RETAIL REAL ESTATE DEVELOPMENT IN BEIJING, THE PEOPLE'S REPUBLIC OF CHINA

by

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ABSTRACT

Much of the current retail real estate development in the People's Republic of China (PRC) is concentrated in the Special Economic Zones, which are areas where China has been experimenting with capitalism. This development is primarily from foreign investment encouraged by the economic reforms of Deng Xiaopeng. Until recently, mainland cities such as Beijing, the capital of the PRC, have been overlooked. With the current reform movement escalating, there are many opportunities to develop retail projects in this city given its favorable demographic trends.

Choosing a prime location in Beijing is only one of a number of important factors to consider. Developers should be aware of urban development transitions, retail development patterns and demographic changes. They should also be knowledgeable of the local urban planning process, real estate development procedures, local customs and laws, and development entity options.

In this thesis, a basic framework is presented to determine the potential real estate development opportunities for retail uses in Beijing. Although specific sites for prospective retail projects are not offered, key information is set forth to provide a foundation for further research.

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INTRODUCTION

There are numerous real estate development opportunities in The People's Republic of China (PRC), the world's third largest country (behind the former Soviet Union and Canada) and home to almost one out of every four people in the world.[1] Because of the economic reforms instituted by Deng Xiaopeng in 1978, this "sleeping giant" is beginning to emerge as an economic powerhouse, with people benefitting from the country's prosperity with higher income and greater spending capacity.

Economic reform has also provided gains to urban cities such as Beijing, which has seen an increase in population during the last ten years, a higher standard of living for its residents and a need for well-conceived retail projects in strategic locations within the city. There have only been a few foreign joint venture retail developments in Mainland China. Therefore, there are avenues for foreign developers to successfully exploit retail development opportunities.

The purpose of this thesis is to determine the potential real estate development opportunities for commercial retail uses in

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[1] Fredric Kaplan, The China Guidebook: 1991-1992, 12th Edition (Teaneck: Eurasia Press, Inc., 1991), p. 20.

Beijing, the capital of the People's Republic of China. Real estate development in Beijing is different from the United States and from other areas of China such as the Special Economic Zones. Thus, identifying retail opportunities requires a general understanding of the present PRC: Demographic trends, local and central political structures, economic reforms, the real estate development process and legal structures of development arrangements.

This research is divided into five chapters. The first contains relevant background information and demographics on Beijing and China which will assist in understanding retail trends and consumer spending patterns. The second chapter covers information on urban development trends, the role of the government in the formation of Beijing, the key urban planning issues facing the municipality and the future retail development patterns. The third chapter discusses the real estate development process in Beijing, the nature of foreign investment and the various legal entities available in structuring foreign real estate developments. The fourth chapter contains two case studies which will analyze retail districts from a foreign developer's perspective. The fifth chapter will finalize the paper by deriving conclusions regarding the potential real estate development opportunities in Beijing based on findings from the previous four chapters.

This thesis serves as a general advisory piece for those with a special interest in conducting future real estate transactions in Beijing, particularly in the retail sector. Specific detailed analysis must be performed and professional advisors should be consulted before considering such a venture.

I. OVERVIEW AND DEMOGRAPHICS

CHINA

Demographic Factors

Prior to 1978, retail real estate development in China was basically one of two forms: (1) Small proprietorships owned by community residents, or (2) Local government-owned department stores. Foreign investment in the retail arena was virtually nonexistent. In 1979, the "Open Door" policy was instituted by Deng Xiaopeng. This program called for substantial economic reforms and paved the way for retail real estate development projects funded by foreign capital. This policy had shown only limited success at the outset since "The door was open, but it was not completely open".[2]

In the early 1980's, the two prevalent forms of foreign investment for retail real estate development, joint and wholly foreign-owned ventures, were in their embryonic stages and many of the pre-economic reform restrictions were still in existence. Joint venture arrangements between the Chinese and foreign partners were encouraged, but joint venture laws within China lacked the foundation and structure to be

[2] Interview with Associate Professor Mao Qizhi, Architecture and Urban Planning Department of Tsinghua University in Beijing, July 11, 1992.

effectively implemented. Wholly foreign-owned enterprises were ladened with too many restrictions to be attractive to outside investors, who had better opportunities in other countries (United States) with lower political risks.

