

Meeting Housing Needs of First-Time Homebuyers in Chinese Cities

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Abstract

The rate of homeownership in Chinese cities increased from less than 20% in the 1980s to 82% in 2007. However, such a high rate mainly resulted from the welfare housing policy which was abolished in 1998. In recent years, it has become much more difficult to become a homeowner in China, particularly first-time homebuyers who do not qualify for public rental housing units or afford private houses for self-use in urban areas. The sharp hike in housing prices in the past few years in Chinese cities have made homeownership a great challenge to most first-time homebuyers to own their home. The housing need for first-time homebuyers will continue to increase because it is the time that young households who are born after the 1980s have started to form their own families. The purpose of this paper is to discuss the challenges of promoting homeownership among young urban first-time homebuyers. This paper also offers suggestions regarding sustainable housing provision for them.

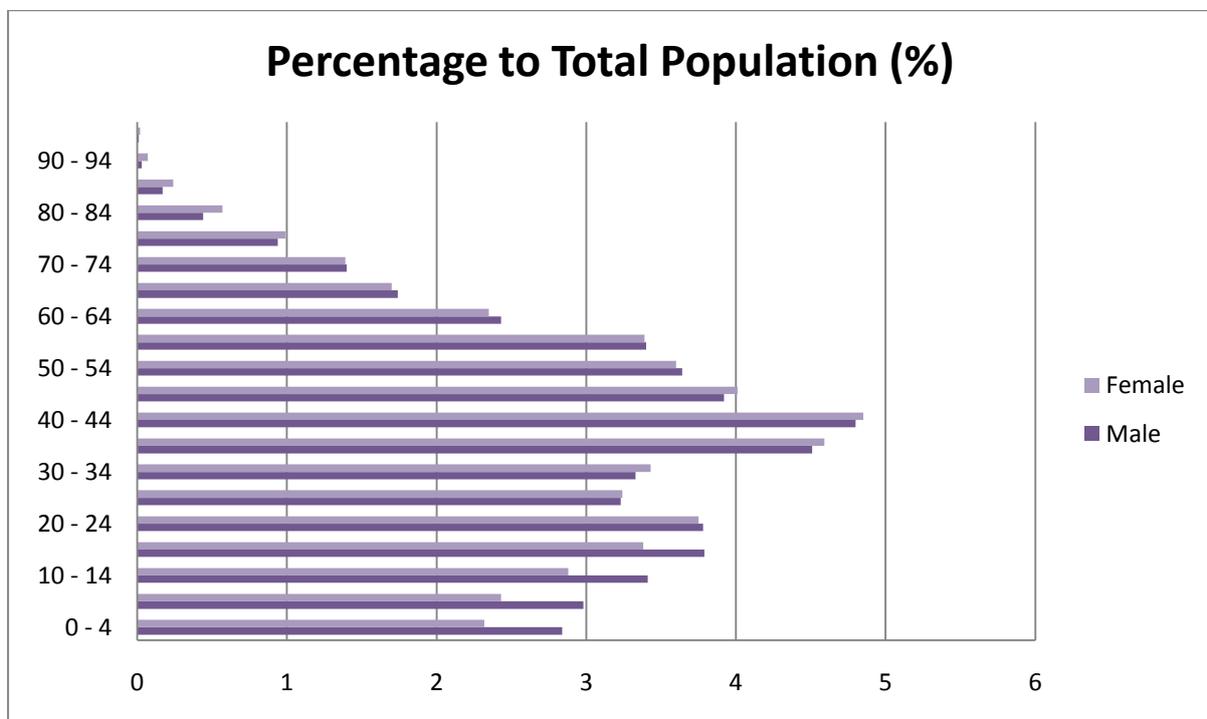
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1. Introduction

Owning a house is a major goal for people who live around the world. Housing is not a homogeneous good as compared to other goods such as food, or clothing, but is composed of thousands of households in different location. As stated by Tan (2011), housing is a human right and a basic need and must have priority. The efficiency and effectiveness of the housing delivery system requires housing provision for all, particularly first-time homebuyers. The Chinese government is committed to provide adequate, affordable and quality housing for all. Ironically, the government faces two challenges. On one hand, there is a mismatch of housing for first-time homebuyers which lead to a low homeownership rate. On the other hand, there is a substantial amount of housing vacancy in Chinese cities.

