Entering into Senior housing & Care Market in China －A Legal Perspective

Abstract: Investment in senior care industry in China relies not only upon culture and ethical fitness for foreign investors, but also a better understanding of Chinese regulatory environment. This article aims to shed lights on the emerging China senior housing and care market from a legal perspective, regarding the issues on market entering, governmental administration and supervision, whilst analyzing the legislation trend which would be in favor of this industry, and furthermore, introducing five common investment models suitable for various types of foreign investors.

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1、Chinese Senior Housing & Care Market

(1) Aging of the Chinese Population

According to a recent study by Chinese Ministry of Civil Affairs, more than 166 million people are aged 60 or older, representing 12.5% of the country's population and almost one-fifth of the total senior population in the world. In some urban areas of medium to large Chinese cities, such as Shanghai, the percentage of senior citizens among the total population has already exceeded 20 percent. By 2030, it will have more than doubled to 360 million people, and the percentage of senior population over age 65 in China will surpasses that of Japan, being the most aging country in the world.

Senior care industry is expected to be an emerging marketing in China that covering various sectors such as senior living institutions, nursing training, supplies for the elderly, financial products for the elderly, elderly entertainment and healthy facilities, etc. For some investors, the integration of the senior care sector will generate numerous prospects. Among others, senior housing development and senior heath care are the most attractive for investors.

(2) Introduction of the Chinese Market

In China, elderly care services are supplied by both public and private/NGO nursing homes and community elderly services, with premium elderly homes emerging as a new service segment.

Community elderly service includes services for seniors living in their own homes, but using community resources and being taken care of by their communities. Roughly there are only around 8,000 community service centers in China.

Nursing homes includes those for seniors living in external elderly nursing homes operated by government or private companies. The market for nursing homes operated by private companies is very fragmented, and most of them are currently believed not to be profitable.

Premium elderly homes include the homes of seniors who purchased or rent elderly apartments, living in communities and being taken care of by service vendors. Most of the premium elderly homes provide high-standard-of-living facilities with high-quality medical and nursing services, entertainment and sport facilities, and tourism plans. Some even offer residence swap programs between cities.

Currently, only a small percentage of consumers are actually using external elderly care services. However a significant portion of elderly may consider them in the future that will constitute a market share of 1.8 trillion by 2020 and 7.6 trillion by 2050.

In recent years, some local developers have invested in large scale senior care communities which are targeting to provide premium elderly homes to rich people. And some big investments by foreign players have already been made and further investment is believed to soar in the future.

2、Regulatory Environment

(1) China's 12th Five-year Plan

On 17 April, 2011, Standing Committee of the State Council promulgated the 12th Five-year Plan on the Development of Chinese senior care (中国老龄事业发展"十二五"规划) following the National 12th Five-year Plan for National Economic and Social Development (中华人民共和国国民经济和社会发展第十二个五年规划纲要) issued early this year, showing the termination of the Chinese authority to generally develop a healthy senior care market. According to the scheme, private capital include foreign investment is encouraged to take part in the sector. The government is trying to stimulate the construction of senior living communities, which is considered as the most suitable and acceptable elderly care model in China, and establishment of nursing home facilities that target to provide 3% of nation-wide "nursing beds" by 2015. At the same time, more legislative incentives is planned to be formulated and improved on the preferential policies in land planning, infrastructure facilities, taxations, etc, with a goal of boosting a transparent and healthy market on senior care industry and therefore attracting more private and foreign investors.

(2) Related Land Policies

（a）Ways for land acquisition

To startup a senior housing and care business, such as develop a elderly community or startup a nursing home, the first step is to acquire land use right and buildings. The most common way to acquire a state-owned land use right is to purchase from local government through bidding procedure, or to purchase or lease premises from an owner. In some cities, pursuant to local legislation, it is possible to acquire collective-owned constructive land use right through due process thanks to the opening up policy of making good use of land resource in the suburban areas which are collectively owned by villagers.

Is it worth mention that curving the real estate bobble has been a dominant voice in the Chinese real estate market resent years, and hence may affect the availability for investors to acquire land use right. Even though it is encouraged by the government to invest in the construction of senior housing, it is still hard for the investors to acquire land at a very low price.