Currently, the retail real estate development potential in The People's Republic of China (PRC) is almost unlimited since the foundation of Joint Venture Laws was strengthened and the many restrictions for foreign investment were eased.[3] As of 1990, it is estimated that the population of China is 1.143 billion people or a 1.45% increase over the 1990 population of 1.127 billion people.[4] Therefore, a gradual growth in income and spending patterns will likely yield enormous benefits to those who invest in the retail sector.

There are currently three trends in the urban areas of China which a retail developer should note:

1. The ratio of urban residents to total population was 26.4%

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[3] There is a note of caveat regarding the statistics presented in this papaer. All of the data was compiled by Chinese statisticians, who are considered by U.S. Embassy officials to be competent. However, the integrity of the imformation compiled is questionable. Therefore, the historical data presented should be evaluated based on the trends that it projects rather than on the accuracy of the data itself.

[4] State Statistical Bureau of the People's Republic of China, China Statistics Abstract 1991 (Beijing: China Statistical Information and Consultancy Service Center, 1991), p. 3.

in 1990, or an 8.5% increase in composition since 1978.[5] This implies that there is an increase in the migration from the rural areas to the urban areas for jobs, thereby fueling demand for additional retail space.

2. The percentage of unemployed persons in urban areas has decreased from 5.3% in 1978 to 2.5% in 1990.[6] This beneficial trend indicates that there is more prosperity in the cities, thereby absorbing much of the excess capacity of the labor pool.

3. Newly employed persons in urban areas have increased 44% from 5.4 million people in 1978 to 7.9 million people in 1990,[7] but the composition is substantially derived from persons of other cities and towns and from graduates of universities. This trend is very important since most of the urban growth has come at the expense of other cities. A retail real estate developer must therefore perform diligent research on the population and work force movement patterns before he/she builds in a city.

The 1990 total value of retail sales increased 533% since 1978

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[5] State Statistical Bureau of the People's Republic of China, China Statistics Abstract 1991, p. 16.

[6] Ibid, p. 20.

[7] Ibid, p. 20.

(from 156 billion to 830 billion yuan, unadjusted for inflation), with the ratio of consumer good purchases to total retail sales increasing modestly, from 81% in 1978 to 87% in 1990 (agricultural good sales accounting for the remaining 19% and 13% respectively).[8] This is further evidence of China's growing prosperity. In general, the PRC will strive for double-digit economic growth through the end of the decade.[9]

An interesting statistic is that urban retail sales as a proportion of total sales throughout the country have decreased from 48% in 1978 to 44% in 1990,[10] with rural areas capturing a greater percentage of retail sales. Two explanations may account for these trends. The first is that rural incomes have risen much faster than urban earnings. The rural areas have prospered a great deal more as a result of the 1978 economic reforms than the urban areas, which have grown at a slower rate. The second explanation is that there are more sales to urban residents at rural locations, where prices are likely to be more inexpensive than city goods. The above trends are difficult to assess because the lines between rural and urban areas are hard to ascertain, especially at the

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[8] State Statistical Bureau of the People's Republic of China, China Statistics Abstract 1991, p. 99.

[9] "China Growth Goal Backs Reformers", International Herald Tribune, (Paris), July 17, 1992, p. 13.

[10] State Statistical Bureau of the People's Republic of China, China Statistics Abstract 1991, p. 99.

edges of the city.

Political Factors

The post-1949 People's Republic of China was considered to be a socialist country, where the government owned all land and no one individual stood above all others within the "great masses". Within this framework, the retail sector of the economy was basically subordinate to heavy industry. The state had owned all of the large retail shops and price controls were set such that they were uniform across the country without regard to the costs of manufacturing and shipping. The quality of products were often poor, inventory shipments were unreliable and inventory levels were inconsistent because wages were fixed and no incentives were built into individual compensation. Service to the ultimate customer was basically non-existent and retail expenditures were low. Much of the money not spent was kept in cash (hidden "mattress" money) and away from government-owned banks to avoid disclosure.

