

# Reflection and Reform of my country's Commercial Housing Pre-sale System

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**Abstract:** With the development of housing system reform, the pre-sale of commercial housing has become the main model of housing sales in China. It is undeniable that the pre-sale system has unique advantages in financing, but the risks that come with it are also gradually emerging. In practice, disputes related to the pre-sale of houses continue to arise. How to better protect the rights and interests of buyers when the sellers and buyers have unequal innate conditions has become an urgent problem to be solved. Therefore, this article will summarize the reasons for the high incidence of pre-sale risks in practice, and put forward reasonable suggestions for the pre-sale system of commercial housing from the perspective of the system itself and legal norms, in order to better promote the healthy development of the domestic real estate industry and safeguard the legitimate rights and interests of the majority of buyers.

**Keywords:** Commodity housing pre-sale system; Legal thinking; Buyer's rights protection.

## 1. Overview of the Commercial Housing Pre-sale System

### 1.1. The Meaning and Characteristics of Pre-Sale of Commercial Housing

According to Article 2 of China's "Administrative Measures for the Pre-sale of Urban Commercial Housing", the pre-sale of commercial housing refers to the act of real estate developers selling houses under construction to buyers in advance, with the buyers paying the corresponding price. In other words, when the pre-sale house is under construction, the buyer and the seller sign a pre-sale contract, and the buyer pays the price to the developer according to the specific provisions of the contract. After the house is officially completed and accepted, the property registration of the commercial housing is carried out, and only then can the ownership of the commercial housing be truly obtained. The components of China's commercial housing pre-sale system mainly include the commercial housing pre-sale permit system, the commercial housing pre-sale fund supervision system, and the commercial housing pre-registration system. Generally speaking, the act of selling houses before the houses are actually built can be included in the category of commercial housing pre-sale.

It should be noted that there are differences between the pre-sale of commercial housing and the normal sale of housing. In comparison, the risks for the buyer are greater, which can be summarized into the following three characteristics:

(1) There are relatively many entities involved and the legal relationship is complex. Compared with the current sale of houses, the legal entities involved in the pre-sale of commercial housing include the buyer himself, the developer, the bank, the contracted construction unit, etc. Since the price of the house is a large expense, most buyers adopt the bank mortgage loan model to buy a house. As a result, a triangular relationship is formed among the buyer, the developer and the bank, namely the mortgage loan relationship between the buyer and the bank, the payment relationship between the bank and the developer, and the buying and selling

relationship between the buyer and the developer. At the same time, due to objective reasons such as the long construction period and high capital consumption of houses, the specific construction process is often undertaken by qualified construction units. From this perspective, the pre-sale of commercial housing also involves the contracting relationship between the developer and the construction unit.

(2) It has a long construction period and high risk. According to the Urban Real Estate Management Law, real estate developers can conduct pre-sales when the funds invested in the project reach more than 25% of the total investment amount of the project and the specific construction progress and completion delivery date are determined. According to the specific circumstances in practice, the normal delivery period is generally 2-3 years, and the parties will specify the formal delivery period in detail in the contract. However, due to the many uncontrollable factors in commercial housing construction, delayed delivery is common in real life.

(3) There is a certain degree of state intervention. Under normal circumstances, commercial housing sales transactions should be completed in accordance with the parties' autonomy, which is mainly reflected in the exchange of money and housing. However, unlike the relative stability of current sales, pre-sales have greater unpredictable risks, so the state needs to conduct stronger supervision to protect the legitimate rights and interests of pre-sale parties and maintain social stability. After the frequent occurrence of pre-sale chaos, the state issued the "Urban Commercial Housing Pre-sale Management Measures" to regulate the real estate pre-sale market, which detailed the basic conditions that need to be met for pre-sales. In addition, regulations are also made for land use and contract filing for real estate companies.

### 1.2. Brief Introduction to My Country's Commercial Housing Pre-sale System

In my country, the emergence and development of the pre-sale system of commercial housing has its practical reasons. In the early stage of the development of the real estate market, the supply of urban housing was far from meeting the demand. However, the real estate industry requires a large amount of

capital investment on the one hand, and the cycle of capital recovery is very long on the other hand. There are also many uncontrollable risks that may lead to a loss of capital, so most companies are deterred from this. Therefore, the pre-sale system has become a solution to this dilemma. For real estate companies, the pre-sale system of commercial housing helps developers to raise funds, promotes corporate capital turnover, and injects strong momentum into real estate development; for home buyers, the pre-sale price is lower than the current sale price, which can save the cost of buying a house, so a large number of home buyers choose to pre-sell houses. Overall, the pre-sale system occupies an important position in the real estate industry and has made considerable contributions to the development of my country's real estate market.

