Steps and Procedures of Selling Residential Properties in China

Description

Very often, we help foreign clients to sell their China properties after they inherit estate properties in China. Indeed, this has been a big part of my team's legal practice for over a decade. We don't just sell properties in Shanghai, but also in Beijing, Shenzhen, Guangzhou, and occasionally in Chengdu, Kunming, Suzhou and other cities as well.

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While most clients trust us and follow our advice in getting the sale done, sometimes, foreign clients may have difficulties in understanding the way property transactions are conducted in China. For example, recently, a client from USA kept saying it is too risky to effect title transfer before receiving full contract price for the property in question, and we really had a hard time to convince her to believe this is the standard way of transacting a real property deal in China.

So it is worth a post to delineate and outline the steps and procedures of selling a property in China. While each city may have some special rules, at large, the steps and procedures are much the same for most cities in China.

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1. Listing Property in the Market

Unlike the North America, China doesn't have a national MLS to promote sale of properties, and instead, sellers always list the properties with realtors firms in the neighborhood. Those realtors will promote the properties on their office windows, online web portals. This is the effective way of promotion because buyers in China generally visit the neighborhood for property listing information where they wish to buy their properties.

Realtors firms tend to ask for exclusive listing with their firm. By "exclusive", it means that other realty firms cannot promote the properties directly for the owners/sellers, and instead, other firms shall have to work with the exclusive realty firm to sell the properties. The advantage of this exclusivity arrangement is that the owner doesn't have to deal with many realtors that can be a big headache by picking up too many phone calls before picking up the final buyer. On the other hand, the disadvantage is obvious: sellers may not be able to find the best offer through the exclusive agent who may intentionally suppress the price in order to make a quick deal.

In practice, once clients hire our services, we always list the property with multiple realtor firms in the neighborhood, and sometime within hours, many calls start coming in.

2. Entering into Letter of Intent or Three-Party Preliminary Agreement

Out of hundreds of calls from different agents, you will always be lucky to have some interested buyers showing up. Realtors generally ask the interested buyer to put down a small amount of earnest money (saying RMB 10,000 – 50,000 depending on the total price of the deal) with the realtor firm, and the realtor will present the offer to the seller.

If major terms (sometimes such terms could be as detailed as those in final contract) are agreed, a preliminary agreement is usually signed among the seller, buyer and the realtor firm.

The primary reason for signing such an agreement is to secure the deal by way of a legal written document before the formal contract is signed. Sometimes, the buyer may need a bit time to get ready the amount of down payment and such agreement affords such time cushion. Since such agreement contains all major terms for the sale of the property, courts will enforce the agreement if one party commits breaches thereunder, despite that such agreement is not acceptable to local real estate registration authority for purpose of transferring title of the property to the buyer.

Please be advised that such a preliminary agreement may not be necessary if the buyer and seller can immediately agree on all the terms and the buyer is financially ready to commence the transaction.

3. Concluding the Official Sale and Purchase Contract and Supplementary Agreement

After the conclusion of the preliminary agreement, it generally takes a few days or a couple of weeks before the parties sign the official and formal sale and purchase contract to finalize their deal.

In almost every municipal city in China, local real estate authority has their official version of sale and purchase contract that must be adopted for purpose of effecting title transfer to the new buyer. The reason is simple: to save time for real estate registration authority to process each deal by standardizing deal terms and streamlining the deal process.

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But in reality, very often, there are always peculiar situations that are not adequately addressed in those official contracts, and thus there is always a side supplement agreement to be signed at the same time of signing the formal contract. In such supplement agreement, you will often see clauses like the following:

(1) Lowering the price in the official contract. As a way to help both parties to reduce tax burden, the parties often agree to lower the price in the official contract which is the price for the governments to assessing the taxes on both parties. Of course, the parties cannot go too far to insert an ridiculously low price in the official contract, since local tax authority always has their own benchmark prices for each properties in their jurisdiction.

As a foreigner owner selling properties in China, we generally don’t advise clients to do that because that will affect the amount of money the foreigner owners can repatriate out of China.

(2) payment of taxes. Very often, to save the trouble of foreigner owners to send money back to China to pay their part of the taxes, it can be arranged that the buyer will pay the taxes that are supposed to be paid by the sellers, and deduct the same amount of money from the sale price.

(3) settlement of contract price offshore. Strictly speaking, it is illegal to settle China transaction in foreign exchanges outside China. However, occasionally the foreigner sellers may need foreign

exchange money to pay off their mortgage loan denominated in USD for their China properties, and when buyers have some foreign exchange fund out of China, it is always sensible for the buyers to help the sellers to clear the mortgage on their properties first as required by the law (With China Civil Code to come into effect the day after tomorrow, such practice may change).