In the 1980's, backed by Deng Xiaoping's leadership, socialism was appearing to wane and citizen's rights and democracy were pledged to be top priorities as China attempted to continuously modernize. The country's official doctrine was economic liberalization but maintenance of the political status quo. "Socialism" was still considered the country's political stance although in reality this posture was constantly tested. The prospects for foreign investment in retail real estate development were promising even though the primary vehicles (joint venture contracts) to fulfill these opportunities have yet to be designed.

In June 1989, an effort to institute democracy was dealt a major setback. At Tian'anmen Square in Beijing, a student-led protest stemming from the government's apparent lack of speed in instituting economic and social reform was abruptly and bloodily dismantled by government troops. Consequently, foreign investment in China had virtually halted. In the U.S., China was temporarily removed from the Most Favored Nation (MFN) status, a designation given to countries who are able to trade with the U.S. on its best terms.

In the few years since the Tian'anmen Square incident, foreign countries again have been placing money into China with contracts (not all real estate) through May 1992 amounting to $10.45 billion, or 2.7 times the amount for the corresponding period in 1991.[11] In the U.S., China again has been reinstated as a Most Favored Nation even though its human rights issues remained. Real estate investments in the PRC have noticeably increased although little, if any real estate

[11] David Holley, "China's Reformers Are Back on the Offensive", Los Angeles Times, July 18, 1992, p. A22.

involvement from the U.S. has occurred since the student uprising. American companies will be forced to become involved as scarce development opportunities exist domestically and as retail development opportunities in China are capitalized by other foreign firms.

Political Hierarchy under the Central Government

China is divided into three administrative levels:

(1) Province (includes autonomous regions and three specified municipalities directly under the Central Government dominion)

(2) County (consists of cities, banners, special districts, industrial-agricultural districts and forest districts)

(3) Township (comprised of towns)

In the first stratum, there are 23 provinces, 5 autonomous regions, and three municipalities (Beijing, Shanghai and Tianjin) directly under the Central Government. In the second and third levels of hierarchy, there are thousands of counties and townships.[12]

At the micro level within a city, there are two additional

[12] State Statistical Bureau of the People's Republic of China, China Statistics Abstract 1991, p. 2.

levels of hierarchy that are important for a developer to know: (1) District Area Level, which is concerned with the development of the local community fabric and (2) "Street" Government, which is involved with issues within specific street neighborhoods.

Economic Considerations

Economic and Agricultural Reforms

Prior to the economic reforms in 1978, the PRC had centrally planned China's economy through careful strategy and controlled growth. This system involved agricultural quota targets and state-directed resource allocation which had stunted change and suppressed worker incentives.

Under Deng Xiaoping's guidance, the PRC in 1978 decentralized control to farmers and private enterprise. Initially, the economic reforms appeared to have little ostensible effect on China's urban economy, which relied predominantly on industry (see Beijing's economic categorization in **Exhibit A**), government-owned businesses and to a lesser extent private enterprise.

Even today, China heavily relies on industry as the leader of its civic economies. Large government monopolies still exist in raw materials such as iron, steel, petroleum and coal and in energy/untilities (e.g. electricity). In addition, the

Central Government owns the major banks. There are presently no plans to dismantle these controlled sectors, which account for most of the urban employment within cities.

Much of transformation of enterprises from the economic reform movement has been in the small segments of China's economy, the rural regions. The prosperity of these sections, especially at the edge of the cities, have permeated the urban areas. The decentralization policy created a "responsibility system" which allowed farmers to sell excess agricultural production over the minimum government quota at the free market prices (i.e. without government-controlled rates). The farmers became more affluent with this motivation to make economically-based business decisions. They started their own businesses and built their own factories. As of June 1992, there were more than 20 million rural enterprises in China and 129 of them had an annual output of more than 100 million yuan ($18 U.S. million) each. Additionally, the total number of employed workers in rural enterprises exceeded 100 million.[13] Thus, the sharp delineation between urban and rural areas became blurred and the need for retail services and development was emerging, specifically along the perimeter "rural" areas of cities such as Beijing.

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[13] "Flexibility is key for rural enterprises to develop faster", China Daily, (Beijing), June 30, 1992, p. 4.

