



JONES DAY
COMMENTARY

CHINA INTRODUCES FURTHER MEASURES TO REGULATE FOREIGN INVESTMENT IN ITS REAL ESTATE MARKET

On May 23, 2007, the Chinese Ministry of Commerce (“MOFCOM”) and the State Administration of Foreign Exchange (“SAFE”) jointly issued a new notice entitled *Notices Governing Further Strengthening and Regulating Approvals and Supervision of Direct Foreign Investment in Real Estate Sector* (“Circular 50”) to further implement the *Opinions Governing the Market Access and Administration of Foreign Investment in Chinese Real Estate Market* (“Circular 171”), issued in July 2006. Circular 50 is intended to reinforce the approval requirements, filing, and supervision of foreign investment in the Chinese real estate market. This *Commentary* will summarize Circular 50 as well as provide some comments on its potential impact on foreign investment in China’s real estate market.

RENEWED EMPHASIS ON ESTABLISHING A BUSINESS PRESENCE IN CHINA

Circular 171 requires that any foreign investor intending to purchase Chinese real estate must do so through an entity established in China. Circular 50 reiterates that in order for foreign investors (either companies or individuals) to invest in Chinese real estate development or operation, they must establish foreign-invested enterprises (“FIEs”). If the established FIEs intend to expand their business into real estate development or operation, they are required to obtain approvals from the relevant approval authorities, *i.e.*, MOFCOM or its local branches. The higher registered-capital requirements for foreign-invested real estate enterprises (“FIREs”) under Circular 171 and the

implementation notices issued by the General Office of the MOFCOM on October 25, 2006, remain the same, *i.e.*, a FIRE must have registered capital representing no less than 50 percent of its total investment amount, if the total investment amount is US\$3 million or above.

MORE RESTRICTIVE PRECONDITION FOR ACQUISITION OF LAND-USE RIGHTS

Under Circular 50, foreign investors are required to acquire land-use rights (or at least the right to acquire land-use rights) or building ownership before applying to set up a FIRE development company in China. This is slightly more restrictive than Circular 171, which allows a FIRE to obtain land-use rights or property ownership. The payment of the land premium will therefore need to be made before the foreign investor applies to set up its FIRE in China in order to develop the land.

CONFIRMATION OF PROHIBITION OF FIXED-RETURN ARRANGEMENTS

Circular 50 confirms the requirement under Circular 171 that in the event the FIRE is in the form of a Sino-foreign joint venture (“SFJV”), the parties to the SFJV must not guarantee direct or indirect “fixed returns” to any party in their joint-venture contract or any other investment documents.

ROUND-TRIP INVESTMENT

Circular 50 restricts local developers from disguising themselves as foreign enterprises by setting up offshore parent companies and thus reinforces the government’s control

over mergers and acquisitions or investment in domestic real estate enterprises by way of round-trip investment. “Round-trip investment” refers to investment from offshore special-purpose vehicles invested or controlled by Chinese enterprises or individuals. In addition, Circular 50 expressly prohibits any disguised change of control over domestic real estate enterprises by way of overseas equity transfer to evade the examination and approval procedures. Further, SAFE and its local branches may impose sanctions on any disguised establishment of FIRE companies and their outward foreign currency payment and any profits derived from such disguised investment in the Chinese real estate market.

FILING WITH MOFCOM

Foreign investors are now subject to an increased approval risk, as Circular 50 requires that any approvals from local approval authorities for setting up FIREs must be immediately filed with MOFCOM. In fact, the requirement for filing with MOFCOM is a reiteration of a long-held internal practice rather than a brand-new stipulation, as the predecessor of MOFCOM (the Ministry of Foreign Trade and Economic Cooperation) required approvals for any encouraged FIEs to be filed centrally. Under Circular 50, MOFCOM must now be notified of every real estate investment by a FIRE. This will no doubt make the procedures for foreign investment in Chinese real estate more complicated, and certainly the process will be greatly slowed because foreign exchange administrations and banks must not permit any capital remittance overseas for FIREs that have not completed the required filing with the MOFCOM. It would seem, therefore, that MOFCOM is taking a more active role in supervising foreign investment in real estate. However, the specific filing procedures and the detailed documentation requirements for FIREs still remain to be further interpreted by the authorities.

CONCLUSION

Circular 50 is additional confirmation of the intention of the Chinese government to reinforce and supervise foreign investment in China's booming real estate market, especially high-end real estate development. It is unlikely that Circular 50, even when read with Circular 171, will slow the pace of foreign investment in China's real estate market, but it might give new entrants pause for thought, since they will encounter more difficulties in acquiring Chinese real estate.

These are clearly uncertain times for foreign investors in Chinese real estate, yet many believe that the underlying value in the market is too great to ignore. Thus, notwithstanding the "cooling" measures adopted by China's government in Circular 50 and the previous Circular 171, it is unlikely that foreign investment in Chinese real estate will slow dramatically any time soon.

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