It has become much more difficult to become a homeowner in China. Most of first-time homebuyers are young Chinese households in urban area aged between 25 and 34 years. The housing need of this age group will continue to increase because first-time homebuyers who were born after the 1980s have started to form their own families. As shown in Figure 1, the proportions in the age group 25-29 and 30-34 constitute the important and active segment of the population in terms of household formation. It appears that the population structure in China experienced a continuous shift from a young one to an older one as evidenced by the changes in the proportionate distribution among the age groups.

Figure 1: China Population by Age and Sex (2009)



The sudden large increase in housing prices in the past few years has resulted in the government intervention to take measures to curb speculative activities in the housing market. The recent government intervention has made homeownership a great challenge to most first-time homebuyers who do not qualify for public rental housing units or afford commodity housing for own use in Chinese cities. The main objective of this paper is to look at housing provision issues for first-time homebuyers. This paper also discusses the challenges of promoting homeownership among the post-1980s urban households. The final section of this paper presents conclusions regarding sustainable housing provision for young urban first-time homebuyers.

2. Homeownership in China

Housing provision has always been an important agenda for the Chinese government over the years because it is a visible output where the development can be seen, which in turn create jobs and generate taxes and wages that positively influence the quality of life. Buying a house has a powerful consumption multiplier. The economic impact of housing does not end when a home is sold and the new house owner moves in. In fact, housing continues to be an economic force long after the sales is closed through activities such as furnishing, decoration, renovation, repairs, home appliances, or landscaping. Macroeconomic modelling in the United States suggests that the consumption multiplier is between 1.34 and 1.62 in the first year or two after the purchase of a new home.

Owning a house is beneficial not only to households but also societies. Benefits of homeownership to both owners and society can be found in many housing studies, ranging from social benefits to economic benefits. Haurin, Parcel and Haurin (2002) and Tan (2008) prove that homeownership improves the home environment in which a child lives, improve child's cognitive ability and reduces behaviour problems. Balfour and Smith (1996) and Rossi and Weber (1996) both point out that homeownership increases households' self-esteem and life satisfaction. Increased parental self-esteem has resulted in a greater emotional support for the homeowners' children. Green and White (1997) also find that children of homeowners stay in school longer than children of renters.

Tan (2009) and Tan (2012) confirm that a higher rate of homeownership is often thought to promote neighbourhood stability. Glaeser and Sacerdote (2000) support their views as homeownership creates incentives for homeowners to improve the quality of their communities and also to improve homeowners' connection to their neighbours. From a financial perspective, it has become important to consider homeownership as an investment for which home owners will receive an attractive and positive financial return. Besides the financial return, owning a house has proved to be an effective instrument to hedge against inflation as compare to other assets (Tan, 2008).

The rate of homeownership in China increased from less than 20% in the 1980s to 82% in 2007 (Huang, 2004; Huang and Yi, 2011). However, such a high homeownership rate is due

to the welfare housing policy which already abolished in 1998. China's public housing system was traditionally characterized by a centrally planned welfare system. Under the welfare system, houses were allocated to the employees who worked in stated-owned enterprises. Employees were only required to pay a nominal rent. The old housing distribution system, however, failed to provide adequate housing for all because the rent received was not sufficient to cover the maintenance cost of public housing stock. The Chinese government decided to stop welfare system and implemented a market-oriented reform by allowing households who had access to public rental housing to purchase their units at subsidized prices. At the same time, the Chinese government gradually increased the rent for urban households who could not purchase highly subsidized units.

