145 Draft of Property Law.

<sup>112</sup> See art. 16 Land-use Right Regulations; *Zhang* (supra note 29), at no. 8 and 16.

<sup>113</sup> Also see art. 154 Draft of Property Law.

<sup>114</sup> Art. 40 Land-use Right Regulations; *Kaufman* (supra note 12); *Zhen* (supra note 15), p. 158.

<sup>115</sup> This is different to the German „Erbbaurecht“, where the building is actually part of the „Erbbaurecht“ and can therefore not be separated, *Zhen* (supra note 15), p. 159.

<sup>116</sup> *Zhen* (supra note 15), p. 159.

<sup>117</sup> *Zhen* (supra note 15), p. 159.

<sup>118</sup> Supra note 77; *Zhen* (supra note 15), p. 159. Also see art. 47 and 68 para. 1 Draft of Property Law.

<sup>119</sup> *Zhen* (supra note 15), p. 159.

<sup>120</sup> See *Zhen* (supra note 15), p. 158.

<sup>121</sup> *Zhen* (supra note 15), p. 159.

<sup>122</sup> See art. 36 para. 2 “Measures of the Guangzhou Economic and Technological Development Zone on the Compensatory Transfer and Assignment of Land-Use Rights” (Guangzhou jingji jishu kaifaqu tudi shiyongquan youchang churang he zhuanrang banfa), August 25<sup>th</sup>, 1992, Chinese-English in: *CCH Asia Pacific* (Editor): *CCH China Laws for Foreign Business – Special Zones & Cities*, Volume 1-3, Hong Kong 1985 et seq. (CCH Special Zones & Cities) ¶102-130.

upon application.<sup>123</sup> In this case the land user remains the owner of the buildings.

### aa) Renewal

A land user who wishes to continue to use the land (and remain owner of his buildings) must apply for a renewal of the grant at least one year prior to its expiry.<sup>124</sup> Local legislation may allow shorter notice.<sup>125</sup> According to art. 41 Land-use Right Regulations, the grant shall be renewed if “necessary”. Art. 21 Urban Real Estate Law, however, contains a less restrictive rule: The application “shall be approved except” where the land is to be reclaimed “as required by public interests”. Considering that art. 21 is newer and has more authority as a proper law, it should be concluded that the government is in principle obliged to renew the grant. Only if it considers such renewal to be contrary to public interests, the application may be turned down.<sup>126</sup> This rule would be clarified by art. 155 of the Draft of Property Law.

How much protection of the land-use right and the building ownership such a rule will give in reality, can only be answered in the future.<sup>127</sup> Only a few short-term grants are currently expiring.<sup>128</sup> So far, the experiences in negotiating extensions have not been good for the land users. But, since the negotiations are not finished, it is too early to come up with firm conclusions.<sup>129</sup> Most current grants will not expire in the next 25 years<sup>130</sup> and the legislation may very well change before then.<sup>131</sup>

Under the current law, the failed applicant has the right to challenge the decision of the land administration authorities by a court action.<sup>132</sup> It seems likely that the courts will make their own decision about whether the refusal was necessary,

instead of deferring to the administration. The concept of “public interest” is rather vague and does not require a special expertise that lies only with administrations.<sup>133</sup> It can at least be assumed that the government cannot refuse the application and then re-grant the right to a similar party for the same purpose.<sup>134</sup> The power of the courts is not unlimited though. Important and controversial decisions might very well be made not by the courts, but by the government as the last instance.<sup>135</sup>

If the application is not approved or the land user does not apply for an extension in the first place, the land-use right will be reclaimed by the State upon expiry of the grant.<sup>136</sup>

If the extension is approved, the land user is to enter into a new contract with the land administration, pay a new fee for the land-use right and undertake registration.<sup>137</sup> The new fee will be based on the current value of the land-use right.<sup>138</sup> The value of possible buildings should, however, not be taken into consideration, since they are legally separate from the land-use right and still owned by the land user.<sup>139</sup> Economically though, the value of the buildings will at least influence the willingness of the land user to pay a higher fee, since he will be losing the ownership of the buildings without compensation otherwise.

### bb) Terms of Renewal

For what duration the land-use rights can be renewed, is still unclear. One author claims that the renewal of the right is only possible, if “the total terms added together do not exceed the maximum permissible length of time”.<sup>140</sup> This seems to suggest that all land-use rights have to be recovered by the State at the latest at the end of the terms set out in art. 12 Land-use Right Regulations. A land-use right granted for the maximum term in the first place could therefore not be renewed under any circumstances. Such a restriction seems unreasonable and can also not be found in art. 41 Land-use Right Regulations or art. 21 Urban Real Estate Law. Apparently, some other scholars have told informally that according to the intent of the legislation residential rights shall be renewable for another 70

<sup>123</sup> Art. 21 Urban Real Estate Law and art. 41 Land-use Right Regulations; *Zhen* (supra note 15), p. 159.

<sup>124</sup> Art. 41 Land-use Right Regulations and art. 21 Urban Real Estate Law. Art. 155 Draft of Property Law.

<sup>125</sup> A six month’s notice is, for example, sufficient in Shenzhen, *Randolph/LOU* (supra note 14), p. 128 note 13 with reference to art. 53 “Regulation of Shenzhen Special Economic Zone on the Grant of Land-use Rights” (Shenzhen Jingji Tequ tudi shiyongquan churang tiaoli), adopted June 18<sup>th</sup>, 1994, latest amendment February 13<sup>th</sup>, 1998, Chinese-English in: CCH Special Zones & Cities ¶71-110. Also see art. 35 para. 2 “Measures of the Guangzhou Economic and Technological Development Zone on the Compensatory Transfer and Assignment of Land-Use Rights” (supra note 122).

<sup>126</sup> *Randolph/LOU* (supra note 14), p. 128.

<sup>127</sup> *Randolph/LOU* (supra note 14), p. 128.

<sup>128</sup> *Randolph* (supra note 8), at 2.3.

<sup>129</sup> *Randolph* (supra note 8), at 2.3.

<sup>130</sup> *Randolph/LOU* (supra note 14), p. 128.

<sup>131</sup> *Randolph* (supra note 8), at 2.3.

<sup>132</sup> *Randolph/LOU* (supra note 14), p. 128 with reference to art. 2 and 11 “Law of Administrative Litigation of the People’s Republic of China” (Zhonghua Renmin Gongheguo xingzheng susong fa), April 4<sup>th</sup>, 1989, Chinese-English in: CCH Business Regulation ¶19-558.

<sup>133</sup> *Randolph/LOU* (supra note 14), p. 128.

<sup>134</sup> *Randolph/LOU* (supra note 14), p. 128.

<sup>135</sup> *Randolph/LOU* (supra note 14), pp. 128 – 129.

<sup>136</sup> Art. 21 para. 2 Urban Real Estate Law and art. 58 No. 3 Land Management Law.

<sup>137</sup> Art. 41 Land-use Right Regulations and art. 21 para. 1 Urban Real Estate Law. Also see art. 155 Draft of Property Law.

<sup>138</sup> *Randolph/LOU* (supra note 14), p. 129.

<sup>139</sup> *Randolph/LOU* (supra note 14), p. 129.

<sup>140</sup> *Zhang* (supra note 29), at no. 14.



years, while non-residential rights will not be fully renewable; they shall only be renewed for shorter periods.<sup>141</sup> The statutes, however, do not contain this distinction or any other reference about the duration of renewals.<sup>142</sup> Up to now, this has not lead to much concern, since most people expect the government to find an acceptable solution before most grants start to expire. Some scholars believe that the government shall and probably will make all residential grants permanent before this happens.<sup>143</sup>

The uncertainty about the terms of renewal creates an economical incentive to construct houses that only stay in a good condition for the initial term. If you are likely to lose the property at the end of that term, it does not make economical sense to invest more. This should have a negative effect on the quality of real estate in China.