In practice, some investors will choose to lease land use right or existing premises from landlord to startup its business. Legally, there are some restrictions to be aware of that, among others, the longest lease terms is 20 years, investors cannot sell the property to individuals whilst a lot of people wants to purchase a senior housing for investment purpose, and it would be hard for the investors to obtain preferential policies from authorities.

（b）Unclear on land usage

There is no such catalogue in the land usage as senior living or nursing purpose, while in practice land use right for residential, commercial, tourism, medical or even industrial purpose are possible to develop a senior housing project. Market price of land use right varies a lot—for example, land for tourism purpose is only half or one third of residential ones, so in the long term we predict it is a must for Chinese authorities to rule this regime, otherwise ultimately the government will suffer the lost of land grant premium.

Based on zoning regulations, there are restrictions on different land usage. For residential land, it is allowed to build a community for senior living; for medical land, only non-profitable purpose is permitted for the business; and for tourism or industrial land, the advantage of low price is coupled with the restriction of sales model of the senior housing products. For commercial buildings, due diligence has to be done on whether the zoning and design specification is fit for living. [i]

In our view, with the upgrade of industrial sectors in some one-tier cities, quite a lot industry projects will be evacuated and therefore provide more land available for service sectors, senior housing and care is definitely a good option. A successful project in Shanghai named Cherish-Yearn is operate on industrial land and has made its name by selling its membership card to seniors.

(3) Regulatory on Nursing Homes and Foreign Invested Medical Institutions

In the regulatory regime of nursing homes, the profitable and non-profitable institution differ a lot in policies, especially in the zoning and construction of facilities, taxations, infrastructure cost, and most important, for non-profitable nursing homes, the local government is prefer to give some financial subsidies, which is however only enough to cover daily costs of the services, and investors cannot enjoy profit. It seems not an option for profit-driven foreign investors to directly invest in a non-profitable nursing home, leaving service provider as the only option. The five models we discuss in the following contents are generally based on profitable purpose.

One essential element for a successful senior housing project is medical facilities, since most retired seniors are counting on social insurance to pay their medical fees occurs from the treatment in authorized hospitals. The more convenient and efficient a connection is created between a nursing home and hospital, the more attractive and accountable the place is for seniors to live in.

Definitely open up a hospital directly in one community is the best choice. Foreign investment in founding medical institutions in China has in the past been limited to equity or cooperative joint venture operations. In December 2010, the State Council announced to gradually relaxing the foreign equity restrictions on medical institutions in China and the position has been reflected in the removal of the joint venture requirements in the recent proposed amendments to the Catalogue for the Guidance of Foreign Investment Industries that foreign investors will, in the near future, be able to invest in medical institutions in China via a wholly-foreign owned vehicle.

(4) Legislative Expectation

By analyzing the regulatory environment in China, we find the following aspects are urgently to be improved.

（a）More clear supervision by competent authorities

Non-profitable senior care institution right now is under double supervision by Civil Affair Ministry and Elderly Committee, but with no self-discipline industrial organization; on the other hand, profitable institutions that mostly invested by private investor are to some extent in lack of any industrial supervision.

（b）Forming standardized industrial criteria

Despite that the State Council and Civil Affair Ministry have promulgated a series of regulations on the guideline of managing senior care institution, and some local governments, such as Beijing also bring out their local standards for senior care services, it is far from forming a standardization of industrial criteria. When different service providers bring in various type of standard, whether from US or Japan, supervision will then be hard for Chinese authorities.

（c）More supportive policies

Learned from the successful experience of western countries, the booming of senior care industry definitely depends on a series of incentive and preferential policies in land price, taxation benefit and financial instruments, among others. Now the Chinese authority has realized that importance, but as for the legislation, no guarantee or timetable is assured. So it is up to the investors to find its own way of making profits under current circumstance.

With the implementation of China’s 12th five year plan, the Chinese authority is committed to introduce more supportive policies for the development of senior care industry, set up a series of criteria for service provider, and proactively encourage more private investors to involve in this market.