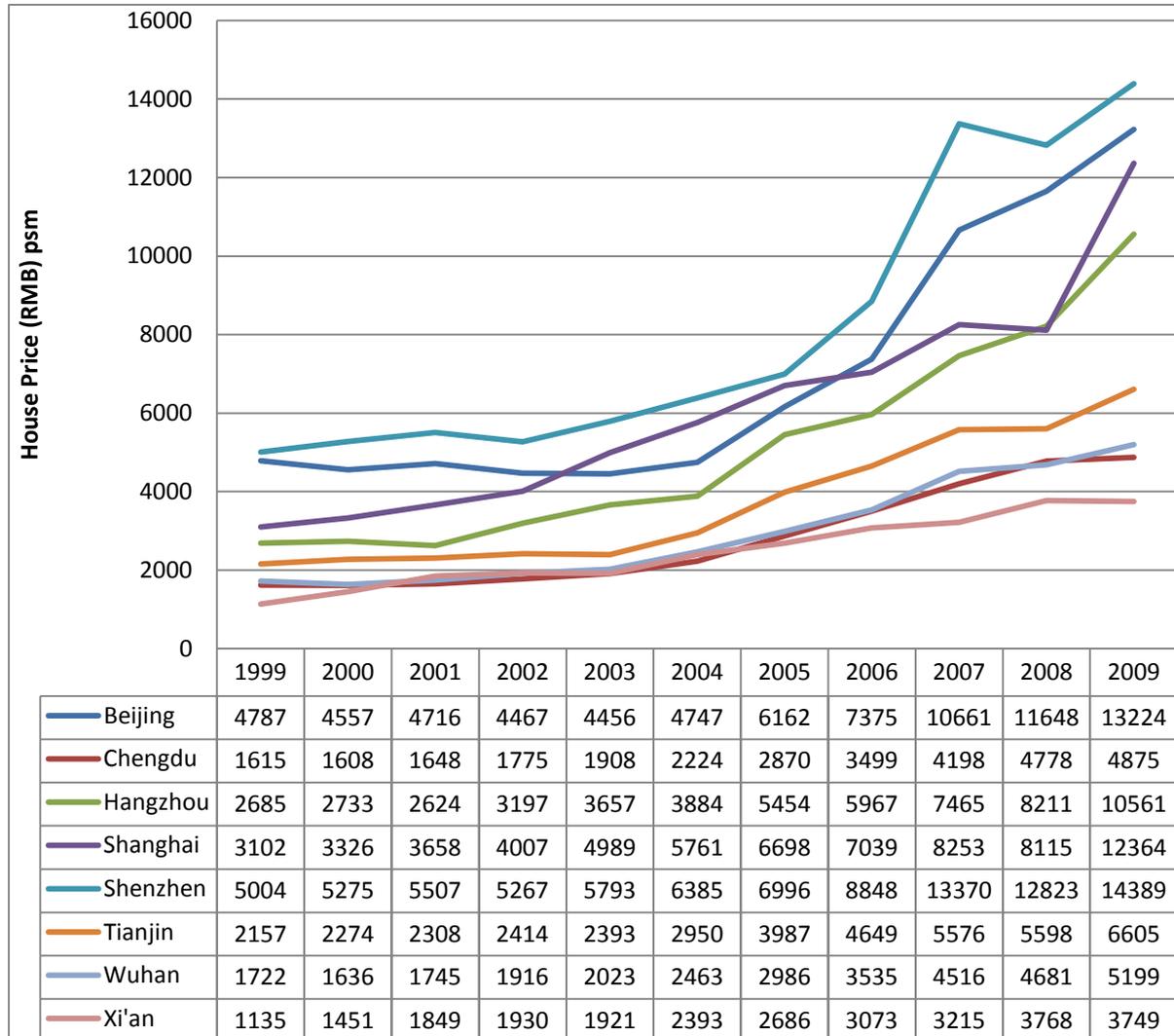
The Chinese government continued its effort to privatize the housing system by introducing the concept of full and partial property right. As stipulated in China's constitution, the transfer and circulation of land ownership by private households is prohibited. With the recent housing reform, homebuyers can purchase a 70-year land-use right for residential uses. Homebuyers who purchased previously public housing at market prices are entitled to full property right which include right of occupancy, right to dispose through resale and right to transfer the property to others. But they have only partial right if they purchased previously public housing or private housing at subsidized prices.

