

Real Estate Development in China's Third Tier Cities

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Abstract: The development of real estate in China is undergoing a difficult time. Development in the third tier cities is at a high rate, yet there is little or no population growth in these cities. Instead, the people are moving from these cities to others, creating a fall in the price of housing. The challenges have been occasioned by the free market in which the firms are operating, even though 60% of Chinese GDP is from these cities. It means that they are important, and there is a need to ensure that they are well regulated to create sustainability. The study used a document analysis method to collect the data. The researcher examined the different papers and documents which have been published on the subject of real estate development in China's third-tier cities. Thereafter, a critical analysis was conducted to make sense of the data and information collected. In the following sections, this paper will discuss the current state of real estate and the potential impact of the overdevelopment in China's third tier cities. This paper notes that tier-three cities are overdeveloped, yet the population is lower than what the real estate sector supplies. This means that the sector is in deep debt, an issue that can and should be avoided. In the meanwhile, the relevant recommendations will be given. Some of the recommendations include the following: Formulating appropriate policies to ensure that there is clear regulation for investors in the real estate industry in China; The government should take an active role in the real estate sector in China; The government needs to ensure that there is little mass flow of people from third tier cities by ensuring that there are incentives to make people stay in the cities.

Keywords: real estate industry, China's third-tier cities, housing prices, overdevelopment

1. Introduction

Housing is an important aspect in China. The rate at which China is developing its real estate industry indicates the premium that has been put on real estate. Chinese cities are increasing in population at a rate that requires strategic responses. A host of studies have been doing an aggregation of the Chinese housing issues while a section of those studies focused on first tier and second tier cities. Cities like Wuhan and Beijing have received focus mainly because of their centrality in issues population and economy. However, recent studies on housing in China has indicated that the locus is on third tier cities which account for about 60% of the country's GDP and an approximate of 50% of the country's housing market value on stock. There has been so much overbuilding in these cities that the sector has recently been thought to have reached its point of diminishing returns. The situation in the third tier cities where there is no longer ground for more construction yet the cities have kept on growing [1]. The analysis of this situation shows that these cities are the points of focus when

analyzing Chinese construction problems. The real estate industry in China is increasingly growing and requires checks and balances to ensure that it serves its purpose while at the same time maintaining the quality that is required. The increasing buildup in third tier cities in China at a time when they are losing their population to first- and second-tier cities indicates that there is a need to analyze the development of this sector. How and why the buildup is happening is of a lot of importance. The financial obligations that these cities have can be argued to play an important role, even though the sector accounts for over 60% of Chinese GDP. There is an outsized weight in third-tier cities and that could only mean overzealous real estate in these cities. For the research method, data were collected using literature analysis. The researchers reviewed different papers and literature on real estate development and the immanent influence of overdevelopment in China's third-tier cities. After that, critical analysis is carried out to make the collected data and information meaningful.

2. A Close Look at Real Estate Development in China's Third Tier Cities

China is developing at an extremely fast rate. It has recently moved into the “big global economies” category. The housing prices have also been changing from city to city, and that has also led to a sudden influx in some parts of China. The population in third-tier cities is reducing while construction is on the rise, which creates a conflict between demand for housing and its supply. More developers keep erecting houses while the population is being lost to second- and first-tier cities, creating an imbalance. There is a population outflow in third tier cities [2]. The foreseeable future has a declining demand for housing, especially in these cities, because there is already enough space per capita. Continued development of the real estate sector therefore renders the already developed houses and offices out of demand since there are already a lot on the market. An approximate decline of 3% per year in the demand for housing in China is expected through 2035 because the space has already been spread out and the demand is extremely low in the third-tier cities. It is critical to note that third-tier cities are experiencing negative population growth while the second- and first-tier cities are gaining population. The available data by the National Bureau of Statistics of China show that third tier cities registered approximately -0.1% in the 2011-2020 period population growth while second- and first-tier had 1.4% and 2.4% in the same period. The 2021 growth rate in third-tier cities was -2.0% at a time when second-tier cities registered an approximate 7.9% growth rate [3].

The dwindling populations in third-tier cities are a pointer to an existing problem. For instance, why is the population growth going lower in the cities while other tiers are experiencing an increase in population? Finding an answer to this question would help to understand why the real estate industry in China faces a bleak future. There is a need to strike a balance between the population and the construction rates. The extent to which the industry is stretching will create difficulties for construction firms. There will be a challenge in completing projects that have already been presold and offloading those that are yet to be sold [4]. The commercial real estate sector has challenges that are parallel to the housing issues in the sector. The inability to maintain the population growth in third-tier is mainly why those cities are experiencing the buildup in the areas. However, there is also a need to examine the regulations that are in place to ensure that the industry remains productive. The importance of the third-tier cities in the productivity to China cannot be overemphasized. It follows that China has regulated the lending regulations for real estate companies which are investing in different cities in the country. The regulations focusing on curbing migrations from third-tier cities, like the “three red lines” policy, would help to ensure that the big cities are not overpopulated while the smaller ones are left without people. It has been determined that third-tier cities are the epicenter of Chinese economic growth, and maintaining their populations would be important in the long run for the entire country [5].

3. Real Estate Companies and Their Regulation

The real estate companies in China are facing tremendous challenges. The cut in funding is making the situation even more difficult for them since the government is trying to bring sanity into the sector by regulating the number of companies that receive funding [6]. As global society and the world's cities and towns continue to expand in order to accommodate the rising population, the companies that are tasked with the management of the development projects across the world, and in China to be specific, are finding themselves at a crossroads. The main reason is the ever-changing business environment, which is managed by the political power in place. China has policies that have been established by the government to regulate the activities of real estate companies and safeguard the interests of the people, especially the buyers of property. The studies that have been done on the development of the real estate industry in China show that most of the companies are crowded in third tier cities where there is still space for development [7]. The difference is that the development does not come with sustainability measures, where excessive construction is leading to reduced prices in housing. The impact is that the developers are unable to finance their loans or even complete other projects for lack of funds.