3、Investment Models for Foreign Investors

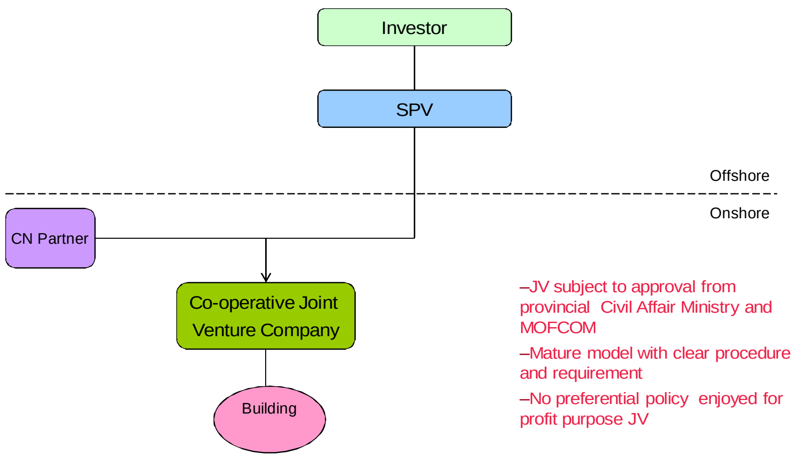
Whereas the senior housing and care industry may cover a wide variety of sectors and each may face different requirement or restriction for foreign investors, we hereby only choose the following five most used models that advisable for foreign investors to enter into this emerging market.

(1) <u>Establishing Nursing Home JV Enterprises</u>

According to the “2007 Guidance Catalogue on Foreign Investment” (外商投资产业指导目录 2007), senior care service is classified as “encouraged” category and therefore shall subject to no restriction for foreign investors.

However, according to the Provision on Administration of Social Welfare Institution (社会福利机构管理暂行办法) issued by the Civil Affair Ministry in 1999, foreign investors shall seek equity or cooperative JV model to startup a nursing home, which is obviously conflict with the essence of the above Catalogue. We believe, as a promise as of China entered into WTO, this obsolete requirement will sooner or later be canceled. Since this model is practiced by decades and before the Chinese authority finally liberalized this regime that allowing foreign investment via a wholly-foreign owned vehicle, procedure to set up such a nursing home is quite the same in different localities even though it is still up to be approved by several authorities.[ii]

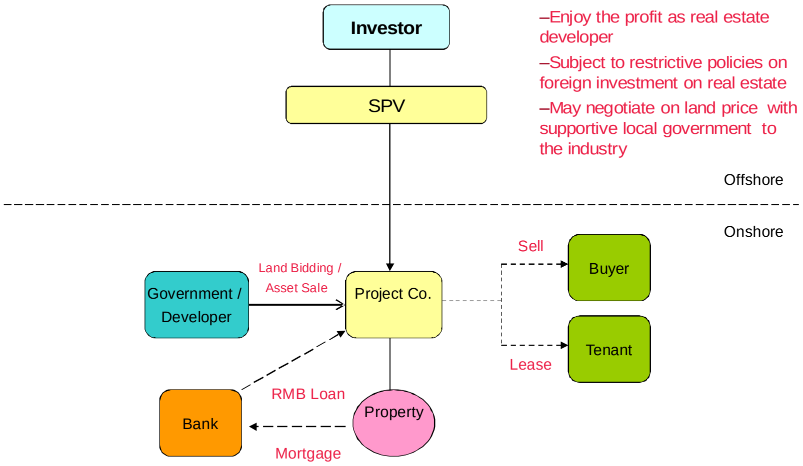
Model I Establish Local JV



(2) Being a Senior Housing Developer

Contrary to Model I that encouraged by Chinese authority, investment in real estate is in recent years under severe curbing, especially to foreign investors, in order to control the housing price and avoid "hot money" from flow in. However, this model is still attractive because real estate investors can use care homes to promote their business and get local governments to back them, especially to acquire land use right at a relatively low price.