3. Challenges of Promoting Homeownership among First-Time Homebuyers

The market-oriented reform in 1998 completely changed the role of work units in housing provision. The housing requirement of homebuyers had to be met directly and entirely by private housing developers, rather than by their work units. Despite efforts by the Chinese government to provide adequate and accessible houses to all levels of society, this desirable goal is still difficult to obtain for some homebuyers in China. They are mainly first-time homebuyers who do not qualify for public rental housing units or afford commodity housing in the market. Home purchase is a distant dream for buyers whose income barely exceeds the ceiling for application for public rental housing. In recent times, it has been a stretch for the average Chinese to purchase a house. Rising house price pressures appear to be a significant challenge to increase the homeownership among first-time homebuyers with comparatively lower income. For example, the average housing prices increased by 176 percent in Beijing,

299 percent in Shanghai, 293 percent in Hangzhou, 188 percent in Shenzhen, and 230 percent in Xi'an from 1999 to 2009. Figure 2 shows house prices across eight major cities in China.

Figure 2: House Prices (RMB per square meter) in Eight Major Chinese Cities



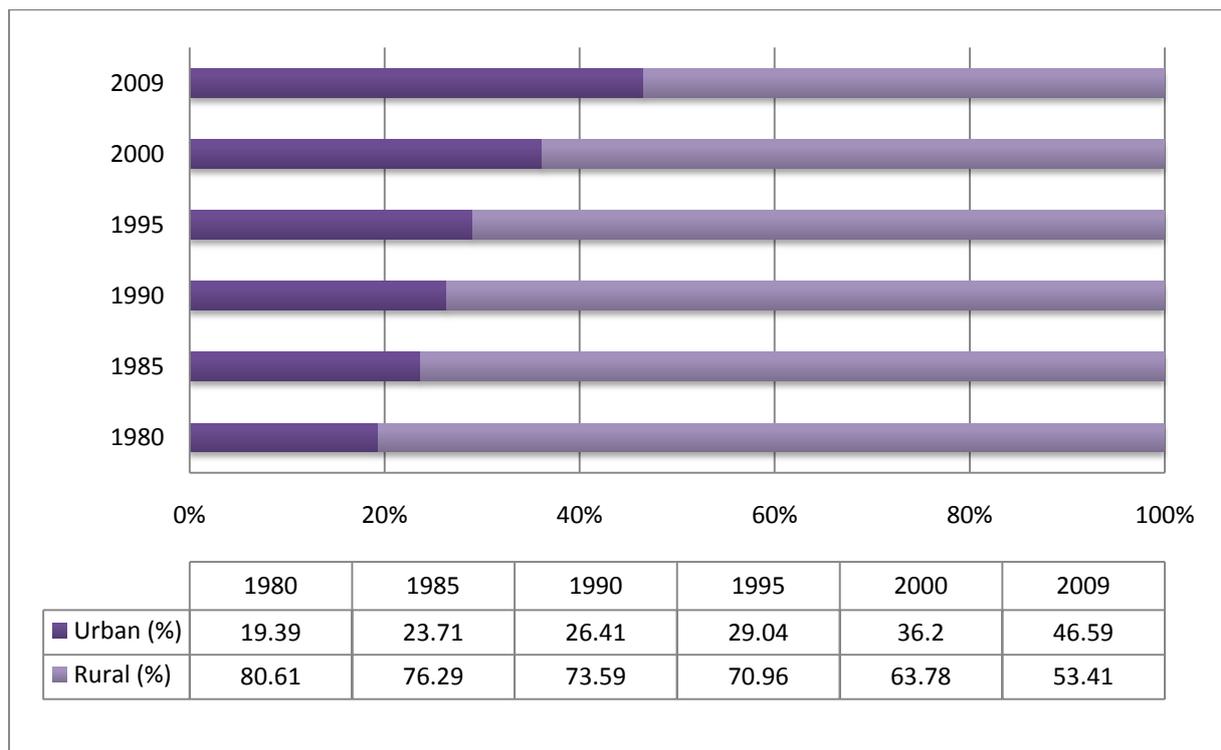
Source: National Bureau of Statistics of China (2010)

One of the main factors contributing to the high prices of houses in Chinese cities is the strong urbanisation development in China. Fast urbanisation has caused the urban population to increase during the last decades. In 1980 the population residing in the urban centres numbered 19.4 percent as against 80.6 percent in the rural area. Since then, there occurred a pronounced shift in the population between these two areas, with respective proportions moving towards 26.4 percent and 73.6 percent in 1990 and 36.2 percent and 63.8 percent in 2000. According to the latest census conducted in 2009, the population living in the urban

area had increased to 46.6 percent, while the number in the rural areas stood at 53.4 percent (Figure 3).