However, as the pre-sale system continues to develop, many problems have gradually emerged due to the uneven risk design of buyers and sellers, the weakness of the transaction supervision mechanism, and the poor real estate market environment [2].

The pre-sale system of commodity houses has allowed some enterprises to find loopholes in the system and adopt the practice of "making money out of nothing", which has led to disorderly competition in the real estate industry. Under the favorable conditions of the pre-sale system, the requirements for enterprises themselves have been reduced to a lower level. As long as they can obtain land resources and hold some funds, the project will be carried out quickly, allowing some weaker enterprises to fish in troubled waters, while the advantages of enterprises with strong strength and good business reputation are weakened. This industry competition model is generally quite backward. In addition, the emergence of the real estate bubble economy crisis in previous years is also inextricably linked to the pre-sale system. In China, even if the quality of pre-sale houses does not meet expectations, and there is even a 2-3 year housing acquisition cycle, the reason why buyers continue to buy pre-sale houses is the psychological expectation of rising housing prices. If the bubble economy breaks out overnight and housing prices show an unstoppable decline, buyers will not buy pre-sale houses, and the market share of pre-sale houses will also shrink. For real estate developers, the core competitiveness of the enterprise lies in the ability to obtain land, and the administrative monopoly of land leads to the non-competitiveness of the real estate market. In fact, developers have created a shortage of supply by hoarding properties and refusing to sell them, and a large number of homebuyers have competed for housing through methods such as "lottery" and "paying tea fees". [3] Under the influence of these two factors, housing prices continue to rise, making the real estate bubble bigger and bigger. It may even lead to systemic risks in the financial sector, which in turn has a great negative impact on the stability of the economy.

Therefore, it is necessary to reflect on the shortcomings of the commodity housing pre-sale system and to reform it accordingly. On the one hand, given the huge share of commodity housing pre-sales in the real estate market, its reform is of great significance to optimizing the real estate market environment, helping to further integrate the resources of the industry and replacing the backward competition order with a fair and reasonable competition mechanism; on the other hand, it is also an inevitable choice to maintain fairness and the rule of law. Although the commodity housing pre-sale system has produced huge economic value, its social benefits

are not satisfactory. Due to various situations such as false propaganda by developers, poor housing quality, and unfinished projects, home buyers often fall into the dilemma of paying the price but not getting the house they expected. This is undoubtedly contrary to the current political goal of improving people's sense of gain, security and happiness. [4] Therefore, the reform of the commodity housing pre-sale system is imperative, not only to promote the healthy development of the industry, but also to solemnly respond to the call for a people-oriented rule of law.

## **2. Analysis of the Pre-sale System of Commercial Housing in China and Abroad**

### **2.1. Hong Kong, China**

In Hong Kong, in general, buyers who purchase pre-sale houses will first pay a deposit of about 5 % of the total price of the house, and then sign a purchase contract. After that, the parties will sign a formal house purchase and sale contract at the law firm designated by the developer. The buyer will pay the down payment and choose the payment method of the balance. It should be noted that the developer cannot directly get the down payment paid by the buyer, which is generally managed by a lawyer. The law firm is the joint manager of the buyer and seller and needs to be responsible to both parties at the same time. When funds are required to be allocated, professional construction personnel are required to issue a progress opinion and a fund allocation opinion issued by the law firm. Only after the construction usage fee and mortgage loan are fully paid, the lawyer will hand over the remaining funds to the developer. In Hong Kong's pre-sale system, lawyers play a pivotal role in reducing the risks of pre-sale transactions.

### **2.2. Japan**

In principle, unfinished houses are not allowed to be sold in Japan, but its deposit trading system is similar to the pre-sale system in China, that is, developers are only allowed to collect a small deposit during pre-sale, and the amount shall not exceed 20 % of the pre-sale house price. Developers must apply for corresponding guarantees at legal financial institutions and hand over the documents to the buyers. This behavior is based on the protection of the rights and interests of buyers, balances the unequal status between developers and buyers, and ensures that buyers can get back their deposits after the developer's project is unfinished. In addition, Japanese law also stipulates that only when the deposit paid by the buyer is less than 5% of the total price of the house and the amount does not exceed 10 million yen, no preservation measures are required. At the same time, developers are subject to corresponding disclosure obligations.

