An Untapped Market: China’s Aging Population and the Senior Housing Opportunity

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Until recently, the notion of a senior housing market in China was nothing more than fantasy. Tradition held that elder care was primarily the province of the family, as children were responsible for supporting and assisting their parents once the children were of age. In post-revolutionary China, the state has provided some limited assistance, but the family has until recently remained the rock anchoring the retirement wellbeing of China’s seniors. However, as major demographic shifts have begun to erode China’s traditional support structure, both the Chinese government and its citizens have started to consider alternatives to the country’s family-based approach.

Background

Declining fertility rates and increased longevity have tilted China’s demographic balance towards a rapidly aging population. China currently has an estimated 193.9 million people aged 60 or above,¹ and that number is predicted to reach 440 million, or one third of the country’s total population, by 2050.² Meanwhile, China’s breakneck urbanization has left more and more of the country’s rural elderly population alone to fend for themselves, as their working-age children flock to the larger, eastern cities on China’s coast. Even when the aging parents move to the cities with their families, they are often left alone during the day due to the emerging “4-2-1 structure” where China’s one child policy has left working-age married couples with the heavy burden of caring for four grandparents and one child.

While it appears that most of China’s working-age citizens would be willing to honor their filial duties towards their elders, China’s (i) rapidly aging population, (ii) increased urbanization and (iii) “4-2-1” phenomenon make doing so no longer feasible. Accordingly, government studies show an increasingly strong interest among China’s population in living in senior communities (especially in larger eastern cities where people are generally more receptive to new ideas and concepts).³ These studies, along with government concerns over a looming aging crisis, have prompted the Chinese government to (a) lift certain restrictions on foreign companies looking to build senior housing communities in China⁴ and (b) list senior housing as “encouraged” in its 2011 Catalogue of Industries for Guiding Foreign Investment.⁵ As a result, many are now beginning to view the senior housing market in China as an increasingly attractive investment opportunity.

⁴ In August 2013, China’s premier Li Keqiang announced that the Chinese government will cut red tape to spur foreign investment into privately-funded care offerings that are common in the West.
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Investment Considerations

While the Chinese senior housing market is undoubtedly appealing, industry players must address several issues before making the investment plunge.

1. Deal Structure

At present, China lacks a comprehensive legal framework governing senior housing projects. Accordingly, most legislation regulating senior housing is promulgated by local governments. Therefore, any foreign investor interested in participating in the market needs to address whether to partner with a local developer familiar with the applicable rules, regulations and local practices.

With so-called “hot-money” placing pressure on China’s currency, Renminbi (RMB), and causing real estate prices in China to appreciate, the Chinese government elected in 2007 to tighten policies on foreign investment. These restrictions on currency inflows, which continue today, have caused difficulties for foreign investors seeking to conduct real estate projects in China, as uncertainty about whether foreign currency can be brought in to invest may make it difficult for would-be foreign investors to capture attractive deals with a short fuse absent the support of a local partner who already has RMB inside the country. Despite recently relaxed regulations authorizing wholly owned foreign senior housing developments, our consultations lead us to believe that partnering with a local Chinese developer through a joint venture is the smarter play due to the developer’s ability to deploy RMB currency assets quickly and to better navigate the confusing, and at times opaque, regulatory process.

Under such a structure, (i) the would-be investor would select a local partner in China, (ii) the local partner would then set up a project company to purchase the target land use rights and (iii) subsequently, the foreign investor would establish a joint venture with the domestic developer to develop and manage the project. The structure might involve vesting ownership of the land use rights in a purely domestically-owned project company and the foreign investor would have an interest in an offshore entity that might have management rights to the project.