The rapid increase in the urban population in all these years can be traced partly to the movement of people from the rural sector to the urban conurbation and partly to the relocation of small town dwellers to the bigger cities. This urbanization trend, a common worldwide phenomenon, has been exerting intense pressures in the urban conurbations with regard to meeting the essential needs of the dwellers, particularly housing. With the rapid urbanisation process, the land supply area has decreased in most Chinese cities and this has resulted in the expectation of the decrease of land supply in the future. The decreasing land supply has a significant negative effect on house price (Yu, 2010). As pointed out by Mengjie, Reed, and Hao (2008), the estimated growth in land prices is almost an eight-fold increase since 2003.

Figure 3: Urban and Rural Population Proportion in Percentage (1980 – 2009)

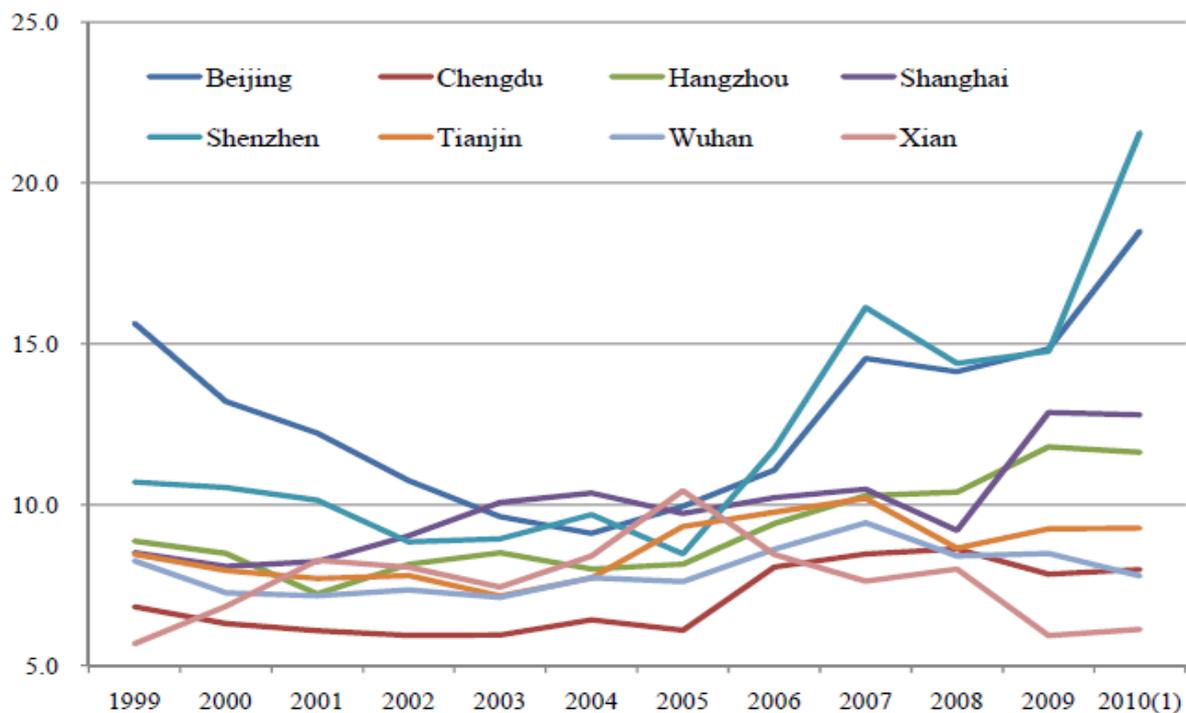


Source: National Bureau of Statistics of China (2010)