## e) Withdrawal

### aa) Public Interest

Art. 19 Urban Real Estate Law and art. 42 Land-use Right Regulations guarantee that the State, in principle, shall not withdraw the granted land-use rights before the end of the agreed term. But at the same time these articles set out certain exceptions: Under “special circumstances”, and if required by “public interests”, the State may withdraw the land-use right. These conditions are stronger than in the case of the reclamation of collective land.<sup>144</sup> The requirement of “special circumstances” is designed to limit the withdrawal to only a few cases, only those that could not be foreseen at the time of the grant.<sup>145</sup> The element of “public interests” has only been specified in a Cantonese regulation with reference to city development projects, public facilities and other special building projects.<sup>146</sup> This recovery of the land-use right for the sake of “public interests” is also laid down in art. 58 no. 1 Land Management Law. Additionally, art. 58 no. 2 Land Management Law contains a special case for the withdrawal: The re-building of old city districts in order to implement urban construction plans. This has been of practical importance in recent years and also applies to people that have automatically

acquired a land-use right due to their ownership of a building.<sup>147</sup>

In all these cases, the former land user is entitled to “appropriate” compensation.<sup>148</sup> The compensation is based on the “number of years of utilisation and the actual development of the land by the land user”.<sup>149</sup> The land user’s investment in the land is therefore taken into account.<sup>150</sup> “Appropriate” compensation does not however necessary equal the “fair market value”.<sup>151</sup> If the land user disagrees with the amount of his compensation, he is entitled to take court action.<sup>152</sup>

The decision about the withdrawal is done by the relevant Land Administration Department with approval of the people’s government that originally approved the land-use or the people’s government that has the power of approval.<sup>153</sup> At least in some administrative regions, the Land Administration Department is obliged to inform the land user six months prior to the withdrawal of his land-use right.<sup>154</sup>

### bb) Sanction

Finally, to prevent speculation<sup>155</sup> granted land-use rights can be withdrawn as a sanction, if the land user fails to develop and utilise the land in accordance with the granting contract.<sup>156</sup> If the land is still not developed according to the land-use purpose two years after the agreed starting time, the land-use right can be reclaimed by the State without

<sup>147</sup> *Zhen* (supra note 15), p. 161. Compare art. 24 para. 1 Land-use Right Regulations.

<sup>148</sup> Art. 19 Urban Real Estate Law and art. 58 Land Management Law. This would also be ensured by art. 128 Draft of Property Law.

<sup>149</sup> Art. 19 Urban Real Estate Law and art. 42 Land-use Right Regulations.

<sup>150</sup> *Randolph/LOU* (supra note 14), p. 129 footnote 22.

<sup>151</sup> *Randolph/LOU* (supra note 14), p. 129.

<sup>152</sup> *Zhen* (supra note 15), p. 161 footnote 408.

<sup>153</sup> Art. 58 Land Management Law; *Zhen* (supra note 15), p. 161.

<sup>154</sup> See art. 37 para. 2 “Measures of the Guangzhou Economic and Technological Development Zone on the Compensatory Transfer and Assignment of Land-Use Rights” (supra note 122). The same was true for Shanghai; see *Zhen* (supra note 15), p. 161 who refers to art. 42 para. 2 “Shanghai Municipality, Granting and Assigning Leaseholds for Value Procedures” (Shanghai shi tudi shiyongquan youchang zhuanrang banfa), November 29<sup>th</sup>, 1987, Chinese-English in: Patrick, Y.W. Wu (Editor), The PRC Property Series, Vol. I – Shanghai, Hongkong 1995, pp. 43-52. This law has however been repealed according to art. 57 “Measures of Shanghai Municipality on Real Estate Transfers” (see infra note 255). Nowadays, a public notice displayed for at least 30 days seems to be sufficient, see art. 39 “Measures of Shanghai Municipality for the Implementation of the Law of the People’s Republic of China on Land Management” (Shanghai shi shishi “Zhonghua Renmin Gongheguo tudi guanli fa” banfa), announced November 17<sup>th</sup>, 2000; Chinese-English in: CCH Special Zones & Cities ¶92-091.

<sup>155</sup> *Randolph* (supra note 8), at 2.

<sup>156</sup> Art. 17 para. 2 Land-use Right Regulations; *Zhen* (supra note 15), p. 161; *Randolph* (supra note 8), at 2.

<sup>141</sup> *Randolph* (supra note 8), at 2.3.

<sup>142</sup> *Randolph* (supra note 8), at 2.3.

<sup>143</sup> *Randolph* (supra note 8), at 2.3.

<sup>144</sup> *Zhen* (supra note 15), p. 160.

<sup>145</sup> *Zhen* (supra note 15), p. 160.

<sup>146</sup> Art. 37 “Measures of the Guangzhou Economic and Technological Development Zone on the Compensatory Transfer and Assignment of Land-Use Rights” (supra note 122); *Zhen* (supra note 15), p. 160.

compensation.<sup>157</sup> This also means a loss of the land-use fee, which has been fully paid in advance.<sup>158</sup> After one year without development the State can already impose a fine of up to 20 % of the land-use fee.<sup>159</sup> Not every delay will justify these sanctions though. The failure to start development due to *force majeure* or governmental interference is explicitly excepted.<sup>160</sup>

Local regulations may provide the exact degree to which the land has to be developed to avoid these consequences. In Shenzhen, for instance, all the development and land-use permits must have been obtained and 25 % of the total investment must have been made.<sup>161</sup> Once the land is sufficiently developed, a discontinuation of further use will not lead to an automatic withdrawal of a granted land-use right. Such rules only exist for allocated land-use rights.<sup>162</sup>

#### IV. The Secondary Market

There are two different business activities conducted by foreign investors in the secondary market. First, the investor may further trade the land-use right, by means of transfer, lease or mortgage. He may also pre-sale his incomplete property as a means of financing the development of the land.<sup>163</sup>

##### 1. Transfer

The transfer of granted land-use rights from one investor to another is a civil activity supervised by the government.<sup>164</sup> It allows the investor to gain profits from his investment in the land-use right.<sup>165</sup>

##### a) Conditions

The transfer of the land-use right requires a written contract between the parties.<sup>166</sup> Local regulation may require notarisation.<sup>167</sup> This contract obliges the buyer to pay the agreed price, while the seller has to provide the land to the buyer.<sup>168</sup> To be

valid the transfer has to be registered with the relevant Land Administration Department.<sup>169</sup> This usually is to be done within 15 days after the contract is signed, upon payment of the transfer-fee.<sup>170</sup>

To prevent speculations with land-use rights their transferability is restricted to some degree.<sup>171</sup> According to art. 19 para. 2 Land-use Right Regulations, land-use rights cannot be transferred, "if the land has not been developed and utilised in accordance with the period of time specified in the contract and the conditions therein". This provision is voluntarily vague.<sup>172</sup> It is specified by art. 38 Urban Real Estate Law, which sets out three general conditions: The seller must have fully paid the land acquisition fee and obtained a land-use certificate. He also has to have at least started to develop in accordance with the contract, completing 25 or more percent of the total investment for building projects or installing the planned infrastructure for industrial or other construction projects.<sup>173</sup> The time period and detailed contractual conditions are in practice specified by the relevant Land Administration Department.<sup>174</sup> There are also various local regulations, which may vary slightly within the local jurisdictions.<sup>175</sup>

##### b) Legal Implications

As a result of the transfer the original rights and obligations laid down in the granting contract and the registration documents are transferred to the buyer.<sup>176</sup> Consequently, the land-use right remains subject to its inherent restrictions.<sup>177</sup> Firstly, the term of use is limited to the remainder of the original term agreed upon in the contract.<sup>178</sup> Secondly, a change in the purpose of the land-use is only possible with the consent of the relevant Land Administration Department and the Urban Planning Department, and requires a new granting contract.<sup>179</sup>

<sup>157</sup> Art. 25 Urban Real Estate Law.

<sup>158</sup> *Randolph* (supra note 8), at 2.

<sup>159</sup> Art. 25 Urban Real Estate Law.

<sup>160</sup> Art. 25 Urban Real Estate Law; *Randolph/LOU* (supra note 14), p. 131.

<sup>161</sup> *Randolph/LOU* (supra note 14), p. 130 with reference to art. 56 "Regulations of Shenzhen Special Economic Zone on the Grant of Land-use Rights" (supra note 125).

