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China's Empty Apartments

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Part I: How the real estate market got stir-fried

By Michael Gsovski

Southeast of Kunming, a new city has risen from the earth, so new that it is literally called the "Chenggong New Area." Giant complexes of towering, modern apartment buildings line the wide, recently built streets, broken every few kilometers by parks as large and as well-designed as any in Kunming proper. Every block of apartment buildings has a police sub-station, and some have functioning schools. Along the recently constructed highways linking the new city to the old, it seems as if farmland has been transformed into a high-rise commuter suburb like those on the outskirts of Hong Kong and Tokyo in less than a decade.

But something is off. Traffic passes through at a languid one to two cars a minute, about one tenth the rate of less densely built urban districts in Kunming. Unlike residential neighborhoods in most Chinese cities, no clothing stores or noodle shops are open for business. Instead, the vast majority of operating storefronts are either real estate offices or furniture stores, and their keepers only report an average of one or two paying customers a week. Most strikingly, the expected throngs of pensioners practicing tai chi and dance in the parks are nowhere to be seen.

A closer inspection explains this eerie quiet. In almost every building, anywhere from ten to sixty percent of the windows lack curtains or any other visible signs of habitation. Chenggong is a fully built city that lies half-empty. It is a modern ghost town. Yet, there are practically no "for sale" signs. The town is both fully built and fully sold.

Similar reports are coming in from all over China. In the Kangbashi neighborhood in the desert city of Ordos, housing that observers estimate can hold between 300,000 and 1 million people has been built and left virtually unoccupied. In the seaside resort city of Sanya, property prices rose 50 percent from 2008 to 2009, yet nobody knows how much of the new construction is being used. And these are only the most visible examples of a more systemic problem. While statistics in China are notoriously unreliable, Shanghai-based economist Andy Xie publicly estimated last year that China had a vacancy rate of 25 to 30 percent, roughly 10 times the amount he would consider normal. Beijing-based Dragonomics property analyst Roselea Yao put the national vacancy rate at around 20 percent, the majority in high quality, recently constructed buildings.

"The problem right now is a structural problem," Yao said. "Specifically, you have a shortage at the low end, but you have an oversupply at the high end."

All this begs the question: in a rapidly growing nation where Yao believes 140 million urban housing units are serving 200 million urban households, how can so many high-quality apartments be built and sold, but then left unoccupied?

Welcome to Chenggong. Ample parking.

He Haojun is a lawyer for the Kunming branch of the Dacheng law firm, representing corporations, developer, and investors. Mr. He can list every problem in the Chinese real estate market today. The government owns all the land, and leases it out at its discretion to earn revenue. Buyers pay more than the market value, while the people living on the land receive less, with the surplus going to local governments. If there is a problem with the government, the courts will be of no help because the judges owe their jobs to the same local officials who depend on that money. Real estate companies therefore are composed mainly of individuals well versed in negotiating with the government but with little skill and even less interest in building housing that fulfills the needs of the average person.

Mr. He has himself invested in an apartment in Chenggong, not in spite of this government interference, but because of it.

"The government wants to increase their revenue, so they have to make sure the price of land increases constantly," He said. "Under these conditions everyone must choose to invest in real estate."

This is the "stir-fried apartment," a phrase that describes apartments bought by wealthy individuals as investments, yet left empty because nobody they know is willing to pay the high rents. Many buyers understand that the market for apartments does not conform to consumer demand, but invest anyway, for two reasons. First, they need a place to store savings outside either the sclerotic banking system, which delivers returns far below the rate of inflation, or the Chinese stock market, which is notoriously volatile.

Second, they are confident that local governments will continue to drive land prices upwards as a way to raise land lease revenues.

Since only the government can own land, all individuals or corporations seeking to build on it have to pay fees to the authorities. In the absence of a real estate tax, these fees constitute the sole way for local governments to make money off real estate development. According to a report by Caixin magazine, they account for an average of 46 percent of all local government revenues.

Patrick Chovanec, assistant professor of economics at Tsinghua University, says that these incentives have been present since the beginning of “marketization” reforms in the housing market over a decade ago.

That real estate prices have since increased by “5 to 10 percent a year,” in Yao’s estimation, and never significantly decreased in this period only intensified the desire to invest. However, now Chovanec believes it has become a “classic bubble,” with prices decoupled from actual consumer demand.