Demand for Better Customer Service

The small but powerful advent of the private economy had other beneficial effects. First, wages offered to workers in the private sector were much higher (as much as 10 times greater) than those employed in government-owned businesses. In addition, private companies only hired and kept the best workers as employees. Those receiving higher wages were therefore able to enjoy the advantages of additional consumer spending.

Another benefit was product quality. Consumer goods made in the private sector were higher in quality although more expensive to produce due to higher labor costs. Third, with better products came the expectation of superior service and a clean environment. Interviews with various shoppers at the Longfusi Temple Market District and the Lufthansa Center in Beijing revealed that customers preferred shopping in department stores or small shops that not only enhanced the shopping experience but also provided superior service. Prices may be higher in those stores but in many cases costs were considered secondary issues. This consumer attitude may explain why retail franchises such as Kentucky Fried Chicken are successful in China. "The Chinese people are poor, but if they receive better service, they are not as price sensitive as one may imagine".[14]

The consequences of the above on retail real estate development are important. If retail development is to be successful, not only is location important but also the selection of tenants who are willing to commit themselves to selling quality products and providing excellent service.

<u>Special Economic Zones and Coastal Port Cities</u>

In 1984, the PRC government established 4 special economic zones to experiment with capitalism. They were: Shenzhen, Zhuhai, Xiamen and Shantou. In 1988, the Hainan Island was added to the list, bring the total to <u>5 SEZ's</u>. In theory, the zones were established to: (1) promote local prosperity, (2) generate foreign exchange and (3) serve as experimental grounds for new managerial and economic systems. This also was a learning framework for administrators from other parts of China to study methods of international business. Foreign investors, particularly those from Hong Kong and Macao, poured in millions of dollars to build factories and to develop real estate. As a result, these zones experienced remarkable success.

From a retail real estate development standpoint, the

[14] Interview with Tsinghua Associate Professor Mao Qizhi, July 11, 1992.

prosperity of the economic zones has resulted in increased consumer spending and opportunities to service the growing sectors of business and housing. However, many retail developments were built too quickly and were poor in quality.[15] In addition, high vacancy rates and an overbuilt retail market may become a problem since many of these projects were speculative in nature (i.e. built without securing tenants). Shenzhen is currently experiencing this situation in some of its new shopping areas.[16]

In addition to the 5 special zones, there were 14 designated cities which were given some of the special policies granted to the SEZ's. Some examples include: (1) simplified procedures for foreign businessmen entering or leaving China, (2) the ability to establish exclusive foreign investment operations and (3) time limit extension for the duration of China-foreign joint ventures. In these coastal areas the local governments' powers were also expanded. The impact on retail development is unknown due to limited economic freedom in these areas. Nevertheless, as China continues to accelerate its efforts to modernize, these port cities are

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[15] Most buildings are designed to last 20 years but they effectively age quicker than their expected lives because of poor construction materials and the lack of maintenance. **Source:** Interview with Professor Zhu Zixuan, Architecture and Urban Planning Department of Tsinghua University in Beijing, July 14, 1992.

[16] Interview with Tsinghua Associate Professor Mao Qizhi, July 11, 1992.

expected to gain the same rights and privileges as the SEZ's and will likely experience similar success.

Foreign Investment and the Open Door Policy

Under Deng Xiaopeng's leadership, commercial laws and tax codes were modified to encourage foreign investment into the People's Republic of China. However, this did not happen as quickly many had hoped. As mentioned previously, "The door was open, but not completely open".[17]

Despite its slow reaction in allowing other countries to partake in China's economic reform, the PRC has repeatedly emphasized its stance and continuance of the "Open Door" policy that had been in effect since 1978. As evidence of this, Shanghai in 1990 had (1) opened the Pudong Redevelopment Area to foreign investment, (2) established the Shanghai Securities Exchange, and (3) approved selected foreign banks to open branches in 1991.

Furthermore, the government's long-term view of the real estate industry is one of great importance to the China economy. It is widely believed that foreign investment, which drives the real estate market, will help provide a solution to the country's cash shortage problem as well as create

[17] Interview with Tsinghua Associate Professor Mao Qizhi, July 11, 1992.

additional employment. Furthermore, foreign capital in real estate joint venture developments is also expected assist in China's drastic reformation of the urban housing process, a 40-year system of subsidized housing which had placed a heavy burden on the country's budget.