<sup>162</sup> Art. 58 no. 4 Land Management Law; also see *Randolph/LOU* (supra note 14), p. 131.

<sup>163</sup> *Zhang* (supra note 29), at no 2.

<sup>164</sup> *Zhang* (supra note 29), at no. 28.

<sup>165</sup> *Zhen* (supra note 15), p. 131.

<sup>166</sup> Art. 20 Land-use Right Regulations and art. 40 Urban Real Estate Law. Art. 150 Draft of Property Law.

<sup>167</sup> *Randolph/LOU* (supra note 14), p. 187; *Zhen* (supra note 15), p. 128 footnote 344.

<sup>168</sup> *Zhen* (supra note 15), p. 128.

<sup>169</sup> Art. 25 para. 1 Land-use Right Regulations; *Zhen* (supra note 15), p. 127. Art. 151 Draft of Property Law.

<sup>170</sup> *Zhang* (supra note 29), at no. 29.

<sup>171</sup> *Zhen* (supra note 15), p. 125.

<sup>172</sup> *Zhen* (supra note 15), p. 125.

<sup>173</sup> *Randolph/LOU* (supra note 14), p. 131; *Zhen* (supra note 15), p. 126; *Zhang* (supra note 29), at no. 28.

<sup>174</sup> *Zhen* (supra note 15), pp. 125 – 126.

<sup>175</sup> *Zhang* (supra note 29), at no. 28; *Zhen* (supra note 15), p. 126.

<sup>176</sup> Art. 21 Land-use Right Regulations and art. 41 Urban Real Estate Law; *Zhen* (supra note 15), p. 121.

<sup>177</sup> *Zhen* (supra note 15), p. 128.

<sup>178</sup> Art. 22 Land-use Right Regulations and art. 42 Urban Real Estate Law. Art. 150 Draft of Property Law.

<sup>179</sup> Art. 27, 18 Land-use Right Regulations and art. 43 Urban Real Estate Law; *Zhang* (supra note 29), at no. 29; *Zhen* (supra note 15), pp. 121 – 122.

The transfer of the land-use right also includes a transfer of the ownership of the above-ground buildings and other attached objects.<sup>180</sup> This is to ensure that the land-use right and ownership of the buildings on this land are not separated, which could cause complications and uncertainties.<sup>181</sup> Consequently, the owner of a building also possesses a land-use right, which is transferred when the ownership of the building is passed on.<sup>182</sup> The transfers of building ownership and land-use rights are therefore closely connected. However, some frictions can arise due to the fact that the land-use right and the ownership of the buildings often have to be registered with different authorities (Land Administration Department and Housing Administration Department).<sup>183</sup> This problem would be solved with the establishment of a uniform national registration system for immovables, which is planned in the new Draft of Property Law.<sup>184</sup>

### c) Governmental Involvement

The government usually does not interfere in the pricing of the transfer,<sup>185</sup> although it may take actions if market prices rise to an “unreasonable extent”.<sup>186</sup> If the transfer price is obviously lower than the market price, the local government enjoys the priority to buy the right.<sup>187</sup>

## 2. Lease

According to art. 28 of the Land-use Right Regulations the investor can lease the granted land-use right together with the above-ground buildings to a third party against a fee.<sup>188</sup>

### a) Conditions

The lease requires a written contract between the parties.<sup>189</sup> The lease of the land and building on it has to be registered with the relevant Land Administration Department.<sup>190</sup> This is to be done

within 30 days after the contract is signed.<sup>191</sup> It is however unclear whether the lease is invalid in the case of the registration requirement being violated.<sup>192</sup>

The land-use right may not be leased, if certain minimal performances stated in the granting contract have not been carried out.<sup>193</sup> They are similar to the transfer restrictions according to art. 19 para. 2 Land-use Right Regulations<sup>194,195</sup>

### b) Legal Implications

The lease gives the lessee the right to use the land. But the leasing transaction does not constitute a transfer of the land-use right in a legal sense.<sup>196</sup> According to art. 30 Land-use Right Regulations the lessor<sup>197</sup> is not relieved from any commitments of the initial grant. He is further obliged to develop the land according to the terms and conditions of the granting contract.<sup>198</sup> In relation to the State the lessor therefore continues to be the contractual partner of the grant. He also remains owner of the land-use right.<sup>199</sup> The lessee, on the other hand, has contractual duties only towards the lessor, not the State.<sup>200</sup>

With regards to the above-ground buildings the situation is similar to the transfer. If land-use rights are leased, the above-ground buildings are included in the lease as well. And the lessee of a building automatically acquires a lease of the land-use right.<sup>201</sup>

### c) Protection of the Lessee

If the land-use right is transferred to another party during the time of the lease, this action does not affect the legal status of the lessee. Art. 229 “Contract Law of the People’s Republic of China”<sup>202</sup> transfers all contractual rights and obligations of the

<sup>180</sup> Art. 23 Land-use Right Regulations. Art. 152 Draft of Property Law.

<sup>181</sup> Zhen (supra note 15), pp. 122 – 123.

<sup>182</sup> Art. 24 para. 1, 2 Land-use Right Regulations. Also see Art. 152 Draft of Property Law.

<sup>183</sup> Art. 60 para. 3 Urban Real Estate Law; Sabine Stricker, VR China Immobilienrecht, Köln/Berlin 1995, p. 17. A uniform certificate is possible under art. 62 Urban Real Estate Law.

<sup>184</sup> Art. 10 para. 2 Draft of Property Law. Also see the temporary provision art. 267, which allows the parties to apply for concurrent registrations before the system is established.

<sup>185</sup> Zhang (supra note 29), at no. 30.

<sup>186</sup> Art. 26 para. 2 Land-use Right Regulations.

<sup>187</sup> Art. 26 para. 1 Land-use Right Regulations.

<sup>188</sup> Also see art. 52 Urban Real Estate Law.

<sup>189</sup> Art. 29 para. 1 Land-use Right Regulations and art. 53 Urban Real Estate Law; Randolph/LOU (supra note 14), p. 203.

<sup>190</sup> Art. 31 Land-use Right Regulations; Randolph/LOU (supra note 14), p. 204.

<sup>191</sup> Cao Pei, Real Estate Law in China, Hong Kong 1998, at 8.17; Randolph/LOU (supra note 14), p. 205.

<sup>192</sup> Zhen (supra note 15), p. 129. While Randolph/LOU (supra note 14), p. 204 claim the registration to be a condition of validity, they state the opposite on p. 171.

<sup>193</sup> Art. 28 para. 2 Land-use Right Regulations.

<sup>194</sup> See supra D I 1.

<sup>195</sup> Randolph/LOU (supra note 14), p. 132.

<sup>196</sup> Zhang (supra note 29), at no. 32.

<sup>197</sup> Some sources of Art. 30 Land-use Right Regulations refer to the duties of the “lessee”. Correctly, however, it must read “lessor”, see Pei (supra note 191), p. 204 and the (accurate) translation of Art. 30 in CCH Business Regulation ¶14-716.

<sup>198</sup> Zhang (supra note 29), at no. 32; Zhen (supra note 15), p. 128.

<sup>199</sup> Zhen (supra note 15), p. 128.

<sup>200</sup> Zhen (supra note 15), p. 128.

<sup>201</sup> Zhen (supra note 15), p. 129 with reference to art. 31 Land-use Right Regulations.