“Unlike the stock market, which they know can go down, people see real estate as a secure store of value, that can only go up,” Chovanec said. “They’ve only seen the upside, they haven’t seen the downside.”

According to Chovanec, investment in real estate exploded after the global financial crisis in 2008, when the Chinese central government dictated that banks increase lending to stimulate the economy. As a result, the Chinese money supply increased by more than 50 percent, with the new money channeled largely into the hands of people who were already wealthy enough to invest.

“They have all this extra cash, and real estate is where they’re stashing it,” Chovanec said. “Now you’ve given them even more cash, and they’re going to put it in the same place, so the prices went up accordingly.”

In Mr. He’s estimation, the fact that housing has become unaffordable for ordinary people will not result in prices falling to meet actual demand, since the government’s policy will drive housing prices and ordinary people simply do not matter in the government’s considerations.

“In theory, [prices should decrease], but, in fact, that will not happen,” Mr. He said. “The only ones who hope housing prices will go down are the poor people.”

“Do you think the poor people are strong enough to fight against the landowners, the government and real estate companies?” He asked, rhetorically.

Unavailable vacancies.

Sun Po knows the problems of the “poor people,” that Mr. He is talking about all too well. As vice director of the Yunnan Women Migrant Educational Research Professional Association, based in the low-income Dashuying neighborhood in East Kunming, he has years of experience working with them. An indication of his leanings comes when he is asked about the importance of “nail-house” incidents, when property owners stay on their land to protest what they believe to be insufficient government compensation for the value of their buildings. While these protests are consistently well-covered in both domestic and foreign media, in Sun’s view at least, the people getting their houses torn down are the lucky ones.

“The tearing down of the houses will benefit the owners a lot,” Sun said. “It makes them rich. If they think the compensation is high enough, they will move.”

Instead, according to Sun, the people that bear the brunt of these demolitions are those who would otherwise rent out the old, cheap buildings being demolished, the people living in places like Dashuying.

“There are many old neighborhoods in the city that the mayor thinks block development,” Sun said. “So these houses are being torn down. People have nowhere to live, they come to the places where the houses haven’t been torn down, therefore the prices increase.”

Sun has felt the effects first-hand. The rent for the office where he works jumped from 450 RMB in 2007 to 850 RMB in 2010, a rise that far outstrips China’s official inflation rate of approximately 8.1 percent during the same period as taken from OECD statistics.

The macroeconomics agree with Sun Po’s experience. Roselea Yao estimates that urban rents have risen nationwide approximately “twenty to thirty percent” over the past three years. And Chovanec believes that the rent situation is primarily hurting new arrivals to the market, be they migrant workers, senior citizens, or young professionals.

“If you don’t have a place, there isn’t a product for you,” Chovanec said. “You have a choice of paying for something that actually doesn’t suit you or is far away enough that it’s actually affordable.”

A case study of this phenomenon would be Yu Huixiang and her family. As migrant workers from Songming county in Yunnan, they have always had to rent. Her family—consisting of herself, her husband, her son and her husband’s mother—rents two rooms that sit at street level in the corner of a Dashuying alley.

Their monthly rent increased 40 percent last year, from 250 RMB to 350 RMB, out of a salary of 2000 RMB made largely from Yu Huixiang’s work embroidering shoe soles.

Her response has been simple. She can’t earn more and she can’t find cheaper housing, so she now spends less on everything but her son’s education.

“The only way is to buy cheap things,” Yu said. “If things are not necessary, I will not buy them. Now that many neighborhoods have been torn down, houses are in short supply.”

When asked why houses were in short supply, Yu answered—without any trace of irony—that the government was building new housing.

“But we don’t have enough money. We can’t afford it,” she said. “Almost all of the new housing is empty, because most people can’t afford it.”

In Yao’s view, unless the government intervenes, sixty million migrant workers like Yu will be forced to continue paying higher and higher rents for substandard housing.

“Their housing needs will not be solved by the profit driven developers,” Yao said. “The government was basically blind to this problem and pushed it away for a decade, but right now they have to solve that problem. They have to do something.”

Whether they will remains to be seen.

Yu and her husband, waiting.

Read Part II of this post here.

Michael Gsovski is a freelance writer who recently spent a year in Kunming China, but is now based in New York City. He graduated in 2010 with a B.A. in Economics from Northwestern University.