Investor Concerns

In spite of the above and the high level of foreign real estate investment through the first five months in 1992, most observers believe that foreign development companies, particularly those in the U.S., are awaiting fundamental changes in China's economic system (tariff and import tax removal) before the "true" flood of investment into the country will come to fruition. Additionally, there are lingering concerns about China's political and social course (human rights) following the Tian'anmen Square incident. There are further concerns regarding China's economic reforms if 88-year old Deng Xiaopeng dies before the movement is complete. The economic and political risks in real estate development are compounded in the retail sector. An anchor tenant is needed to secure financing but is difficult to attract (other than a department store owned by the local Chinese government) because of Chinese trade restrictions and import taxes imposed on foreign retail establishments. Finally, determining the appropriate rate of return to foreign investors is a problem since few transactions have been consummated and pricing political risk requires subjective judgement.

Development Barriers

There are Chinese barriers which further discourage foreign investment in China. These obstacles are categorized into 3 areas: Import barriers, Service barriers and Investment barriers.

Import barriers are obstructions the Central Government places on foreign investors to neutralize their effect on existing domestic businesses. The most common import barriers relating to foreign real estate development are tariffs and other import charges on raw materials used for construction. To a large extent state planning and price controls on government-controlled materials have reduced the effect of tariffs and other charges but their impacts (3 to 200%)[18] on certain raw goods may be significant.

Service barriers are hurdles that foreign service industry professionals (lawyers, accountants, insurance carriers) encounter which place them at a competitive disadvantage when bidding against similar Chinese professionals. This is of particular importance to foreign developers who need

[18] USC International Business Education & Research (IBEAR) Program, "5th Annual Asia/Pacific Business Outlook", (unpublished seminar materials, March 16, 1992), p. 60.

consultants with real estate expertise to evaluate the markets and economic prospects of a specific site. Relying on indigenous firms can be dangerous if real estate knowledge and technical expertise are lacking and if secondary research information is solely used to make decisions. Some progress has been made in allowing foreign service firms to operate (e.g. Chinese insurance monopoly and restricted charters on air transport) but none of these changes relate to real estate.

Investment barriers are limitations which discourage capital infusions by potential investors since they limit the ability of capital markets to fully function. The ones relevant to retail real estate are:

1) Foreign currency regulations - These laws limit the convertibility of domestic currency (RMB) into foreign exchange and have a direct impact on real estate investments in China. This probably is the most critical factor influencing the decision to invest in retail real estate development.[19] If investors can not repatriate profits back to their domicile countries, there is no

[19] The Reminbi (RMB), called the "People's Money", is not convertible into foreign exchange and is therefore devalued in the "unofficial" foreign exchange process (black market). Its value therefore fluctuates according to demand. As of July 1992, the black market rate was approximately 6 yuan (RMB) to $1 U.S. dollar, or 10% above the official exchange rate of 5.4 yuan (FEC) to $1 U.S. dollar.

incentive to invest in China. The foreign currency exchange problem is discussed in the below Profit Repatriation Issue section.

2) Interregional barriers - Local economies have proprietary interest by provincial governments which bar imports from other regions of China. This may effect those retail tenants that need to ship inventory at multiple locations throughout China.

3) Access to raw materials - The recentralization of the raw material supply source limits the alternatives available to foreign companies in need of such unrefined goods. This limitation hurts retail real estate development since certain raw materials produced in China may be in short or restricted supply, thereby requiring the shipment of those needed materials from other countries. The cost of construction will likely increase due to high delivery costs, tariffs and other import charges.

4) Dispute resolution - Formal resolution over outstanding problems may be performed through a government agency or a foreign organization, whose ultimate decision may not be recognized by the Chinese government (see below Dispute Resolution section).

Foreign Investment Issues

There are two basic problems that the Chinese government must solve before international investment in real estate development accelerates: (1) Perception on China's stability and (2) Imperfect land lease pricing. First, many foreign real estate contracts have been signed but some of the registered foreign funds have not come to China as promised. For example, in the Special Economic Zone of Xiamen, only 20% of the registered foreign funds have placed the capital that they had promised.[20] Some effort must be made by the local government to determine why the actual flow of capital is not entering the Chinese domain and if possible, to placate foreign company reservations.