<sup>202</sup> Zhonghua Renmin Gongheguo hetongfa, March 15<sup>th</sup>, 1999, Chinese-English in: CCH Business Regulation ¶5-650.

lessor to the transferee.<sup>203</sup> He is therefore required to guarantee the effectiveness of the lease.<sup>204</sup>

### 3. Mortgage

Granted land-use rights can also be mortgaged by the investor,<sup>205</sup> usually to secure a loan.<sup>206</sup>

#### a) Conditions

The mortgage requires a written mortgage contract between the investor and the lending institution.<sup>207</sup> This mortgage contract is separate from the lending contract.<sup>208</sup> The mortgage has to be registered with the relevant Land Administration Department,<sup>209</sup> which has to be done within 15 days.<sup>210</sup> Without such registration the mortgage contract is not valid.<sup>211</sup>

The mortgage is always dependent on the secured obligation. Without a debt the mortgage is not valid.<sup>212</sup> This even applies, if the obligation ceases after the mortgage has been registered;<sup>213</sup> in this case the registration has to be nullified.<sup>214</sup>

The people involved in the mortgage are the mortgagee and the mortgagor. While the mortgagee has to be the creditor, the mortgagor can be the debtor or any third person that owns the land-use right and possible buildings.<sup>215</sup>

#### b) Legal Implications

The mortgagor remains owner of the land-use right and possible buildings.<sup>216</sup> The mortgagee, on the other hand, obtains the right to dispose of the mortgaged property, if the investor (the mortgagor) fails to repay his debt.<sup>217</sup> This can be done by sale or

auction.<sup>218</sup> The mortgagee has the priority of compensation from the funds obtained from the disposal.<sup>219</sup> This priority is not absolute though. Some local regulations give first priority to the costs of the disposal and taxes.<sup>220</sup> If the lending institution is fully repaid, the mortgage registration will be nullified.<sup>221</sup>

Although art. 34 “Secured Interests Law of the People’s Republic of China”<sup>222</sup> (Secured Interests Law) lists land-use rights and buildings separately as objects of a mortgage,<sup>223</sup> the land-use right and possible above-ground buildings are closely connected in the case of a mortgage. The mortgage of land-use rights automatically includes the mortgage of possible above-ground buildings.<sup>224</sup> And the mortgage of the buildings also results in the mortgage of the respective land-use right.<sup>225</sup> Consequently, neither of them can be mortgaged, if the land-use right and buildings are owned by different persons.<sup>226</sup>

The mortgaged property does not, however, include buildings that have been built after the mortgage came into existence.<sup>227</sup> Although these buildings may be auctioned off together with the other assets, the mortgagee does not have priority in compensation with regards to these buildings.<sup>228</sup> In practice, this is of minor importance in China, since the debt usually cannot exceed the value of the mortgage in the first place.<sup>229</sup>

#### c) Risks for the Mortgagee

The mortgage of a land-use right contains a number of risks for the mortgagee, some of which he cannot control: Firstly, the mortgagee cannot use his right to dispose, if the mortgaged land-use right cannot be legally transferred, because it has not yet been developed according to the conditions of the

<sup>203</sup> *Zhen* (supra note 15), p. 129.

<sup>204</sup> *Zhang* (supra note 29), at no. 33.

<sup>205</sup> Art. 32 Land-use Right Regulations and art. 47 para. 2 Urban Real Estate Law.

<sup>206</sup> *Zhen* (supra note 15), p. 136.

<sup>207</sup> Art. 34 para. 1 Land-use Right Regulations, art. 49 Urban Real Estate Law and art. 38 “Secured Interests Law of the People’s Republic of China” (Secured Interests Law) (*Zhonghua Renmin Gongheguo danbaofa*), June 30<sup>th</sup>, 1995, Chinese-English in: CCH Business Regulation ¶5-605. Also see art. 207 Draft of Property Law. Some local regulations require notarisation of the contract, *Zhen* (supra note 15), p. 137.

<sup>208</sup> *Zhen* (supra note 15), p. 137. This would be clarified by art. 194 Draft of Property Law.

<sup>209</sup> Art. 35 Land-use Right Regulations and art. 41 Secured Interests Law.

<sup>210</sup> *Zhang* (supra note 29), at no. 36; *Zhen* (supra note 15), p. 137.

<sup>211</sup> Art. 41 Secured Interests Law; *Zhen* (supra note 15), p. 137.

<sup>212</sup> Art. 52 Secured Interests Law.

<sup>213</sup> *Zhen* (supra note 15), p. 137. Also see art. 200 para. 1 Draft of Property Law.

<sup>214</sup> Art. 38 Land-use Right Regulations.

<sup>215</sup> Art. 33 Secured Interests Law; *Zhen* (supra note 15), pp. 138 – 139.

<sup>216</sup> Art. 33 Secured Interests Law; *Zhen* (supra note 15), p. 144.

<sup>217</sup> Art. 36 Land-use Right Regulations and art. 53 Secured Interests Law.

<sup>218</sup> Art. 53 Secured Interests Law and art. 46 Urban Real Estate Law; see *Zhen* (supra note 15), pp. 153 – 154 for further details. This is unchanged in art. 219 Draft of Property Law.

<sup>219</sup> Art. 37 Land-use Right Regulations and art. 33 Secured Interests Law.

<sup>220</sup> *Zhen* (supra note 15), p. 152.

<sup>221</sup> Art. 38 Land-use Right Regulations; *Zhang* (supra note 29), at no. 36.

<sup>222</sup> Supra note 207.

<sup>223</sup> *Zhen* (supra note 15), p. 139. This is unchanged in art. 202 para. 1 and 2 Draft of Property Law.

<sup>224</sup> Art. 33 para. 1 Land-use Right Regulations, art. 47 para. 1 Urban Real Estate Law and art. 36 Secured Interests Law. This is unchanged in art. 203 Draft of Property Law.

<sup>225</sup> Art. 33 para. 2 Land-use Right Regulations and art. 36 Secured Interests Law; *Zhen* (supra note 15), p. 139. This is unchanged in art. 203 Draft of Property Law.

<sup>226</sup> *Zhen* (supra note 15), p. 138.

<sup>227</sup> Art. 51 Urban Real Estate Law and art. 55 Secured Interests Law:

<sup>228</sup> Art. 51 Urban Real Estate Law; *Zhen* (supra note 15), p. 142. This is unchanged in art. 223 Draft of Property Law.

<sup>229</sup> Art. 35 Secured Interests Law; *Zhen* (supra note 15), pp. 142 – 143.

grant.<sup>230</sup> Secondly, the mortgage ceases if the land-use right is withdrawn by the State in the case the land user does not comply with the development and utilisation conditions of the granting contract.<sup>231</sup> Finally, since the land-use right is only granted for a certain term, the mortgage of that right is also limited to this term.<sup>232</sup> Economically, the mortgage is therefore only valuable for the remainder of the term.

#### d) Practical Importance

The use of mortgages as a means of raising real estate finance has not been fully developed in China yet. In fact, it is quite difficult for foreign investors to borrow money from local Chinese banks.<sup>233</sup> This significantly reduces their importance with regards to foreign investment.

#### 4. Pre-development Sale of Properties

In order to finance the construction of buildings, properties in China are often sold in advance before their actual development is completed. One of the reasons for that is that the State-owned banks are restricted in various ways with regards to development loans. They are, for instance, not allowed to lend more than the land, as their security is worth, at the time of the loan.<sup>234</sup> In case of pre-development sales, the buyer usually buys only a bare concrete cubicle with utilities stubbed. The floors, interior walls, plumbing and electrical facilities have to be designed and installed separately by the buyer.<sup>235</sup>

In order to carry out the pre-sale of commercial houses a number of conditions have to be satisfied:<sup>236</sup> The investor must have obtained the land-use certificate and paid all the land-use fees, he must have a permit for the construction project, he has to have completed 25% of the total investment and must have set a schedule for the construction including the date of completion. Finally, he must have registered for pre-sale at the Real Estate Management Department of the People's Government at county level or above and must have obtained the certificate of permission for the pre-sale of commercial houses.<sup>237</sup>

The pre-sale contracts shall be submitted to the Real Estate Management Department and the Land Administration Department for registration and record within 30 days after being signed.<sup>238</sup> The money obtained in the pre-sale is then to be used for the construction project.<sup>239</sup> Some more protection for the buyer would be provided by art. 21 of the Draft of Property Law: If the buyer has paid half of the required payment, he is entitled to advanced registration in order to restrain the seller from transferring the property to a third party.

