

## China's Hainan hopes to avoid property crash

Written by Reuters

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(Reuters) - With new home prices rising by almost 20 percent a month, Haikou would seem to be the dictionary definition of a property market bubble.

After China unveiled plans in late December to turn tropical Hainan island into an international tourist destination, tens of thousands of real-estate speculators headed for Haikou, the capital. Property prices predictably rocketed.

Whether the authorities succeed in deflating the bubble -- or preventing one, depending on your views -- will be a litmus test of Beijing's campaign to defuse public anger over fast-rising prices nationwide without doing serious damage to a sector that is critical for the economy.

That policymakers are facing one of their stiffest challenges in Hainan brings a sense of déjà vu. After a property collapse in the province in 1993, it took more than a decade to clear up the bad loans and vacant lots that were left behind.

Feng Ke, head of the property research institute at Peking University, is confident that history will not repeat itself.

"Prices are a bit too high now, but it's unlikely to crash," Feng said.

Back then, developers were speculating with borrowed money to buy land in a game of pass the parcel. When prices peaked, the developers saddled with property -- and their bankers -- were left high and dry. This time round, the buyers are investors and many of them are paying cash, Feng explained.

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Still, fully aware that an overheated property market could ultimately lead to a hard landing for the entire economy, policymakers have rolled out a series of tightening steps.

"You know, things are really nasty in places like Hainan," said one senior government official, who declined to be identified given the sensitivity of the subject.

The State Council, China's cabinet, has mandated higher down payments and mortgage rates and made it harder for investor-speculators to buy multiple homes.

The measures will moderately cool market sentiment, but demand from owner-occupiers will remain strong, particularly in second- and third-tier cities, underpinned by rising incomes and China's urbanization drive, Fitch Ratings says.

"This is consistent with the government's goal to deflate bubbles when necessary to ensure a healthy long-term trend in the real estate sector," the ratings agency said in a recent report.

### SOARING PRICES

Walking along a deserted street in Haikou, Cao Ying can hardly believe what she has just heard: all the flats in the surrounding blocks are sold out, even though no one seems to live there. Perhaps two apartments in 10 are actually occupied, local property agents say.

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New flats will come onto the market this month, but they will be priced about 15,000 yuan (\$2,200) per square meter, triple the level a year ago.

"That's outrageous," she said, after getting similar information from three real estate agents, all indifferent to her protestations. "I bet they'll offer a discount when we come next time around in June," she said, not sounding sure of herself.

Pan Shiyi, chairman of top property developer SOHO China (0410.HK), told a forum on April 24 that more than 70 percent of China's listed property firms had over 10 billion yuan of cash in hand and would not rush to cut prices.

And Fu Wenyan, a real estate agent in Haikou, said there was no sign of a decline in the price of the villas on her books despite the new tightening rules.

"Both sides will wait and see for a while," Fu said.

Cao, in her mid-30s, flew more than 1,700 km (1,100 miles) with two friends from Sichuan province to buy a flat so her son could enroll at a prestigious middle school in Haikou.

Hainan's warm weather, lush landscape and clear sea only add to the island's attractions as a holiday or retirement retreat.

Would-be buyers like Cao expect their properties to going up as the island executes its ambitious development blueprint.

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But with memories of the U.S. subprime crisis and Dubai property crash still fresh, the Hainan authorities have taken various measures to clamp down on speculation.

In mid-January they suspended the approval of property construction and the allocation of land for development until the end of March to give investors time to think twice.

The tightening campaign by the central and local governments drove transactions down as some investors took to the sidelines.

Ma Xin, a client manager with China Everbright Bank's Haikou branch, has seen the number of mortgage applications he examines a week fall from over 100 in January at the peak of the frenzy to just several in April.

"In the medium- to long-term, property prices in Hainan will move upward, despite short-term uncertainties," he said.

### FULL PAYMENT

Property prices nationwide fell briefly in late 2008 as the impact of an earlier round of tightening bit at the same time as the global credit crunch caused China's economy to pull back from its rapid growth rate.

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The trend started to reverse by March 2009 in response to massive monetary stimulus and steps to help the property market.

By the second half of last year, prices had soared past their pre-crisis levels, driven by a shortage of flats on the market and rising demand as a hedge against inflation risks.

The question for global markets is whether the latest tightening will topple the market, crushing China's demand for materials such as steel, cement and copper, and whether Chinese banks will be lumbered with a new bundle of bad loans.

Andy Rothman, China macro strategist with brokers CLSA in Shanghai, judges that Beijing wants to cool, not kill, the residential property market.

"The impact of the new rules will not be dramatic in most cities," he said in an April 20 report.

A survey by CLSA in 60 cities in late March and early April showed about half of families in second- and third-tier cities had paid for their first and second homes entirely in cash.

The proportion was even higher in Haikou. Guo Zhenxi, a local real estate agent, said all his clients paid the full amount in cash, making it easier when they want to sell out.

To get a mortgage in Hainan, banks insist that the family liabilities of a borrower do not exceed half their income. Otherwise, they require a higher initial down payment.

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Cash buyers, or those not borrowing much, will return to the market if prices fall because the new rules do not raise the cost of holding property once it has been purchased, analysts say.

Ren Zhiqiang, chairman of Huayuan Property, said prices might even stage a "revenge" rally later this year as developers slow their investment, exacerbating the shortage of new properties.

He said Beijing would turn supportive if the market overreacted.

"If property prices drop to the desired level or farther than expected -- if there's a panic fall -- the authorities will change policies," Ren said in a blog.