

# A Review of the Causes of Real Estate Cycle Formation

## -- The Case of Xi'an City

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### Abstract

**This report discusses the main problems and obstacles encountered in China's real estate development industry since the 1988 land reform and reviews the cycle of real estate development using Xi'an as an example to analyse the possible reasons for the formation of the cycle.**

### Keywords

**Real Estate Cycle Formation; Finances; Land.**

## 1. Obstacles Encountered by China's Real Estate Development Industry

Land has been playing an important role in the economy of China. Since 1978, mainland China has been adjusting the land reform in the process of Economic Reform and open up to adapt to the unique development model of China. In 1988, the State Council decided to generally implement land use fees (taxes) in cities and towns across the country. At the same time, it began to try to implement paid transfers of land use rights and regularly grant land use rights. On the one hand, real estate developers find effective ways and channels to develop real estate and seek profits, on the other hand, landowners are also aware of the economic benefits of land resources, and the real estate market is booming in mainland China. Up to now, the booming real estate market extremely promote China's economy. Concurrently, the real estate development industry is also facing the following specific problems and obstacles:

1) The development system of the real estate market is unsound. China's experience of real estate development is not long, the market is not too mature, the level of development is not balanced. At present, there is still a real estate bubble in many first-tier cities. Generally, the supply of high-end residential houses exceeds demand, while the supply of commercial and affordable housing is relatively small. Although government departments try their best to balance supply and demand through macro regulation to ensure the stable development of the real estate development industry while maintaining prices [3], there may be the lag in the policy approach, and the management approach is relatively simple. Due to the nature of society and the development situation, the real estate market in our country has a lot of government participation. So, it cannot make its own automatic adjustment and improvement according to the relationship between supply and demand, nor can it fully mobilize all resources to allocate according to the law of the market. For instance, in xi 'an in recent years, due to the continuous

rise of housing prices, the government currently only make adjustment through more and more strict purchase restriction orders. The conflicts between the short-term adjustment and sustainable development, and between guaranteed housing and commercial housing has not yet been resolved temporarily [4]. Therefore, this is also an obstacle to the in-depth development of the real estate development industry.

2) Constructive issues of affordable housing. Affordable housing has been given more attention by the government in recent years. Because of the lack corresponding regulations for supervision, the guaranteed housing cannot be accurately meet the actual demand. For many vacant affordable properties, policy set purchase limit, housing supply and a purchase demanders' work life area don't match, such as project location deviation, lack of form a complete set of public resources. Moreover, unlike the suburban commercial housing, which can be flexibly priced, for these real estates, the price and the proportion of property ownership is predetermined. Therefore, in actual transactions, if the price / performance ratio is lower than that of commercial housing, many people would abandon to purchases. For instance, in 2018, Beijing proposed a total of 32,000 sets property with shared property rights. Although house prices are 30-50% cheaper than surrounding properties, sales are still only 50%.

On the other hand, the pricing of this type of housing is not very transparent. When calculating the cost, developers may have covert deal for their own benefit, and it is difficult to verify and supervise, which makes the price of affordable housing too high for middle - and low-income families to buy. How to solve the related problems of affordable housing that are concerned in the real estate market is also a noticeable problem in the real estate development industry.

3) Investment excessive growth and high property prices. Since 1998, the investment capital of the real estate industry has been on an increasing trend. In 2003, China's urban real estate development investment accounted for 8.66% of GDP, by May 2019, nine provinces had increased by more than 60%. It is necessary for investment and prices to rise steadily to promote economic development. However, if the growth is not well controlled, the growth of real estate investment will be greater than the growth of sales, and the vacancy rate of commercial housing will rise. Once there is a bubble in real estate investment, the economy will be impacted. In terms of prices, although the government will adopt macro-control to control the housing price, for many cities, it just can reduce the price increases and make the prices has stabilized. But the price still exceeds the purchasing ability of the majority. Obviously, the housing price has always been an important issue in the real estate development industry. How to stabilize house prices and expectations in the real estate development industry, provide a reliable reference for market participants such as enterprises and buyers, and allow them to have sufficient knowledge and confidence to participate in the long-term market competition and development is a long-term concern.

4) Funds for the renovation of shantytowns in some areas. During the 13th five-year plan in China, renovation of shantytowns has always been a crucial task. In my city, Xi'an, the initial plan for urban renewal also focused on this and made great progress. During the transformation, out of concern that monetization resettlement might drive up market prices, financial institutions led by China Development Bank last year made fine-tuning of policy on monetization resettlement. However, owing to the debt burden and budget gap, some regions have postponed the implementation of compensation funds and construction for relocating households, or reduced the amount of compensation funds and the scale of resettlement housing construction. While overcoming the capital problem in the future real estate development, protecting the rights and interests of residents is also an issue that cannot be ignored.

The above are the current problems faced by the real estate development industry. Relevant departments are also constantly improving the real estate market and gradually alleviating those problems, in order to better develop the real estate industry.

