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China Home Sales Skirt Policies With Fake Divorces, Attics (1)
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(Updates with developers' cash flow in seventh paragraph, SouFun July home prices in ninth.)

By Bloomberg News

Aug. 16 (Bloomberg) -- Frank He said he faked a divorce from his wife of 10 years to skirt China's ban on third mortgages and obtain a bank loan for a third property, a 12 million yuan (\$1.9 million) suburban villa.

"My wife and I love each other, but as long as we can get the mortgage from the bank for the deal, we'll take it," said He, a 40-year-old manager at a chemical company. The forged document, which cost the Shanghai couple 20,000 yuan, helped them get a loan amounting to 60 percent of the purchase price, he said.

Chinese homebuyers and developers are finding loopholes as they come under pressure from government policies to curb gains in residential prices, such as limits on the number of properties owned. Builders are refraining from cutting prices, offering free parking lots and attics instead, as they face higher borrowing costs after Standard & Poor's downgraded their outlook in June.

Their actions may hamper the government's efforts to prevent a bubble in the housing market. Sales surged 25 percent in the first seven months from a year earlier and prices climbed in 67 of 70 cities monitored by the government in the first half.

"These are actually price cuts in disguise," Sun Mingchun, Hong Kong-based economist at Daiwa Securities Capital Markets, said in an interview. "Developers are reluctant to offer discounts and are playing games with the government."

Some sellers are throwing in gardens and basements, according to a Century 21 China Real Estate report in June. In Shanghai, properties with the additional offerings draw 30 percent more customers to display homes than those without, according to the country's second-biggest real estate brokerage firm with 22,000 employees.

Cash-Flow Crunch

Chinese developers are facing a strain on liquidity. Almost 70 percent said their cash-flow conditions worsened in August from July, independent investment advisory firm CEBM Group Ltd. said in an Aug. 5 report, citing a monthly survey of real-estate companies in 12 cities. That compared with 22 percent in July.

Cash flow in the first quarter dropped 38.9 billion yuan, the most in at least five years, based on Bloomberg calculations from financial statements of 136 developers based in China and listed on the mainland and Hong Kong exchanges.

Developers may have to cut prices to stave off a capital shortage as the government tightens the market further, said Danny Ma, Shanghai-based director of China research for CB Richard Ellis Group Inc. in an

interview. Home prices rose at the slowest pace in 11 months in July, according to SouFun Holdings Ltd.

Reducing Prices

China Overseas Land & Investment Co., a Hong Kong-listed developer controlled by the nation's construction ministry, said it reduced prices in four projects around the country this year by 10 percent to 15 percent from a year earlier.

The developer is not throwing in incentives and has no plans to do so, said Yang Haisong, the company's Hong Kong-based head of investor relations.

"Tightening policies have already had an impact on the physical market, especially for top-tier cities," said Yang in a telephone interview. "We were taking flexible launches and accelerating leftover projects."

Passion for Property

Some couples who aren't willing to pay for the forged documents to fake a divorce go to the extreme of getting an official one, said Qian Yusheng, an agent for Century 21 in Shanghai. Some agents also help with forged marriage licenses and documents to prove local residency and allow potential buyers to purchase more properties, said Qian, adding that he doesn't engage in what he calls common practices in the industry.

China's home ownership mania stems in part from the fact that a private residential property market has only existed for 13 years and has coincided with surging incomes. China's five-year plan, running through 2015, aims to raise incomes by an annual average of more than 7 percent.

"Traditionally people in east Asia all have a passion to possess properties," said Liu Li-Gang, a Hong Kong-based economist at Australia & New Zealand Banking Group Ltd. "But economic theories also apply here. In eastern Asian countries we have less land with a high intensity of people. Properties are a scarce commodity, so if you enter the market early, there is a bigger chance of high returns later."

'Biggest Industry'

There also are less options in China for people to park their money. The Shanghai Composite Index has declined 17 percent from a November high, and inflation is running at 6.5 percent, the fastest pace in three years, outstripping the one-year deposit rate of 3.5 percent.

"Real estate is the biggest industry in China. What other business can get better returns than speculating on property?" said Larry Hu, a Shanghai-based director in the residential department of Knight Frank LLP. "People hold cash on hand and are really fearful of inflation."

Small and medium-sized developers are giving away free space such as terraces to avoid cutting prices. Such areas aren't included in building plans submitted to the government nor booked as expenses during construction, according to Lu Qilin, a senior research manager at Deo Volente Realty, Shanghai's third-biggest property brokerage. That means when demand wanes, developers can stop charging for the space, luring buyers with extras that won't eat into balance sheets, he said.

Gardens, Attics

Free space offered for storage or a garden typically adds as much as 20 square meters (215 square feet), while attics and basements amount to as much as 70 square meters, Century 21 said. Parking lots are between 20 square meters and 30 square meters, the broker said.

"Developers don't really want to directly cut prices because it's not only bad for their image, but there are also risks that previous buyers would come back and ask for the same discounts or even return those homes," said CB Richard Ellis's Ma. "They would rather start with these soft marketing strategies."

For a 120-square-meter two-bedroom apartment in the eastern city of Nanjing, the additional space amounts to as much as 27 square meters, according to SouFun, the country's biggest real estate website. Home prices in Shanghai averaged 23,856 yuan per square meter in July, while those in Nanjing were 12,282 yuan per square meter, according to SouFun.

Marketing Techniques

Apart from freebies, developers are also helping buyers secure financing. Pan Hong Property Group Ltd. provides bank guarantees for buyers and in some cases offers loans with interest rates similar to those offered at financial companies, according to Executive Chairman Wong Lam Ping.

China this year raised the minimum down payment for second-home purchases, and about 40 Chinese cities including Beijing and Shanghai started limiting the number of apartments to two for each family, and one for non-locals. The central bank increased interest rates five times since October.

In September, the government asked commercial banks to stop offering loans to third-home buyers and extended a 30 percent down-payment requirement for all first-home buyers.

Shui On Land Ltd., a Shanghai-based developer of luxury apartments near the city's Xintiandi bar and restaurant district, extended the deadline for down payments by an additional one to two months this year, Chief Executive Officer Freddy Lee said. "Everybody uses marketing techniques," he said. "The market is just more competitive right now."

The developer, controlled by Hong Kong billionaire Vincent Lo, has no plans to cut prices because there's still "real demand" among buyers, Lee said.

Cash-Rich

Along the eastern coastal Zhejiang province, some homebuyers are purchasing properties through the companies they own, because the restrictions only apply to families, not businesses, according to Centaline Property Agency Ltd., China's biggest property brokerage with 38,000 employees.

"This group of buyers are cash-rich," said Liu Yuan, a Shanghai-based researcher at Centaline. "The only thing that they worry about is buying eligibility."

Property companies are still reporting gains in residential sales this year. Housing transactions from January to July climbed 25 percent to 2.4 trillion yuan from a year earlier.

"You need to understand that this is China," said Knight Frank's Hu. "Whenever the government has a policy, people will find a counter strategy."

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