### **2.3. United States**

In the United States, pre-sales are closer to existing home sales. Generally speaking, after the buyer signs a pre-sale contract with the developer, the buyer needs to pay part of the price as a deposit, usually 10 % of the total price. This deposit will be held in trust by a third-party notary agency. After the developer and the buyer complete the transaction, the trustee will set up a special account to hold the funds. The funds will only be transferred to the developer when the project is completed and delivered. In other words, the third-party trustee supervises the entire process of pre-sales in the United

States, as a way to balance the status differences between the buyer and the seller, and effectively reduce the risks that may be brought about by pre-sales.

To sum up, the pre-sale systems in Hong Kong, Japan, and the United States basically require that developers can only receive the purchase money after the house is delivered. Some countries even store a portion of the purchase price as a quality guarantee. They attach particular importance to fund supervision. The institutions that exercise fund supervision functions are different, but they are all supervised by professional legal, financial or insurance institutions to better balance the information gap between the two parties to the transaction and ensure that the project can proceed smoothly and achieve the expected quality.

### **3. Reasons for the Risks of my country's Commercial Housing Pre-sale System**

#### **3.1. Imperfect Credit System in The Real Estate Industry**

In practice, problems with the pre-sale system frequently occur, and disputes are common due to multiple sales of one house and unfinished housing projects. This is mainly due to the developer's breach of trust. Compared with the emphasis on the credit system by enterprises and countries,

In fact, there is still a lot of room for improvement in the construction of the credit system in China's real estate industry. For example, the United States also has a transaction model of pre-sale of future homes, but the corresponding practical problems have relatively rarely occurred. A large part of the reason is that the United States attaches great importance to corporate credit evaluation. There are 16 pieces of legislation related to this, more than half of which involve consumer protection. [5] The defects of China's real estate industry credit system are mainly manifested in three aspects: lack of corporate credit awareness, lack of relevant laws and regulations, and lack of a reasonable reward and punishment mechanism.

#### **3.2. The Entry Threshold for Commercial Housing Pre-Sale Is Relatively Low**

According to the laws of our country, developers can obtain the pre-sale qualification of commercial housing by meeting four conditions, namely, holding a construction permit, paying the land transfer fee in full and obtaining a use right certificate, investing 25% of the total investment, and registering with the relevant departments. Among these four conditions, the one with relatively practical restrictions is the capital investment, but it should be noted that there is no clear standard for the amount of capital investment in practice. Some real estate companies even include the land transfer fee in the calculation of the pre-sale investment. This results in the threshold for meeting these four conditions being relatively low, which in turn allows some companies with poor credit and weak risk resistance to enter the real estate industry, bringing possible higher risks to multiple parties such as home buyers and banks.

#### **3.3. Lack of Supervision on Funds Raised from Pre-Sales**

In general, the main problem with pre-sale fund supervision in China is that the effectiveness of pre-sale fund

supervision is low. In the current legal system related to pre-sale fund supervision, the most effective one is the Urban Real Estate Management Law. However, its provisions on the supervision of pre-sale funds are not very detailed, and only limit the main use of pre-sale funds. The "Urban Commercial Housing Pre-sale Management Measures" promulgated by the Ministry of Construction only clearly states that the pre-sale funds collected by developers should be used for subsequent project construction, and more specific supervision details are formulated by local real estate management departments. It can be seen that the details of supervision are not involved in the laws with higher effectiveness. In practice, a large number of detailed standards are regulated by local documents. However, due to the low legal effect of local documents, when relevant litigation disputes arise, it is often necessary to provide theoretical support for appropriate laws [6].

### **4. Suggestions on Improving the Pre-Sale System of Commercial Housing**

#### **4.1. Building a Real Estate Credit System**

In response to the country's call to vigorously advocate the construction of a long-term mechanism for the real estate industry, the importance of building a real estate credit system is self-evident. This can not only provide a basis for financial institutions to lend, reduce the capital risks of banks and other financial institutions, but also help to better protect the legitimate rights and interests of home buyers.