(4) though in most cases, sellers will only hand over properties to the buyers after receiving the full value for the properties, but sometimes buyers may require earlier handover for purpose of early renovation. The parties may wish to set out special clauses for such special arrangements.

There could be other reasons for such supplement agreements.

4. Escrow Arrangement

While escrow arrangement in property transactions is customary practice in western countries, it is nonetheless not always used in China. For example, in Shanghai, people don't really use escrow account at all. Earnest money and down payment are always paid into the seller's account directly.

In some other cities in China, they have compulsory requirement to utilize escrow arrangement to ensure the safety of the transactions.

5. Buyers Applying for Bank Loan

Though buyers should have talked with their banks about availability of bank mortgage loan, the paperwork shall only start after the execution of the official contract. Only when the buyer's loan is approved by the bank will the parties apply for title transfer at real estate registration center.

When a buyer needs mortgage loan financing from the bank, it is critical that the loan will be approved and honored by the banks. In practice, seldom does any bank default on their approved loans. So once the loan is approved by the bank, the seller should feel secure to proceed to transfer the title to the buyer.

As a practice in real estate transactions, typical contracts always requires that the buyer shall make up in cash for any shortfall of bank approved loan, and such cash shall be paid before or upon the day of title transfer.

6. Seller Clearing Mortgage Loan on the Properties

As mentioned above, if the seller still has unpaid mortgage loan on their properties, it is required that such mortgage loan shall be paid off before the seller can sell the property. Therefore, after the signing of the official property sale and purchase contract, sellers shall apply to prepay their outstanding mortgage loan.

While China Civil Code now allows properties to be transferred with mortgage on, it remains to be seen how banks will react to such new rules. However, as a matter of contract law, the seller's transfer of title doesn't transfer the mortgage obligation automatically to the buyer. Thus, banks may only require the sellers to prepay the outstanding mortgage loan before the title transfer becomes possible.

7. Title Transfer

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Once the down payment is made upon signing the official contract, and buyer's application for mortgage loan approved, and seller's existing mortgage deregistered, then it is time when the parties apply to local real estate registration center to effect title transfer to the buyer.

Here is often a point leading to worry and concern to foreign owners of China properties. They cannot believe that before receiving the full price of their properties they are now transferring title to the buyer. Well, it does make sense to many foreigners who are familiar with their home countries practice, but things are just different across borders.

8. Payment of Taxes and Issuance of New Title Deed

Taxes are unavoidable in property transactions, though there may be exemptions available to either sellers or buyers.

Taxes shall have to be paid and cleared before the new title deed is issued to the buyer. In practice, in about a week time after submission of documents for title transfer to real estate authority, the parties shall go to tax authority to pay their respective taxes.

Taxes can be complicated in most countries. China is no exception. When it comes to taxes on property transactions.

(1) Residential properties differ a lot in taxation from commercial properties. The latter carries a lot more and heavier taxes.

(2) Residential properties are divided into two categories: ordinary properties and non-ordinary properties, which shall be decided considering local applicable standards. Heavier taxes attach to non-ordinary residential properties.

(3) Generally, a seller of residential property is imposed with two taxes: VAT tax and personal income tax. VAT is based on the difference between sale price and original purchase price, and personal income tax is either levied on the same difference or on the total value with a lesser rate. A buyer of residential property ought to pay the deed tax, which varies from 1.5% to 3% depending on size and category (ordinary or non-ordinary) of the said property.

As mentioned above, in practice, sellers often ask the buyers to pay VAT and income taxes shifting such costs to the buyers. However, at the end of day, such costs are all reflected in the negotiation of the final prices. Foreigners may be confused on this but again the Chinese people have their own way of doing things.

Once taxes are paid, the real estate authority will issue the title deeds to the buyers on the same day of tax payments.

9. Release of Bank Loans to Sellers

Till now, the deal is not done yet as the seller has not received the full price in case that the buyer relies on a mortgage loan to finance his or her purchase.

Banks shall only release the loan proceeds after the property is mortgaged (hypothecated) to the bank.

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If the bank defaults, then it is the liability of the buyer to the seller.

Now, the tricky part is about release of the mortgage loan proceeds obtained by a buyer in such a property deal. The mortgage loan is applied for by the buyer and normally it is supposed to be paid to the buyer. In practice, the loan money doesn't stay long with the buyer borrower but is swiftly paid to the seller after hitting the account of the buyer. In other words, the buyer borrower doesn't have any chance to manage the fund in his or her account before the money leaves for the seller. It is in this sense that the sellers can be assured that they will receive the mortgage loan proceeds in due course.

10. Handover of the Property to Buyer

Finally, it is time to hand over the property from seller to buyer once the full price is paid to the seller.

In some cases of property transactions, such as sale of garden villa properties in Shanghai, a more complicated issue of paying land grant fee to local government can be involved, a process seldom handled by most realtors. Since it is only exceptional, we won't write much about it here.

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