2. Grant of Land Use Rights and Operational Models

Distinctive aspects of China’s land use ownership system create both challenges and opportunities. Essentially, the state owns all land, and corporate entities and individuals are only given the right to use the land for specific purposes for a set period of time. Because senior housing remains largely unregulated at the national level, investors are not required to seek land zoned for a specific classification, but instead can acquire property zoned for commercial, residential, industrial, tourist and even public use (industrial, tourist and public uses are hereinafter referred to as the “Remaining Uses”). However, because certain classifications limit marketability (usually, only land use rights associated with residential, commercial and a portion of industrial properties may be transferred), the nature and type of land use right is exceptionally important because it is largely determinative of the way in which the investor will structure the offering to would-be residents (i.e., direct sale of units, long-term rentals or the sale of memberships). Therefore, before going into the acquisition stage, interested investors must determine the project model, understanding that the nature of the underlying land use rights will play a vital role in which model is most economically appropriate.

Although the direct sales model may appeal to some, many industry experts contend that better alternatives exist. For one, the startup costs associated with the direct sales model can be very high because land zoned for commercial and residential use is much more expensive than other classifications. In addition, sustainability is an issue, as maintaining a senior community is much easier with a club/rental model because the investor can guaranty that the community will remain comprised of the elderly (unlike a direct sales model where the consumer could resell to any part of
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the population). Because of these high start-up costs and continuity concerns, interested investors are recommended to look to acquire land zoned for one of the Remaining Uses and operate under a rental or membership model after negotiating with local governments.6

3. Medical Care

Lastly, and regardless of how a senior housing project is operated, investors must ensure that the facility offers medical care services, whether directly or indirectly. While numerous care models exist, the effectiveness of deploying a direct care model in China has not yet been proven. At present, some of the leading senior housing projects being developed or coming on-line utilize foreign investment. However, certain regulatory restrictions exist regarding foreign investment in health care, and in view of the regulatory requirements applicable to the licensing of foreign-invested health care providers, having the senior housing facility directly provide a full range of on-site medical care to residents as is common in UK or U.S. projects may not be feasible. In view of these potential hurdles, investors may wish to consider using a multifaceted approach. If the facility will not provide a licensed clinic on-site, then it should consider hiring qualified nurses to assist and serve the community on a daily basis, while also establishing referral or service relationships with certain hospitals that would permit doctors from the partner hospitals to regularly visit the communities and conduct check-ups. This relationship would then allow any seniors determined to be in need of care to visit the partner hospital to obtain the necessary treatment and/or prescriptions.

Sample Project

A recent project in Shanghai nicely illustrates the recommended approach discussed above. Unwilling to pay the high prices associated with commercial and residential land, a domestic developer recently entered into negotiations with the local Shanghai government to purchase the land use rights for 66,000 square meters of land in the Minghang district. Because the property was zoned for “public use” (and was thus not transferable), the developer was able to obtain a 50-year land use right for a deep discount, paying only RMB150 million (about 24 million U.S. dollars).7 Rather than owning a transferrable land use right, the developer acquired a right akin to a nontransferable leasehold estate. The developer then entered into a joint venture with a well-known foreign senior housing company, tasking it with operating and managing the venture.

The domestic developer and housing company (collectively, the “Company”) are still in the development stage, but plan to use a membership model that will offer both (i) 50-year memberships (transferrable among the senior’s family members) and (ii) lifetime memberships (non-transferrable and terminable at death), with membership fees varying based on the size of the unit and type of membership purchased. The membership fee, however, will only cover the senior’s housing, and the senior (or his or her family) will be required to pay an additional monthly fee for necessities such as food and nursing services. Aware that this additional expense could turn away potential residents, the Company intends to try and offset these costs by introducing investment banks into the project, with the hope that senior members will (i) invest any excess funds they may have with the investment institution and (ii) use the returns to pay the additional monthly fee.

Conclusion

With China’s elderly population projected to increase at a rapid rate and societal attitudes towards institutional care changing, the time appears ripe for industry players to join China’s senior housing

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6 Please see the brief summary below of a sample project in Shanghai that employs a special procedure for the land use right grant and its associated operational model.

7 Market prices for similar sized properties zoned for commercial or residential use range from RMB375 million to RMB1.5 billion.
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market. However, before doing so, interested investors must understand that the market remains immature and largely unregulated (at the national level), and that success will depend upon investors taking a calculated approach that addresses all of the considerations set out in this article, including the need to devise flexible and creative land use structures that support appropriate project pricing. If investors are able to do this, significant returns could be on the horizon.

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