

China real estate scandals: the lesson you should learn when investing in real estate projects

Description

No one will dispute the fact that real estate industry is one of the most dirty and corrupt industries in China. Any worse one? A slew of scandals in real estate sector exposed recently in media has cemented the above statement.

1. An official from local Minhang District government of Shanghai Municipality was discovered to be engaged in illegal business activities in which his wife and son set up a real estate development company to develop a piece of land in the jurisdiction he oversaw. Later it is found that the originally approved plot ratio of this development project was increased from 1.2 to 1.49, which resulted in an increased sellable construction area of 20,571 square meters which will further translated into RMB 100 millions profits. Strictly speaking, the increased part of construction shall be deemed as illegal construction which shall be subject to government penalty.
2. Another development project in Xiamen city, Fujian province has bred more than 300 lawsuits ever since its completion back in 2,000. The main problem arose from the calculation of size of the common area of that condominium, *namely*, whether the transfer floor should be included in the common area. Stupidly, the local real estate authority denied its own calculation of common area back and forth. Such self-denial by the authority had sparked many owners that had bought units in the condo to sue the developer. More ridiculously, local courts delivered contradictory judgments which made the fights more complicated.
3. One boss of the real estate developer company in Wenzhou made off with around RMB 400 millions that are the pre-sale proceeds of the development project which is not completed yet. Buyers besieged the China Construction Bank that supervised the deposits demanding explanation why the money can be withdrew by the fleeing boss.
4. The latest and most shocking news is that the local zoning and land bureau in Shenzhen, the metropolis booming city bordering Hong Kong, issued a penalty ruling in which the authority confiscated a commercial plaza which is said to be worth RMB 6 billions. This confiscation is believed to be the aftermath of the fall of the former party secretary of the city, Xu Zongheng who was put under investigation into his corruption, and the boss of this developer of the plaza is also detained in conjunction with the alleged corruption of disgraced party secretary. It is a piece of shocking news because there has never been heard of a penalty involving such a big amount of money, but further more, the penalty is challenged with respect to its legality and reasonableness.

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This list does not have an end.

With many foreign investors are still looking to invest in Chinese property market, such scandals in the real estate industry should raise the alarm about the potential risks that may associate with their

property investment. It would be more reasonable to believe that there is bribery, graft or other type of corruption behind those glamorous facades of real estate projects. You cannot see them with your eyes, but most likely you can find them out with your lawyers' investigation.

So the gist of this post is to tell foreign investors that you shall never put money into any real estate investment projects in China before a thorough due diligence investigation is conducted on the target property esp in the case of acquisition or leasing of a whole block or building. The DD shall start from acquisition of land use right by the developer or owner (delving into the nature of land use, proceeding of acquisition, zoning conditions of the land etc.) to detailed zoning conditions and requirements, to construction of the project, to construction areas, to mortgage and financing, to shareholders of the project developer, and to management and operation of the property operation. This is probably the primary reason why those international institutional investors burned pretty much money on legal fees when they made investment in real estate projects in China on which I was involved in conducting the DD work.

So never spare efforts in due diligence investigation when you invest in Chinese properties.

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