The real estate managers are at the center of struggle to free the industry from the numerous challenges that they face [5]. China is restructuring its property development industry because of the rise in demand for property as the population in urban centers surges. However, this is only true in first- and second-tier cities. The situation is dire in the third-tier, where the population is reducing instead of surging. A reconstruction of the industry in the third tier cities has been argued to be one of the most urgent solutions that would help prevent a dilapidation in the economy in the near future [8]. Since companies are operating in a free economy, it is noted that the free market is causing a strain on both investors and developers. The real estate industry needs to be run on the premise of quality and credit worth, where companies that are unable to finance their projects and have debts should be restricted from doing further constructions. The free market within which the real estate companies are operating constitutes a major cause of the current industry issues, with the government playing a key role in leading both the public and the investors down this path. It is clear that the government has the ability to put in place measures to help the companies that are struggling with debt as a result of falling housing prices. And it is also true that the same government can regulate key industry players when it comes to the development of property in the third tier cities [9]. However, since there is a huge benefit in terms of GDP that the government draws from these cities, it is extremely difficult for it to put the necessary measures in place to regulate the already challenged sector and its companies.

4. Potential Impacts of the Overdevelopment in Third Tier Cities in China

It is already established that there are numerous challenges that developers are facing. One of the main developers, Jinke Property, noted that maintaining business in the environment that currently exists is a big challenge. The manager of the company pointed out that China's "three red lines" policy has brought several challenges to the industry, but they are mainly a result of funding. The policy has the potential to reshape the industry and make every player responsible while ensuring that there is a slowdown in the development that is currently being experienced [10].

One of the most frequently cited challenges or potential impacts that has been cited is the place of the unoccupied properties that are developed by the companies in the third tier cities. Examining the challenges indicates that the third-tier cities have several properties that have not been occupied and that need to be paid for. The impact of such development is that the place becomes unnecessarily crowded and yet does not have a return on investment [1]. Such property only attracts taxes, yet the developers are finding it difficult to pay off their loans, leading to an overload on their debt

obligations. The overloading of investor debt is a potential economic bomb that would hurt the country [11]. It points to a situation of imbalance when investors would not be able to sustain their activities, causing a huge burden on the economy of the country.

Another notable potential impact is the loss of space for future construction. While the current developers are overdeveloping the available space without getting the returns that would sustain them in business, a lot of important space is being lost. The significance of this space will be noticed when there will be nowhere else to do further constructions yet the already existing ones are managed by companies that would have run out of business or are badly in arrears [12]. As an economic impact, such properties will not have any economic value since they exist in space that is valuable but has no value by itself. Unless the government comes up with other measures to ensure that the next 10 to 15 years are largely regulated for the industry, this potentiality will become real in a matter of few years. China risks losing a big source of GDP if the third tier cities are lost to unscrupulous developers. The government needs to act fast if the per capita income in the cities has to have an impact on the national economic growth [9].

5. The Future of Real Estate Industry in China

China is growing at a very fast rate, as noted in the foregoing sections of this paper. The players in the industry do not seem to have a clear plan about the industry in ensuring that there is sustainability. The main players include investors and the government, since they both have direct benefits from the activities in the industry. The government thus seems to have no clear regulations to make sure that the future is certain. The future of the industry is therefore not guaranteed if there is little or no regulation [13]. The manner in which both public and private investors will respond to the current situation is important in showing the direction that the industry will take in the next ten years. While the global community is quickly moving towards modern cities, there is also a need to make sure that the majority of the global population can access affordable housing and office space. The movement of the masses to large cities in China means that they are leaving no chance for developers in small cities that fall under the third tier of China. In that case, the future of the real estate industry is still uncertain [5].

However, if their balance sheets are not put in check and maintained at a manageable level, they risk landing the sector in a never-ending debt situation that would eventually affect the costs of houses and other property. In statistics and financial aspects, the decisions that concern the debt ratios, rates of borrowing, and other critical issues make it important for the management to ensure that all the activities undertaken lead towards an optimal situation [14]. The decisions of the management and the entire team within the company has to ensure the survivability and future thriving of the company. This shows how company management can secure the future of the real estate industry and help reshape it for purposes of continuity. Putting in place the right structures is the first step towards a more assured real estate industry in China. Further, third tier cities still hold potential for China as a country and for all the developers in particular [15]. The challenge is in ensuring that the population outflow is reduced or totally curbed. The future of these cities depends on the settlement of these masses that are moving out into larger cities. Nonetheless, it is also important to create a conducive business environment so that it becomes easier to create a sector that is not only productive but also sustainable.

6. Conclusion

It is noted in this paper that China is a major global economy. Also, there is data to show that third-tier cities are experiencing a population outflow, an aspect that is creating a business challenge for real estate developers. However, there is a need to create a balance between the properties that the

companies in the industry are developing and the prices of these properties. Falling housing prices will eventually hurt the economy because of the economic imbalance that will arise between the tier one and two cities and their third-tier cities. It is an established finding that China needs to have policies that will make sure that developers invest where there is value instead of in the free-market in which they are operating. It would help ensure that the future of the industry is certain. However, in view of the findings of this paper and the existing shortcomings, it is noted that there will be a need to establish the impact of tier-one and tier-two cities on the development of tier-three cities. Thus, more research needs to be carried out outward, opening the space for a better understanding of the issues in the real estate sector in China.

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