#### V. Legal Structure of Housing Units

For many urban Chinese the housing situation has changed significantly in the last few years. For decades they could live in apartments provided by their work units at a pittance.<sup>240</sup> Since the housing reform (beginning in 1988)<sup>241</sup> the Chinese are ordered to obtain their housing on a market basis. Many were given, or cheaply bought, the apartment they previously rented from their work unit.<sup>242</sup> As a result, an estimated 80% of urban Chinese now own their home.<sup>243</sup> This also means they now have to pay for the maintenance. This is good news for the working units; many of them were practically broke and could hardly bear the maintenance responsibilities for the aging apartment blocks.<sup>244</sup> Most people that could afford it have moved to new and better housing units which has caused a strong demand for such housing.<sup>245</sup>

This new situation has brought up questions about the legal structure of housing units. Overall, there still is a lot of uncertainty. The legal concept of condominiums has not been properly established in China.<sup>246</sup> This could change when the Draft of Property Law comes into force. The draft contains a separate chapter on condominiums, although it certainly does not solve all the current issues.<sup>247</sup> So far, there are only a few regulations about the rights and obligations of the millions of homeowners in China.<sup>248</sup>

Some rules about the legal structure of housing units exists in the "Provisions Concerning the

<sup>230</sup> Art. 19 para. 2 Land-use Right Regulations; *Zhen* (supra note 15), p. 126.

<sup>231</sup> Art. 17 Land-use Right Regulations; *Zhen* (supra note 15), p. 156.

<sup>232</sup> *Zhen* (supra note 15), p. 140.

<sup>233</sup> *Zhang* (supra note 29), at no. 37 - 38.

<sup>234</sup> *Randolph* (supra note 8), at 3.3.

<sup>235</sup> *Randolph* (supra note 8), at 3.3.

<sup>236</sup> Art. 44 Urban Real Estate Law.

<sup>237</sup> For the procedures see *Pei* (supra note 191), at 8.49 - 8.51 with reference to the "Administrative Measures on Urban Commercial Housing Pre-sale" (Chengshi shangpinfang yushou guanli banfa) promulgated by the Construction Ministry on 1 January 1995, revised

on August 15<sup>th</sup>, 2001, Chinese at: <http://www.cin.gov.cn/law/depart/2001090702.htm> (visited on August 23<sup>rd</sup>, 2005).

<sup>238</sup> Art. 44 para. 2 Urban Real Estate Law; *Pei* (supra note 191), at 8.52.

<sup>239</sup> Art. 44 para. 3 Urban Real Estate Law.

<sup>240</sup> *Randolph/LOU* (supra note 14), at 3; *Zhen* (supra note 15), p. 123.

<sup>241</sup> *Randolph* (supra note 8), at 21 et seq.

<sup>242</sup> *Randolph* (supra note 8), at 3; *Zhen* (supra note 15), p. 123.

<sup>243</sup> *Randolph* (supra note 8), at 3.

<sup>244</sup> *Randolph* (supra note 8), at 3.

<sup>245</sup> *Randolph* (supra note 8), at 3.

<sup>246</sup> *Randolph/LOU* (supra note 14), p. 49; *Randolph* (supra note 8), at 3.2.

<sup>247</sup> See Chapter 6 of the Draft of Property Law.

<sup>248</sup> *Zhen* (supra note 15), p. 124.

Administration of Urban Connected Properties”, issued by the Ministry of Construction in 1989, and revised on August 15, 2001.<sup>249</sup> According to its art. 6 and 9 the rights related to a housing unit consist of three different parts: Firstly, a legally separate ownership of the parts of the house that are exclusively owned by the occupant. This applies to the space within their own units including related parts as balconies, for example.<sup>250</sup> Secondly, a co-ownership with regards to the common areas of the building and all other parts and facilities that are necessary for the continuance and maintenance of the house.<sup>251</sup> This includes such things as stairs, gardens, vestibules, water and electricity facilities and the structural elements of the house itself.<sup>252</sup> This is a co-ownership by shares, where each owner has a percentage interest in the common area property.<sup>253</sup> Thus, the rights and obligations are shared and no part can be separated and assigned separately.<sup>254</sup> Thirdly, joint owners of a building obtain a land-use right (art. 24 para. 1 Land-use Right Regulations). How all the unit-owners obtain a land-use right is not laid down in the Land-use Right Regulations, but in other local regulations. In Shanghai for example, each owner obtains a certain percentage of the land-use right.<sup>255</sup> It is important to note that these different ownership parts of a housing unit are inextricably connected.<sup>256</sup> Ownership of the housing unit cannot exist if one of these parts is missing.<sup>257</sup>

In practice, a certificate is usually issued to the unit owners stating that they possess a land-use right in the building’s site together with all the other owners.<sup>258</sup> Furthermore, the owners typically sign a common contract at the outset. It obliges them to pay for maintenance assessments and to obey the rules of the owner association.<sup>259</sup>

<sup>249</sup> “Chengshi yichan pilian fangwu guanli guiding”, available in Chinese through the homepage of the Ministry of Construction at [www.cin.gov.cn/law/depart/2001090701.htm](http://www.cin.gov.cn/law/depart/2001090701.htm) (visited August 25<sup>th</sup>, 2005).

<sup>250</sup> *Zhen* (supra note 15), p. 124; *Randolph/LOU* (supra note 14), p. 47. Also see art. 73 Draft of Property Law.

<sup>251</sup> *Zhen* (supra note 15), p. 124. Art. 73 Draft of Property Law.

<sup>252</sup> *Zhen* (supra note 15), p. 124. Also see art. 75 and 266 para. 2 Draft of Property Law.

<sup>253</sup> *Zhen* (supra note 15), p. 124; *Randolph/LOU* (supra note 14), p. 47. Compare art. 83 Draft of Property Law.

<sup>254</sup> *Zhen* (supra note 15), p. 124.

<sup>255</sup> Art. 26 para. 2 “Measures of Shanghai Municipality on Real Estate Transfers” (Shanghai shi fangdichan zhuanrang banfa), April 30<sup>th</sup>, 1997, latest revision on June 24<sup>th</sup>, 2004, Chinese-English in: CCH Special Zones & Cities ¶92-100.

<sup>256</sup> Compare art. 75 Draft of Property Law.

<sup>257</sup> *Zhen* (supra note 15), p. 124.

<sup>258</sup> *Randolph* (supra note 8), at 3.2.

<sup>259</sup> *Randolph* (supra note 8), at 3.2.

## VI. Special Rules for Foreign Investment Enterprises

For foreign investment enterprises there are some special rules concerning the ways to obtain land-use rights.<sup>260</sup> Furthermore, there is a special type<sup>261</sup> of granted land-use right for developing Large Tracts with Foreign Investment.

### 1. Ways to obtain Land-use Rights

Land-use rights can be obtained by foreign investment enterprises only against compensation. In fact, the system of compensated land-use has been especially introduced for foreign investors.<sup>262</sup>

There are different ways to obtain land-use rights for foreign investment enterprises: A “lease” from the State (1), via investment contribution by the Chinese Partner of a Sino-foreign JV (2), by a regular grant (3) or by acquiring a land-use right on the secondary market (4). Since these methods vary to some degree for the different enterprise forms, these forms shall be quickly introduced first.

### Background: Enterprise Forms

Foreigners can invest in China using three different enterprise forms: Sino-Foreign Equity Joint Ventures (Equity JVs), Sino-Foreign Co-operative Joint Ventures (Co-operative JVs) and Wholly Foreign-owned Enterprises (WFOEs).

An Equity JV is a Chinese company with its own legal identity set up by a Chinese and a foreign partner. Profits, risks and losses are shared according to the proportion of their contributions.<sup>263</sup> They are governed by the “Law of the People’s Republic of China on Sino-foreign Equity Joint Ventures” (EJV-Law)<sup>264</sup> and the corresponding “Regulations for the Implementation of the Law of the People’s Republic of China on Sino-foreign Equity Joint Ventures” (EJV-Regulations).<sup>265</sup> According to art. 5 para. 3 EJV-Law land-use rights might be used as an investment contribution by the Chinese partner to the JV. Otherwise the JV is required to pay a land-use fee to the government.

<sup>260</sup> *Zhen* (supra note 15), p. 197. This is illustrated by art. 85 Land Management Law, which states that “This Law will apply to the use of land by sino-foreign equity joint ventures, sino-foreign cooperative joint ventures and foreign-funded enterprises; where laws stipulate otherwise, those provisions will prevail”.

<sup>261</sup> *Randolph/LOU* (supra note 14), p. 142.