Model II Senior Housing Developer



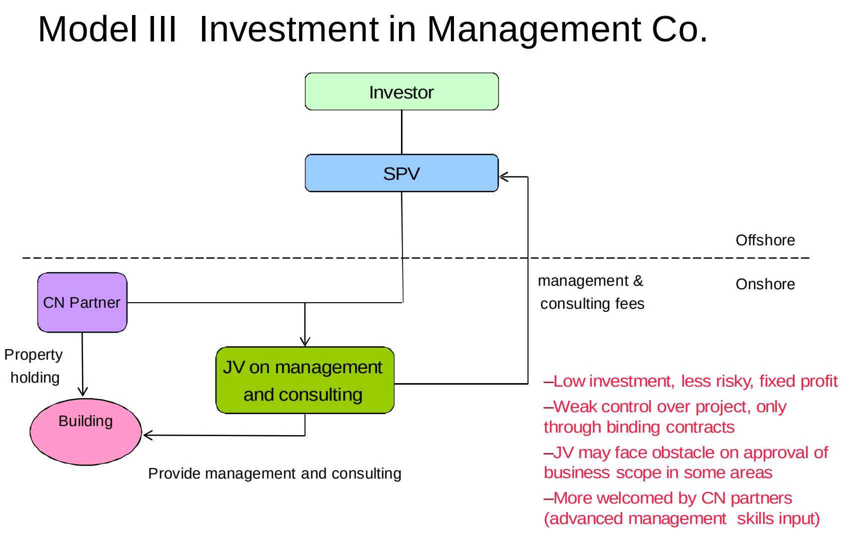
Pursuant to Circular 171(关于规范房地产市场外资准入和管理的意见）and Circular 50 (关于进一步加强、规范外商直接投资房地产业审批和监管的通知) issued in 2006 and 2007 respectively, foreign institutions or individuals need to set up a wholly Foreign-owned Enterprise (WOFE) for the purchase of non-self use properties. Approval from Ministry of Commerce (MOC) and related government departments including State Development and Reform Commission (SDRC), Ministry of Construction, etc. are required for setting up the WOFE. It generally costs several months to obtain these approvals.

However, the approval may be avoided if the foreign investors acquire the shares of an offshore SPV. Foreign investors can acquire real estate properties in China by either asset transfer or shares transfer of company holding the assets. On shares transfer, while acquisition of shares of an onshore company can be made, a more common deal structure for foreign investors is through shares transfer of a Special Purpose Vehicle (SPV) offshore which indirectly holds the property in China. From a tax perspective, the offshore deal structure may not enjoy preferential treatment as it used to due to one tax legislation as of 2009 that impose more prohibition and supervision on tax evasion for those offshore transactions. [iii]

Even though investment in Chinese real estate market is still pursued by many foreigners, capitals into senior housing sector are quite limited, partially due to unclear profitable business model and regulatory environment, partially are just waiting for a good timing. Currently, investors follow this model are mainly domestic developers and insurance companies, mostly are targeting at high-end products.

(3) Investment in Management and Consulting Enterprises

Aiming at exporting its expertise in senior care service, foreign investors may use this model by establishing a joint venture enterprise, to provide nursing facilities with consultation, management on operation or staff training as approved by local authorities. Since as a national strategy, home-nursing will be the dominant solution for most elderly, this model is promised to be in great demands in the future.



What worth mention is the flexibility of this model, for example, if the investor does not want to cooperate with a local partner, they can choose to set up a WOFE to operate consulting, training service, or even render community or medical service based on the opening up policy in the abovementioned point 2.3.

For some foreign investors, this model is relatively acceptable since investment amount is low that taking one shot as a test of the Chinese market seems to be a good starting point. One recent example is an equity JV incorporated by MCS, a Japanese investor, and Sanmao Group, a SOE local partner to operate a nursing home. The MCS contributes 49% of the total investment of 3 million US dollars while its local partner contributes the other 51%. The JV is planned to provide operation and management service while the property ownership is still hold by Sanmao Group. The Japanese investor can not only charge a fixed consulting fee from the JV, but also will eventually enjoy JV's profits as a shareholder.

Among others, protecting their IP and well trained professionals are two big issues that foreign investors mostly concern about. This model is to be tested from business perspective, and we will, on the other hand, discuss legal solution for investors in another article.