Secondly, there is no independent pricing mechanism for land use rights. A retail developer's concern is that the land lease rates charged by a municipality may be too high if a market-determined pricing system does not exist. Local governments in limited areas have responded to these issues by discounting such land use rights to very low rates (sometimes below market). Retail developers who are capable of determining market values for sites will therefore be able to capitalize on the current imperfections of government land lease pricing.

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[20] Zhu Ling, "China's land reform takes flight", China Daily: Business Weekly, (Beijing), June 28-July 4, 1992, p. 1.

The local government's land pricing system is currently described as follows: Small amounts of area are originally offered at ridiculously low lease rates to determine market value. For example, land in Shenzhen was initially priced at one yuan per one square meter for the full 50-year term. Because the amount of land rights sold at this price is small, the government loses little money and the expectation is that this "giveaway" rate will eventually adjust to market forces. In the Shenzhen case, land lease rights for comparable land currently cost approximately 1,500 yuan per square meter for the same 50-year term.[21] However, this rate may still be below the true market value since it was set by the local government.

The municipality's justification for these actions is that selling land rights cheaply is a small price to pay for attracting the enormous business potential that foreign developments will provide for the local economy. This tactic has resulted in similar action by other cities and provinces, which have escalated this price cutting competition by undercutting each other to attract foreign ventures. Municipalities are currently considering an auction or a land price bidding system to ascertain "true" market value but the implementation process has yet to be devised. Therefore,

[21] Interview with Tsinghua Associate Professor Mao Qizhi, July 11, 1992.

retail developers should quickly find these underpriced areas and exploit these opportunities before a solution is found.

Revamping the Foreign Commercial Code

The PRC instituted the following legal modifications to its current commercial code to further encourage real estate development and to re-emphasize its stance on the "Open Door" policy. Although they fall well short of a bilateral investment treaty, they are an improvement from prior years.

<u>April 1990 Commercial Code Amendments</u>

1) A foreigner could sit as Chairman of the Board on an equity joint venture. This allows more flexibility in forming the management structure. Previously, foreign firms hesitated from establishing a partnership since they did not want to risk losing control over their venture with a mandatory Chinese chairman in place.

2) Certain kinds of equity joint ventures could be established without explicit time limits. Real estate development ventures do not generally fall within this category. Nevertheless, the maximum term of 30 years may be extended to 50 years if the investment is large or if the construction period is long and the return on

investment is low.[22]

3) There are assurances against nationalization, except under special circumstances. These special situations are not business in nature but involve actions by a joint venture which may pose a threat to the security of the PRC or are contrary to the country's national interest.

Tax Law Changes

1) The preferential tax treatment accorded real estate equity joint ventures will be conferred to wholly foreign-owned real estate enterprises and contractual joint ventures. As discussed in the below Wholly Foreign-Owned Enterprises section, a unified tax system is expected and will eliminate the differences between the two types of entities.

2) Income tax rates for certain types of companies are decreased from a maximum of 55% to 33%. Real estate joint ventures are now subject to a basic rate of 30% plus a 10% surtax on taxes paid, or 33%. Newly-established joint ventures may apply for a 2-year complete exemption from taxes plus a 3-year add-on at a

[22] Arthur Andersen & Co, China Perspectives, 3rd Edition (New York: Arthur Andersen & Co, May 1989), p. 176.

50% reduction in income tax rates.[23] A foreign tax specialist should be consulted to determine the exact requirements to qualify for these tax abatements.

3) Additional tax preferences are granted for companies established in the Special Economic Zones or in real estate projects encouraged by the Central Government. The types of preferences are not specified but they are usually deductions or tax credits on project expenditures made.

BEIJING MUNICIPALITY

Retail Development Outlook

Beijing is the capital of the People's Republic of China and is a political, cultural and transportation center. It's population in 1988 was estimated to be 9.88 million, the majority of which reside within the urban area.[24] There is sufficient basis to believe that there are opportunities for profitable retail developments given the large number of people who reside within the city, the projected increase in individual incomes from urban prosperity and the growth in tertiary industries (such as services relating to tourism,

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[23] Arthur Andersen & Co, Chapter 8.