Although the income of the average households in urban areas is increasing, it appears that house prices have been rising at a faster rate, causing an affordability problem. Homebuyers are believed to have housing affordability problem when they are required to pay a large

portion of their income to consume adequate levels of housing. The most commonly used affordability benchmark is the house price to the median annual household income ratio. It is commonly accepted that a desirable Price-to-Income Ratio (PIR) ranges between 3 to 6 and this depends on individual cities and their actual locations. If the ratio is above 6, it has surpassed the general affordability for one to own a house. Over the past few years, house price appreciation has outpaced the high income growth in urban areas. The most recent data show price-to-income ratios have reached their highest levels ever in Chinese cities. As shown in Figure 4, PIR in Shenzhen, Beijing, Shanghai and Hangzhou are above 10, indicating the mismatch between income and prices is considered as one of the biggest obstacles to increasing homeownership among young urban first-time homebuyers.

Figure 4: Price to Income Ratio in Eight Major Chinese Cities



Source: Wu, Gyourko and Deng (2010)

4. Sustainable Housing Provision for First-Time Homebuyers

Rising house prices are evident in the property market around the world. In less than a decade, house prices have shot up a number of folds to levels that are out of the reach of the lower income group. This seems to be the situation faced by many countries in different continents of the world today. During such time, more affirmative policies need to be undertaken by the

government to help young urban first-time buyers tide over the difficult and challenging times. As a result, affordable housing scheme has become as an important social agenda to address the steep housing prices and rising cost of living if societies are to continue to be functional and sustainable.

The Chinese government should look into sustainable ways to provide affordable housing to cater to the needs of first-time homebuyers. To ensure this noble measure gets off on the right footing, it should be planned based on a long-term and holistic approach. Furthermore, it should not take too long to serve the needy. If well planned and executed, the affordable housing will turn out to be among the best efforts in improving the quality of life and encouraging homeownership among low-income first-time homebuyers.

The Chinese government should consider the experience of the affordable housing scheme in Malaysia in an effort to improve liveability by supplying affordable housing for first-time homebuyers. In the case of Malaysia, the government has recently announced My First Home Scheme which is targeted at first-time homebuyers earning RM 3,000 (1US = RM3) and less per month to acquire apartment units costing from RM 100,000 to RM 400,000. This scheme also allows 100% financing for first-time homebuyers. The government subsequently launched the 1 Malaysia People's Housing Scheme (PR1MA) later. This scheme, which is an addition to the My First Home Scheme, will only focus on apartment units priced between RM 220,000 and RM 300,000 being built for first-time buyers with a household income of RM 6,000 per month. Under this scheme, eligible buyers can apply for a loan of up to 105% from financial institutions with a 30-year payment scheme. The extra 5% from the loan is to assist the homebuyers to pay for the cost of insurance and legal aspects of the purchase.

As indicated earlier, the rate of rural-urban migration for the past 20 years has caused the growing demand for affordable housing. However, housing developers in China are not keen to produce houses at prices which are affordable enough for homebuyers. It is due to the fact that the increased compliance and regulatory costs relating to the whole value chain of housing production. Furthermore, the government has completely monopolised the land supply. All lands for residential development could only be transferred through public bids or auction. As a result, affordability conditions are highly related to land bidding. Land parcels transacted via auction tend to achieve a higher price as developers need to pay the highest prices to win the bid.

Housing developers have been giving low priority to the affordable housing. In order to achieve sustainable affordable housing provision, the government and housing developers should look into ways to help ease the developers' burden caused by rising construction costs. It is important for the central government and the local government to work together with developers to build affordable housing. Instead of leaving the responsibility to build these homes to developers, it should be a joint initiative between the governments and housing developers. Since land matters in China falls under the jurisdiction of state governments, it is advisable that these governments provide and allocate enough parcel of good land for the projects, while the developers provide their expertise.

While pricing the property affordably is one the main objectives of the government, there should not be any compromise on the quality of affordable low-income houses. It is also vital to ensure that these houses are accessible to good public transportation facilities and are close to public amenities such as retailing centres, hospital and education facilities. It is because the lower income group is most dependent on these amenities to improve their standard of living. There is insufficient space within the city to house all urban dwellers. Therefore, it is important to plan and undertake well-connected residential housing development projects in the suburban areas to avoid the centralization of economic activities in the few core areas. This sustainable planning is needed in order to keep up with the rapid urbanization and rising housing needs of inhabitants. There is a need to have a well-integrated public transportation system to facilitate travel between the city suburbs and the city centre. As pointed by Tan (2012), affordable housing should be built and equipped with good amenities. Therefore, housing developers should develop areas near public transport system line for affordable housing to address rising house prices in urban areas as houses prices in the city suburbs are not way above the affordability of young urban first-time homebuyers.