## 2. The Formation of Real Estate Cycle, Taking Xi 'an as an Example

There are many different explanations for the formation of the property cycle. Mueller (1995) analyzed the relationship among vacancy rate, supply and demand, and price, as well as identified four stages of a physical real estate cycle. In addition, the relationship between physical property and financial market cycle is also proposed, and it is pointed out that capital flow has a direct impact on real estate by influencing alternative investment, capital cost and exchange rate. Leitner (1994) believes that economic cycle, demographic factors, capital transfer and investment decisions are related to the formation of construction cycle [1]. Dehesh and Pugh (2000) find the sensitivity of property cycles to international economic forms [2].

Generally, due to the external impact mechanisms such as the policy, state system, external supply demand, international policy and economic etc, and the internal impact mechanism including internal supply and demand, real estate-related industries, land prices, and talent etc, the real estate economy will fluctuate regularly during the development process, which will form a property cycle. It shows for the real estate industry economy appears alternately the expansion and the contraction stage, the recovery - the boom - the recession - the depression four links. Broadly, the property cycle is consistent with the macroeconomic cycle. However, since the macroeconomic cycle itself has impact on the real estate cycle, investors need time to observe and predict the market conditions, so there will be time gaps compared with the four stages of the macrocycle, sometimes leading and sometimes lagging.

In my city, xi 'an, judging from the real estate market situation in the last two decades, the causes of the real estate cycle in Xi'an are as follows:

1) National development strategy. In the 1990s, Xi'an real estate has just completed the initial start-up phase, beginning in 2000, the central began to implement the development of the western region in China. Affected by the policy, Xi'an rapidly promoted market improvement, people gradually accepted the commercialization of housing, market demand increased significantly.

2) The policies of domestic credit, land and finances. At present, the purchase funds of most people come from bank loans, so the tightness of bank loans directly affects the effective demand of the market, thus affecting the formation of the real estate cycle. If the supply of land is limited or the transfer is restricted, the price is bound to rise, and the rising cost is reflected in the final price of the house. For example, the reform of land transfer fee system and exchange rate system in 2004 enhanced the activity of the real estate market and ushered in the prime development period. After 2008, the state financial allocation of 4 trillion yuan to stimulate the national economy, and in terms of credit, the central bank has cut interest rates five times, not only the first home interest rate is adjusted to 30% of the benchmark interest rate, but also exempt stamp duty, land value-added tax, business tax, etc. Due to the timely adjustment of these related credit and policies, the real estate in xi 'an, which experienced the recession in 2008, recovered again and gradually entered the rising period.

3) Investment of real estate enterprises. In 2005-2007, the government has been introduced policies to slow down the development of the real estate industry and tighten credit in order to reduce the prices, the property market in Xi'an still maintained a 30% -40% annual growth in supply and sales. At this time, large foreign real estate has entered the Xi'an market, further promoting the prosperity of the Xi'an real estate market, becoming a period of rapid development of Xi'an real estate's expansion into the new urban area.

4) International economy. With the increasing frequency of international trade transactions, real estate is also very sensitive to the international economic situation. The biggest impact was the outbreak of the financial crisis in 2008, which brought Xi'an real estate into a recession and depression phase and ushered in the most difficult time in July that year. Despite the

aforementioned government stimulate development, it took a long time for Xi'an Real Estate to recover slowly.

5) Government macro-control. In addition to the credit and fiscal policies mentioned above, the government will also influence the property cycle with other policies. This is also the main cause of the current. In 2011, after the property price recovered from the depression in 2008 and continued to rise, Xi'an explicitly stipulated that residents could only buy two houses with a minimum down payment of 60%, and proposed that the increase price of new houses should not be higher than the economic and social development target and the growth rate of per capita disposable income in that year. Besides, in order to keep the prices from rising quickly, the government again issued policies requiring second-hand houses to be charged 20% personal income tax and stopped issuing loans to the third or more real estate, strictly controlling the pre-sale permit system in 2013.

Then, when the real estate market continued to decline, Xi'an cancelled the purchase restriction policy for commercial housing below 60 square meters in 2015, since September, people who purchase commercial housing in the Xi'an area will no longer declare their household registration and original housing situation, making Xi'an entered a new property cycle, prices soar up again. Two years later, when the market price increase greatly again, the purchase restriction was reinstated, the administration introduced the residents' families can only have one real estate in the main urban area, transaction property must obtain the Certificate of Immovable Property Rights and at least two years, the loans for the common reserve fund from 750,000 yuan to 650,000 yuan, etc. Further, a lottery was introduced to buy a house and the scope of purchase restrictions was expanded in respectively 2008,2009 to avoid the property bubble caused by the rapidly rise of prices, so as to maintain the mentality of property consumer and guarantee the real estate with rigid demand.

6) Population and market expectations. In 2016 and 2017, Xi'an set up an open settlement policy to attract talents. More people settled in Xi'an, demand for urban housing increased, and the real estate market naturally prospered. After Xi'an has been established as a national central city in 2018, considering the future trend, more buyers saw the development potential of the Xi'an real estate market to invest and have a stronger demand, which directly promoted the development of the real estate and prices climbed. The initial regulation did not well restrain the increasing trend, which is also the reason why the regulation policy has been more stringent since 2017.

In summary, through reviewing the fluctuation and cycle trend of real estate in Xi'an over the past two decades, the above points are the main reasons for property cycle.

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