<sup>262</sup> *Zhen* (supra note 15), p. 198.

<sup>263</sup> Art. 4 and 1 EJV-Law (supra note 24).

<sup>264</sup> Supra note 24.

<sup>265</sup> “Zhonghua Renmin Gongheguo zhongwai hezi jingying qiye fa shishi tiaoli”, September 20<sup>th</sup>, 1983, revised December 21<sup>st</sup>, 1987, latest revision July 22<sup>nd</sup>, 2001, Chinese-English in: CCH Business Regulation ¶6-550.

Co-operative (or Contractual) JVs, on the other hand, are a more flexible form of a JV. They do not necessarily have to have a separate legal identity and the distribution of profits, risks and losses is primarily decided by the contract.<sup>266</sup> They are regulated by the “Law of the People’s Republic of China on Sino-foreign Co-operative Enterprises” (CJV-Law)<sup>267</sup> and the corresponding “Detailed Rules for the Implementation of the Law of the People’s Republic of China on Sino-foreign Cooperative Enterprises” (CJV-Rules).<sup>268</sup> According to art. 8 CJV-Law and art. 18 CJV-Rules the land-use right can be an investment contribution by the Chinese partner or a condition of co-operation.

Wholly Foreign-owned Enterprises are Chinese companies with their own legal identity, fully owned by foreign investors.<sup>269</sup> They are governed by the “Law of the People’s Republic of China Concerning Enterprises with Sole Foreign Investment” (WFOE-Law)<sup>270</sup> and the corresponding “Detailed Rules for the Implementation of the Law of the People’s Republic of China on Wholly Foreign-owned Enterprises” (WFOE-Rules).<sup>271</sup> They can acquire land-use rights after paying a land-use fee to the State.<sup>272</sup>

When being involved in real estate development these companies also have to comply with the requirements for real estate development companies, and especially have to have sufficient registered capital and personnel for their business.<sup>273</sup>

### a) “Lease” from the State

One possibility to obtain a land-use right for foreign investment enterprises is by “lease”<sup>274</sup> from

the State. This requires an application for the land-use with the Land Administration Department. If the application is approved, a yearly fee has to be paid.<sup>275</sup> This method is explicitly possible for Equity JVs and WFOEs.<sup>276</sup> In practice, Co-operative JVs can also use this method, although there is no explicit provision in the CJV-Law or the CJV-Rules.<sup>277</sup>

This method of “leasing” from the State differs in some aspects to allocation or granting. With respect to allocated land-use rights one difference<sup>278</sup> lies in the existence of a contract about the land-use.<sup>279</sup> The contract contains a specific term for the land-use, which is usually the same as the term of the enterprise’s operation.<sup>280</sup> Further differences exist with regards to the fee:<sup>281</sup> Technically, the user of allocated land does not have to pay for the land-use itself. He only has to pay possible development and expropriation costs.<sup>282</sup> In case of a “lease”, however, the fee also includes the commercial interests of the State as landowner.<sup>283</sup> This difference is however minimal, since users of allocated land also have to pay a land-use tax, which is a substitute for the land-use charges.<sup>284</sup>

The main difference to granted land-use rights in the past has been the restricted transferability of “leased” land-use rights.<sup>285</sup> According to art. 53 of the old EJV-Regulations the assignment of land-use rights was forbidden.<sup>286</sup> In July 2001, however, this provision has been repealed, so that land-use rights “leased” by Equity JVs should now be transferable.<sup>287</sup> The same should be true for Co-operative JVs, as there never was an explicit restriction in the first place. A slight difference only remains for land-

<sup>275</sup> *Zhen* (supra note 15), pp. 199 – 200. See art. 49 EJV-Regulations.

<sup>276</sup> Art. 44 EJV-Regulations and art. 34-36 WFOE-Rules; *Zhen* (supra note 15), p. 199, who also refers to art. 6 “Interim Provisions on the Use of Land for Construction by Chinese-Foreign Joint Ventures” (Guanyu zhongwai heying qiye jianshe yongdi de zanxing guiding), July 26<sup>th</sup>, 1980, English in: Institute of Chinese Law (Editor), Statutes and Regulations of the People’s Republic of China, Hong Kong 1987 et seq., 800726.2.

<sup>277</sup> *Zhen* (supra note 15), p. 200; *Randolph/LOU* (supra note 14), p. 112.

<sup>278</sup> See *Randolph/LOU* (supra note 14), p. 112 footnote 107.

<sup>279</sup> Art. 44 EJV-Regulations. Co-operative JVs and WFOEs usually enter into contracts as well, see *Randolph/LOU* (supra note 14), p. 112 including footnote 109.

<sup>280</sup> Art. 40 WFOE-Rules; *Randolph/LOU* (supra note 14), p. 114 including footnote 114; *Zhen* (supra note 15), p. 201, who also refers to art. 9 para. 2 “Interim Provisions on the Use of Land for Construction by Chinese-Foreign Joint Ventures” (supra note 276).

<sup>281</sup> Art. 44 EJV-Regulations and art. 36 WFOE-Rules.

<sup>282</sup> See supra C.I.

<sup>283</sup> *Zhen* (supra note 15), p. 200.

<sup>284</sup> *Randolph/LOU* (supra note 14), p. 115.

<sup>285</sup> *Randolph/LOU* (supra note 14), p. 115 footnote 116.

<sup>286</sup> Art. 53 EJV-Regulations.

<sup>287</sup> Compare *Fengwen Jiang*, Expansion of Trading Rights for FIEs: Further Steps in China’s WTO Accession, in: *China Law and Practice*, Vol. 15 (2001), No. 8, p. 44, who states that the provisions on the acquisition and transfer of land use rights, which have been amended, were outdated or inconsistent with current PRC laws.

<sup>266</sup> Art. 2 CJV-Law (infra note 267). See *Zhang* (supra note 29), at no. 23.

<sup>267</sup> *Zhonghua Renmin Gongheguo zhongwai hezuo jingying qiye fa*, April 13<sup>th</sup>, 1988, latest revision October 31<sup>st</sup>, 2000, Chinese-English in: CCH Business Regulation ¶6-100.

<sup>268</sup> *Zhonghua Renmin Gongheguo zhongwai hezuo jingying qiye fa shishi xize*, September 4<sup>th</sup>, 1995, Chinese-English in: CCH Business Regulation ¶6-105.

<sup>269</sup> Art. 2 and 8 WFOE-Law (infra note 270).

<sup>270</sup> *Zhonghua Renmin Gongheguo waizi qiye fa*, April 12<sup>th</sup>, 1986, revised October 31<sup>st</sup>, 2000, Chinese-English in: CCH Business Regulation ¶13-506.

<sup>271</sup> *Zhonghua Renmin Gongheguo waizi qiye fa shishi xiye*, December 12<sup>th</sup>, 1990, re-promulgated April 12<sup>th</sup>, 2001, Chinese-English in: CCH Business Regulation ¶13-507.

<sup>272</sup> *Zhen* (supra note 15), p. 198.

<sup>273</sup> Art. 29 Urban Real Estate Law and art. 5 “Administrative Rules on Urban Real Estate Development Operations” (Chengshi fangdichan kaifa jingying guanli tiaoli), July 20<sup>th</sup>, 1988, Chinese-English in: CCH Business Regulation ¶19-595. *Randolph/LOU* (supra note 14), p. 331; *Pei* (supra note 191), at 12.02.

<sup>274</sup> Some authors classify them as „allocated“ land-use rights, see *Pei* (supra note 191), at 5.02 – 5.03. Also *Randolph/LOU* (supra note 14), p. 115, who hesitated though because of the differences (p. 112 footnote 107). Due to those differences, the author prefers to use the term “lease”.

use rights “leased” by WFOEs. According to art. 35 WFOE-Rules their land-use rights cannot be assigned without prior approval during their terms of operation. But even for Equity JVs some differences to granted land-use rights remain. While users of granted land pay a lump sum fee, the fee for “leased” land-use rights by Equity JVs is to be paid annually, and can be adjusted during the term of the contract.<sup>288</sup> Furthermore, the term of “leased” land-use rights is more closely connected to the continuation of the enterprise.<sup>289</sup> The same should apply for Co-operative JVs, although there is no explicit rule stating that.