(4) Entering Via Financial Market of Insurance

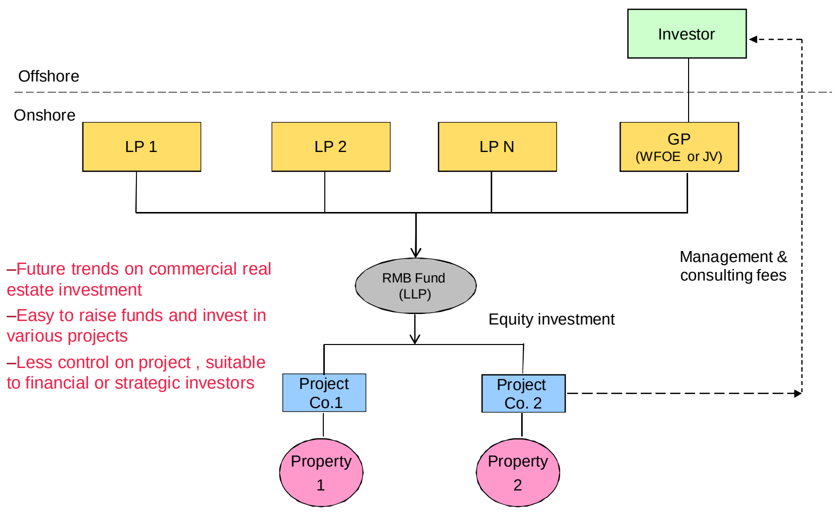
Foreign insurance investors, especially those multi-national enterprises, have already spread their business in the Chinese market years before, and now are facing fierce competition. Involving in the senior care industry seems to be not only a trend that proved to be well worked for insurance companies, but also an urgent desire for those player aiming to dominate the market by combining the senior care industry with their elderly insurance products.

The good news is Chinese authority has already relaxed the investment to senior care institutions and real estate by insurance companies as of year 2009. While imposing a series of restriction on insurance funds that invested in the real estate, such as a investment caps of 10% of the company's total assets, and forbid insurance companies to directly invest in real estate projects, the regulators really turn "green light" for insurance companies to invest in senior care housing, and thereby creating a potentially new, large and influential institutional player in the Chinese senior care landscape. By far, most related investment is conducted via equity investment, financing structure and property purchasing.

(5) Through PE Fund Investment

Private equity fund investment is a luring and heating market in China recent years, and "gold rush" in the senior care industry is no exception. Strategic investment in mature projects or directly developing projects through RMB fund vehicle can meet the capital needs of local market players, and in return the investors can enjoy the benefit once the projects start to profit. By far, quit solutions applicable for these funds in commercial real estate are still limited, however, we believe once the REITs legislation in china is clear, a huge amount of fund investment in this sector will be seen. We will discuss the RMB fund and REITs regulatory environment in another article.

Model IV Fund Investment



Two symbolic investments can illustrate the heat of the market. Within a couple of months at the end of last year, Trust Bridge Partner signed a RMB100m investment with Cherish-Yearn, a Shanghai senior care company; and Fortrees Investment, a leading hedge-fund investor announced to seek senior care projects in China with a planned investment of 1 billion US dollars. Both the investments are believed to be only tip of the iceberg, and most spectators are now rushing into the market.

4、Conclusion

We believe investors will find its own way to fit the Chinese demand, most importantly cater for Chinese tradition towards elderly care. In the senior housing sector, as long as reverse-mortgage is far from legalized, and most seniors traditionally hope to leave assets to their next generation, proven business models for most developers are still under market testing.

Finally, let's take a glance at the draft of China Elderly Law as a conclusion of this article. In this draft, elderly care is defined by legislation and responsibilities for elderly nursing and care are allocated to different levels, while home-nursing service, community elderly care facilities and elderly care institutions (nursing homes) are the three major resources to the elderly nursing market demands.

Serving China's growth in elderly population promises to be a very attractive proposition in the coming years. Now it is the time for foreign investors with a long-term vision to build their foothold in the Chinese market. Given the limitation of this article, some legal issues cannot be touched upon, such as the social welfare system for elderly people and the role the government is about to play in the process. We will continue to focus on the senior housing & care market and provide our firsthand expertise to the market players.

We are commercial real estate lawyers. In particular, we provide assistance to clients in the fields of commercial real estate development, retail, hotel & leisure, senior housing & care and private equity investment.

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Borrowing	Foreign investment

Corporate and business affairs

Commercial agreements	Tax
Corporate governance	Partnerships and joint ventures

Litigation

Business litigation	Real estate litigation

[i] To understand China land system, please refer to the article "Chinese land system and the basic principle and practice for foreign investors on real estate" on our website http://www.lawviewer.com/index.php/English/View/infoid/6653

[ii] To understand foreign investment vehicles, please refer to the article "Introduction of Business Structure for Foreign Investors" on our website http://www.lawviewer.com/index.php/English/View/infoid/6729

[iii] For more information regarding restriction on foreign investment in real estate, please visit our website for relevant article http://www.lawviewer.com/index.php/English/View/infoid/6211