In addition to efforts by the government to promote homeownership among first-time homebuyers, the government has to be very careful to ensure that only the deserving first-time homebuyers benefit from affordable houses. Therefore, stringent enforcement of the regulation of qualifying households into the affordable housing programme is needed to prevent affordable houses ending up in the hands of homebuyers who want to make quick profits. Additionally, first-time homebuyers are not allowed to sell their homes on the market

for profit within the first few years in the hope that this type of housing only benefits homebuyers who need help for basic housing need.

Recently, the Chinese government has increasingly tightened controls on the housing market in an effort to rein in sky-high house prices. The government has introduced a series of tightening measures to cool the property market with the focus switching to existing homebuyers from the supply of new housing coming on the market. However, these tightening measures could prevent low-income first-time homebuyers from owning their own homes. For example, first-time homebuyers in China are being hit with tightening measures such as higher minimum down payments and mortgage rates. As reported by Zhou (2011), Chinese banks have raised minimum down payments on first homes from 30% to 40% and controlled home loan amounts. Furthermore, the banks have stopped offering discount on mortgage loans for first-time homebuyers by raising mortgages rates for first home purchases by 5% to 10% above the benchmark lending rate. Chinese bank used to offer first homebuyers a 15-percent discount on the lowest mortgage rate.

Homeownership requires affordable housing financing. In view of rising house prices in the urban areas, the government should make home financing more available and affordable by providing incentives in terms of a lower minimum down payments and mortgage rates to first-time homebuyers who do not afford commodity housing in the market. Housing incentive is a central issue in the housing policy for the lower income group. One of the good examples is the public housing policy in Singapore. They price the 3-room flat to the affordability level of 90 percent of Singaporean households. This substantial financial incentive represents a major commitment by the government and is an important aspect of the Singapore housing policy to improve living condition of the lower income households.

In addition, the government should allow withdrawal of contributions from the mandatory provident fund for down payment purposed. As pointed by Tan (2008), provident fund appears to be an important determinant of homeownership. Similar to the Employee Provident Fund (EPF) in Malaysia, China's Housing Provident Fund is a mandatory housing saving programme in which employers and employees both contribute a certain percentage of employees' salaries to HPF accounts. Since the contribution is salary based, only employees with higher incomes receive larger contributions from their employers. In the case of first-time homebuyers, they receive less or no benefit owing to the lower-end of the income

distribution. As a result, the government should explore ways to increase the contribution from first-time homebuyers' employers.

5. Conclusions

Homeownership is an important objective in the China's social and economic development programmes. However, this objective is especially tough for first-time homebuyers, whose income increases have in no way kept pace with rising house prices. Housing developers in China has been giving low priority to the affordable housing programme. The construction of high-end housing, on the other hand, has contributed to the problem of double digit vacancy rates. In order to achieve sustainable housing provision, housing policies and programmes should be economically viable, socially acceptable and technically feasible.

One way to address the housing need of first-time homebuyer with lower income is to increase the supply of affordable low-income housing. Affordable housing is required as a public duty, not a commercial operation, and the government's housing policy is to sell homes to the people at prices they can afford. The government must ensure that those who are eligible will be provided affordable houses that they can afford. In this regard, appropriate policy guidelines of the supply of affordable housing must be drawn up to facilitate the provision of affordable housing to first-time homebuyers.

Furthermore, a detailed and comprehensive housing information system is needed in the country to allocate affordable housing and monitor its consumption. This system is crucial to prevent speculative buying among investors moving from one city to another. Efforts are also needed to make home financing more available and affordable by providing incentives to first-time homebuyers. Policies are developed to cheapen the cost of homeownership through financial assistance with down payment and mortgage interest payments. The government should also increase the availability of alternative home financing by liberalizing Housing Provident Fund (HPF) savings for home purchase.

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