Specifically, we can start from the following aspects: First, improve the credit legal system. In modern society, the orderly development of any industry requires legal protection, but in the real estate industry, the clauses related to credit are scattered in multiple clauses, and there is no integrated legislation, so it is necessary to formulate corresponding laws to regulate the dishonest behavior of real estate companies; second, the government needs to build a corresponding credit system management platform, strengthen supervision, and timely do a good job of information disclosure. In view of the current practice, most real estate credit information platforms are based on local evaluation standards in various cities to disclose information, and the impact is limited. Building a national information management platform, establishing a unified credit standard, and realizing a cross-provincial and cross-city information sharing mechanism are a feasible path to promote the construction of real estate credit; third, optimize the credit reward and punishment mechanism. At present, although there are corresponding incentive and punishment mechanisms in various places, the punishment consequences of dishonesty are generally not enough for real estate companies to learn from them. Therefore, the dishonesty of real estate companies is common, and it is necessary to strengthen the punishment while increasing the incentives for trustworthy companies; fourth, give play to the guiding role of industry associations, combine all forces that can be combined, and strengthen the auxiliary role of real estate industry associations, which will help to better improve the credit system.

#### **4.2. Broadening Real Estate Financing Channels**

Compared with other countries and regions, the main function of my country's pre-sale system is financing. The introduction of this system was to help enterprises with

insufficient strength to develop this business and promote infrastructure at that time. The real estate financial market in other countries and regions is already in a relatively mature and stable state, with diversified and sufficient sources of funds, and relatively speaking, there are fewer problems. The financing nature of my country's pre-sale system has not been weakened in the development of the real estate industry. The root cause is that other financing channels have developed slowly, and most small and medium-sized enterprises cannot obtain financing through company listing.

Therefore, in response to this dilemma, we first need to continue to develop the real estate market to eliminate the financing nature of my country's pre-sale system as much as possible. At the same time, companies also need to grasp the financing focus in a timely manner, increase the proportion of internal financing to adjust possible risks, and better meet long-term financing needs. In addition, we must always pay attention to the financial market and consider applying emerging financing methods to obtain funds, such as adopting a combination of bank loans and trust funds. This can improve financing efficiency while reducing investor risks.

### **4.3. Raising the Entry Threshold for Pre-Sale**

At present, the entry threshold for pre-sales in China is relatively low, which is also one of the important reasons for the chaos in the industry. Developers can start pre-sales after investing more than 25 % of the funds in the project and determining the completion and delivery date. This standard is essentially unable to achieve the purpose of measuring the strength of the enterprise, and also lays hidden dangers for whether the subsequent projects can be completed as scheduled. Therefore, in practice, there are many cases where real estate companies have unfinished houses due to broken capital chains.

Combined with the practices of other countries and regions, this article believes that it is possible to make the developer provide a guarantee as a pre-sale condition. Taking this measure can better ensure the smooth completion of the project and reduce disputes such as unfinished housing. On the other hand, it also prompts developers to pay attention to their own credit, because credit is related to the amount of guarantee provided by the third-party institution and whether to provide a guarantee for it. Under this premise, if real estate companies disregard the interests of home buyers and engage in false propaganda, produce low-quality houses, etc., which is consuming the life of the company in the long run, then it will naturally achieve the purpose of regulating the chaos in the real estate industry, protecting the rights and interests of home buyers, and creating a more fair and reasonable market environment.

### **4.4. Implementing Supervision of Pre-Sale Funds**

The supervision of pre-sale funds can be said to be the core

of the pre-sale system, and it has a great influence on the standardization of the pre-sale system. It is not only related to the use and circulation of the funds by the developer, but also runs through all aspects of the production and operation of real estate enterprises. Unfortunately, the national law has not yet been issued, and the local real estate management department is often responsible for supervision, which may cause some regulatory risks and make it difficult for home buyers to seek relief.

Therefore, it is particularly important to have a suitable subject for fund supervision. In the pre-sale of Hong Kong, lawyers play the role of this subject. With their rich legal knowledge as the basis, they can better play the role of supervision. At the same time, as an independent subject, lawyers are independent in terms of responsibility. Lawyers can play a supervisory role to a certain extent to make up for the natural difference of information asymmetry between home buyers and developers, which is a feasible path. However, considering the current national conditions in my country, it is not appropriate for lawyers to act as the subject of responsibility, mainly because the credibility of lawyers in my country still needs to be strengthened. Therefore, this article believes that joint supervision by banks, engineering supervision agencies and the government is more in line with my country's basic situation. At the same time, the avoidance system is flexibly used, with the government as the core, to play the credibility facing the public, combined with the professionalism of the supervision agency and the bank's fund procedures, to improve the supervision of funds.

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