### b) Investment Contribution of the Chinese Partner

In case of an Equity or Co-operative JV the JV can acquire the land-use right of the Chinese Partner as his investment contribution.<sup>290</sup> The foreign investor as part of the JV is then automatically entitled to use the land,<sup>291</sup> without having to pay any land usage fees to the government.<sup>292</sup> But the land-use is not truly free for the foreign investor. While the value of the contributed land-use right has to be equivalent to the usage fee for “leasing” the right to use a similar site in the case of Equity JVs,<sup>293</sup> the parties of a Co-operative JV can determine the value of the land-use right by themselves, and do not have to do so in currency terms.<sup>294</sup> Nevertheless, the contribution has a certain value for which the investor pays with his contribution. Thus, the foreign investor does not pay directly, but usually indirectly for the land-use right.<sup>295</sup>

#### aa) Allocated and Granted Land-use rights

Traditionally, only allocated land-use rights could be contributed, as granted land-use rights did not exist before 1987.<sup>296</sup> But even afterwards it has been argued that only allocated land-use rights could be contributed, because JVs could not assign their land-use rights.<sup>297</sup> This reasoning is not

convincing however, since it turns legal effects into legal conditions. Now that land-use rights of Equity JVs can be transferred, this point of view is certainly outdated. Therefore, the Chinese partner can contribute land-use rights, which have been either allocated or granted to him.<sup>298</sup> This would be confirmed by art. 149 of the new Draft of Property Law, which allows the contribution of land-use rights without differentiating between allocated and granted ones.

When allocated land is contributed to a JV, the Chinese party is obliged to complete supplementary procedures and has to pay a fee.<sup>299</sup> This is because allocated land-use rights, which were traditionally free and without time restriction, are now commercialised.<sup>300</sup> The fee is equivalent to the total amount of the fee the JV would have to pay when “leasing” the right.<sup>301</sup>

Although the contribution of allocated or granted land-use rights can be financially beneficial for the partners, they are not obliged to the contribution. They may alternatively choose to pay the Chinese government for the land use.<sup>302</sup>

#### bb) Transferability and Duration

In the past, JVs could not transfer, mortgage or lease contributed land-use rights.<sup>303</sup> However after art. 53 EJV-Regulations was repealed in 2001, the assignment of these rights is now possible,<sup>304</sup> provided the contributed right itself is transferable.<sup>305</sup> This is certainly the case for granted land-use rights. The JV therefore has the right to transfer, lease or mortgage them.<sup>306</sup>

Allocated land-use rights, on the other hand, can generally not be transferred.<sup>307</sup> They could however have become transferable as a result of the contribution. According to art. 40 “Provisional Measures on Administration of Allocated Land Use Rights”<sup>308</sup>,

<sup>298</sup> *Wan/Pu/Chang/Qu* (supra note 293), at 6-025 – 6-035.

<sup>299</sup> *Wan/Pu/Chang/Qu* (supra note 293), at 6-030 and 6-065 with reference to art. 9 of the “Administrative Measures of the Shanghai Municipality on the Use of Land by Foreign Investment Enterprises”, June 21<sup>st</sup>, 1996, Chinese-English in: CCH Special Zones & Cities ¶92-090.

<sup>300</sup> *Zhang* (supra note 29), at no. 22.

<sup>301</sup> *Zhen* (supra note 15), p. 203; *Wan/Pu/Chang/Qu* (supra note 293), at 6-030.

<sup>302</sup> Art. 5 para. 3 EJV-Law; see also *Randolph/LOU* (supra note 14), p. 113.

<sup>303</sup> *Wan/Pu/Chang/Qu* (supra note 293), at 6-030.

<sup>304</sup> Compare *Jiang*, (supra note 287), p. 44, who states that the provisions on the acquisition and transfer of land use rights, which have been amended, were outdated or inconsistent with current PRC laws.

<sup>305</sup> Compare *Zhen* (supra note 15), p. 108, who states that one can usually not acquire more than what can be sold.

<sup>306</sup> *Wan/Pu/Chang/Qu* (supra note 293), at 6-035.

<sup>307</sup> Art. 44 Land-use Right Regulations.

<sup>308</sup> Huabo tudi shiyongquan guanli zhanxing banfa, March 8<sup>th</sup>, 1992, Chinese-English in: CCH Business Regulation ¶14-713.

<sup>288</sup> Art. 49 EJV-Regulations.

<sup>289</sup> Art. 40 WFOE-Rules; *Zhen* (supra note 15), p. 201, who also refers to art. 9 para. 2 “Interim Provisions on the Use of Land for Construction by Chinese-Foreign Joint Ventures” (supra note 276).

<sup>290</sup> Art. 5 para. 3 EJV-Law, art. 8 CJV-Law and art. 18 CJV-Rules; *Guo Guang*, Rechtsfragen der Gründung und des Betriebs von Joint Ventures in der Volksrepublik China, Berlin 1998, p. 68. Art. 149 Draft of Property Law.

<sup>291</sup> *Zhang* (supra note 29), at no. 22.

<sup>292</sup> *Zhang* (supra note 29), at no. 20.

<sup>293</sup> Art. 45 EJV-Regulations.; *Isabelle Wan/Zhang Pu/Jesse Chang/Philip Qu*, A Professional’s Guide to PRC Land Legislation, Hong Kong 2001, at 6-030; *Zhen* (supra note 15), p. 203.

<sup>294</sup> *Zhang* (supra note 29), at no. 23.

<sup>295</sup> *Zhen* (supra note 15), pp. 202 – 203.

<sup>296</sup> *Randolph/LOU* (supra note 14), p. 110 footnote 103.

<sup>297</sup> *Zhen* (supra note 15), p. 203.



promulgated on March 8<sup>th</sup>, 1992, the contribution of an allocated land-use right to a JV is deemed as a transfer of this right. Although this is not absolutely clear,<sup>309</sup> this provision should also be applicable for the Chinese partner of an Equity or Co-operative JV. It has been argued that allocated land-use rights are therefore converted into granted land-use rights during the process of contribution.<sup>310</sup> After the contribution these land-use rights should therefore be transferable.<sup>311</sup>

It has been argued that, once converted into a granted land-use right, the duration of the right could also no longer be connected to the continuation of the JV.<sup>312</sup> If the grant has not expired at the time the JV ceases to exist, it seems appropriate that the land-use right is not automatically returned to the State, but to the contributing partners.

### c) Granted Land-use rights

According to art. 3 Land-use Right Regulations all enterprises – including those with foreign investment – can also obtain regular granted land-use rights from the State.<sup>313</sup>

### d) Acquisition of Granted Land-use rights on the Secondary Market

Foreign investment enterprises can also acquire granted land-use rights by transfer from another party, including the Chinese Partner of the Equity or Co-operative JV.<sup>314</sup>

### e) Summary and Comparison

The four ways to obtain land-use rights for foreign investment enterprises differ in some aspects. First of all, the content of the obtained rights can be different. Granted land-use rights can be transferred, leased or mortgaged. In the past, the other land-use rights (“leased” or contributed land-use rights) only gave the right to possess and use the land.<sup>315</sup> However, after art. 53 EJV-Regulations has been repealed, the possibilities to transfer, lease and mortgage land-use rights, which have been “leased” from the State or contributed to the JV, have significantly increased.

Secondly, the duration of the land-use rights may vary. The terms of granted land-use rights are governed by the granting contract and are limited by art. 12 Land-use Right Regulations. “Leased” land-use rights are connected to the existence and continuation of the enterprise. In case of a JV-contribution, granted and converted land-use rights should be returned to the contributing partners rather than the State when the JV ceases to exist.

Finally, the costs of the land-use rights are different. The fees for the “lease” from the State and the investment contribution are regulated by law and usually fairly low.<sup>316</sup> The fee for granted land-use rights, on the other hand, is to be paid up front and determined by the market. Thus, it is usually considerably higher.<sup>317</sup>

In recent years land-use rights are acquired more and more as granted rights from the State or by transfer. Only in provinces with few investments the other methods (“lease” and contribution) are still frequently used.<sup>318</sup> As the land reforms are not finished yet, it can be assumed that the different ways of obtaining land-use rights will continue to co-exist in the coming years.<sup>319</sup>

## 2. Land-use rights for developing Large Tracts of Land with Foreign Investment

In order to develop infrastructure facilities the Chinese government has adopted a policy to attract foreign investors to develop large tracts of land. This is because neither the central nor the local governments have sufficient funds to quickly improve infrastructure facilities (like water supply, electricity, roads and communications facilities) necessary for foreign investment.<sup>320</sup> To solve this problem, long-term land-use rights for large tracts of land can be granted to foreign enterprises under the “Provisional Administrative Measures governing Commercial Land Development and Management by Foreign Investors” (Land Development Measures).<sup>321</sup> The application of these measures are limited to the open coastal cities and specified economic zones<sup>322</sup> and complemented by many municipal regulations.<sup>323</sup>

<sup>309</sup> *Zhen* (supra note 15), p. 203.

<sup>310</sup> See *Zhen* (supra note 15), pp. 203 and 205. Also see *Stricker* (supra note 183), p. 14.

<sup>311</sup> Compare *Zhen* (supra note 15), p. 204.

<sup>312</sup> *Zhen* (supra note 15), p. 203.

<sup>313</sup> *Zhen* (supra note 15), p. 204.

<sup>314</sup> *Zhen* (supra note 15), p. 204; *Wan/Pu/Chang/Qu* (supra note 293), at 6–40.

<sup>315</sup> *Zhen* (supra note 15), p. 205.

<sup>316</sup> *Zhen* (supra note 15), pp. 205 – 206.

<sup>317</sup> *Zhen* (supra note 15), p. 206.

<sup>318</sup> *Zhen* (supra note 15), p. 204.

<sup>319</sup> *Zhen* (supra note 15), p. 206.

<sup>320</sup> *Pei* (supra note 191), at 5.09.

<sup>321</sup> *Waishang touzi kaifa jingying chengpian tudi zanzing guanli banfa*, May 19<sup>th</sup>, 1990, Chinese-English in: CCH Business Regulation ¶14-723.

<sup>322</sup> Art. 18 Land Development Measures.

<sup>323</sup> *Pei* (supra note 191), at 5.09.

## a) Rights and Obligations

After obtaining the land-use right, the investor is obliged to provide the land with the basic infrastructure needed for further industrial or other construction purposes.<sup>324</sup> Once these basic facilities are developed, the investor has the right to either transfer his land-use right to others or to proceed with further development, such as constructing industrial buildings and supporting facilities for production and residence.<sup>325</sup> He should then engage in the business of transferring or leasing these buildings.<sup>326</sup> In order to carry out such development, the foreign investor is required to form an Equity or Co-operative JV or WFOE.<sup>327</sup> These development enterprises enjoy autonomy over their business operations and their relationship to other enterprises is of commercial nature.<sup>328</sup>

## b) Grant

The grant of the land-use right to the development enterprise requires a written contract that specifies the bounds of the tract of land, the term and purpose of the use as well as the granting fee. It also needs to be approved by the relevant authorities according to the amount of land and the approval power of each administrative level.<sup>329</sup> Each development and construction project is controlled by a comprehensive planning system. All projects have to have clearly specified development objectives at the outset as well as definite construction projects after the primary development.<sup>330</sup>

## c) Transferability

The land-use right can only be transferred after the development enterprise has carried out the development according to the plan, and has satisfied all conditions of the contract.<sup>331</sup> Regional legislation determines in more detail, when the development according to the plan is completed. In Beijing, for example, the total amount of the land fees and 25 % of the total investment have to be paid, the land-use certificate and building permit have to be obtained and the construction plan must

be approved, including the speed of construction and a fixed final date of completion.<sup>332</sup> The transfer, mortgage and termination of the land-use right is handled in accordance with the laws and regulations on the administration of land.<sup>333</sup>

## VI. Conclusion

In China the State owns all urban land, but individuals and organisations can obtain land-use rights. In the last decades these land-use rights have been more and more commercialised. This has resulted in a growing importance of granted land-use rights, especially for foreign investors. Generally, they can obtain land-use rights only for a certain period and against payment of a fee. As the latest development, government-controlled land can only be obtained by auction or public tender. At the end of the term granted land-use rights are automatically reacquired by the State without compensation. This also applies to the buildings previously owned by the land user, which creates an economic incentive not to construct long-lasting buildings. There is no sign that this will change, should the new Draft of Property Law come into force.

The possibilities to transfer land-use rights have increased in recent years. After art. 53 EJV-Regulations has been repealed in 2001, Equity JVs can now transfer land-use rights, which have been "leased" from the State or contributed to the JV by the partners. This will further increase the importance of the secondary market. In this market the transfer, lease and mortgage of land-use rights and above-ground buildings is closely connected.

The land-use right system is a good means for the government to stay in control of land resources. The limited term of granted land-use rights allows the recycling of land-use at intervals to satisfy the community needs of about 1.3 billion people in China.<sup>334</sup> The compensation ensures constant revenue for the State, which enables it to shape the countries' future.

There are however still a number of problems in the real estate market. Besides corruption and a lack

<sup>324</sup> Art. 2 para. 1 Land Development Measures; *Zhang* (supra note 29), at no. 17.

<sup>325</sup> *Pei* (supra note 191), at 5.10; *Guang* (supra note 290), pp. 62 – 63.

<sup>326</sup> Art. 2 para. 1 Land Development Measures; *Pei* (supra note 191), at 5.10.

<sup>327</sup> Art. 4 para. 1 Land Development Measures.

<sup>328</sup> Art. 4 para. 3 Land Development Measures; *Pei* (supra note 191), at 5.14.

<sup>329</sup> Art. 5 Land Development Measures; *Pei* (supra note 191), at 5.17. Also see art. 3 para. 2, 3 Land Development Measures.

<sup>330</sup> Art. 2 para. 2 and art. 7 Land Development Measures; *Pei* (supra note 191), at 5.15.

<sup>331</sup> Art. 9 para. 1 Land Development Measures.

<sup>332</sup> *Pei* (supra note 191), at 5.19 with reference to art. 9 of the "Beijing Municipal People's Government, Real Property Development Business Using Foreign Investment Several Provisions" (Beijing Shi Renmin Zhengfu guanyu waishang touzi kaifa jingying fangdichan de ruogan guiding), enacted 20 November 1992, Chinese-English in: Patrick, Y.W. Wu (Editor), *The PRC Property Series*, Vol. III – Beijing & Northern China, Hongkong 1995, pp. 39-43.

<sup>333</sup> Art. 9 para. 2 Land Development Measures. Amongst others, this should refer to the Land-use Right Regulations.

<sup>334</sup> *CHAN Nelson* (supra note 4).

of transparency,<sup>335</sup> there is a significant amount of legal uncertainty. It is, for example, unclear under which conditions granted land-use rights can be extended and for what period of time. Furthermore there is no clear legal concept of condominiums yet. The new Draft of Property Law would clarify a few, but certainly not all of these issues.

Despite these disadvantages, a lot of investments are made in the real estate business. One important reason for this is the booming economy and currently high returns on investment.<sup>336</sup> Investments are usually fully returned long before the grants expire and legal uncertainties become relevant. Another reason for continuing legal uncertainties lies within the Chinese State-run banking system. If the lenders would be seriously profit oriented in the Chinese financial market, they would be demanding a lot more certainty.<sup>337</sup> This would be especially true for shorter-term land-use rights,<sup>338</sup> as they bear higher risks.

It will therefore be interesting to see, what happens should the Chinese economy significantly slow down. With decreasing returns on investment, the demand for certainty and efficiency is likely to increase. This might very well change some of the legislation in place today.

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<sup>335</sup> *Randolph* (supra note 27), at 2.3.

<sup>336</sup> See Shanghai's Social & Economic Development in Relation to China's Accession to the WTO (2004) - Chapter 17: The Construction and Real Estate Industry (supra note 1).

<sup>337</sup> *Randolph* (supra note 8), at 2.3.

<sup>338</sup> *Randolph* (supra note 8), at 2.3.