[24] China International Economic Consultants, Inc., The China Investment Guide, 4th Edition (Hong Kong: Longman Group (Far East) Ltd., 1989), p. 111.

real estate, law, accounting, consulting).

Currently, Beijing has areas in need of retail development, particularly between the Second and Third Ring Roads (See **Exhibit B** for City Map). In the short term, the east portion of the city (Chaoyang District) will require retail development to service its concentration of small business, financial centers and foreign embassies. On the west side of the city in the research and high technology Xicheng and Haidian Districts, retail establishments will be essential to service residential developments housing workers in those areas. In the central core of the city, there will be opportunities to redevelop in small pockets but the site redevelopment restrictions will be much more stringent than those in the outer periphery of the city.[25]

In the long term, retail projects similar to the ones identified on the west side will be needed as development occurs in the northern edge of the city (near Tsinghua University) and as redevelopment and residential conversions begin in the southern end. In general, the areas of commercial innovation will be predominantly in the well-established neighborhoods and along the perimeters of the

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[25] Interview with Professor Zhu Zixuan, Architecture and Urban Planning Department of Tsinghua University in Beijing, July 14, 1992.

city.[26]

Retail shops in Beijing essentially fall into four categories: (1) extremely small (2-4 square meters), (2) small (less than 100 square meters), (3) medium (approximately 5,000 square meters) and (4) large (30,000 or less square meters). The extremely small and small retail constitutes the largest quantity of establishments, roughly 10,000, and ranges from portable stands which sell food or small goods to occupied space in buildings which house specialty stores or restaurants. Although extremely small shops involve little or no real estate ramifications, small shops consist of sole proprietors who predominantly own their occupied space. The medium retail developments number approximately 100 and are government-owned. Finally, there are 10 large shops which are substantially government-owned (Longfusi Temple Market District) or in a joint venture with the local government as a partner (Beijing Lufthansa Center).[27] Future foreign ventures in retail development will likely be large in scale since foreign investors with an abundance of capital will want to maximize their investments through economies of scale and to negotiate with local governments from a position of strength.

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[26] Interview with Tsinghua Professor Zhu Zixuan, July 14, 1992.

[27] Interview with Tsinghua Associate Professor Mao Qizhi, July 11, 1992.

Social Labor Force and Balanced Economy

Beijing's social labor force in 1990 totaled 6.5 million people, which is second among the three municipalities controlled by the government[28] but very low compared to the much larger provinces such as Sichuan and Shandong, which have 58.7 and 41.4 million people, respectively.[29] The 6.5 million labor force is distributed among 13 industry sectors and is summarized in **Exhibit A** attached. As shown in the Exhibit, Beijing as well as the two other province-status municipalities (Shanghai and Tianjin) have balanced economies compared to the national total. But Beijing has shown the highest growth rate out of the three municipalities with an increase of 5.8% between 1989 and 1990. This implies that retail development will be needed to service the added labor force in the coming years.

Wage Statistics and Consumer Spending Patterns

Beijing residents enjoy a relative advantage over 25 other provinces in terms of wages: it ranks 5th in income per

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[28] State Statistical Bureau of the People's Republic of China, China Statistics Abstract 1991, p. 2.
Note: Administratively, Beijing is only one of three cities (Shanghai and Tianjin are the other two) classified as a "municipality directly under the Central Government", which is equivalent to a province. The city also has 8 counties and 10 districts.

[29] State Statistical Bureau of the People's Republic of China, China Statistical Yearbook 1991 (Beijing: China Statistical Information and Consultancy Service Center, 1991), p. 81-82.

capita with an annual average of 2,312 yuan in 1989.[30] Furthermore, the cost of living index in Beijing is in the lower third of the ranking compared to the other 30 provinces.[31] Therfore, from an economic viewpoint, the quality of living in Beijing is favorable compared to other areas of China and the level of consumer spending should increase.

Beijing was ranked 13th in overall retail sales with 30.8 billion yuan in total trades and ranked 13th in consumer goods sales compared to 30 other provinces in 1990. But consumer goods accounted for over 95% of all retail sales (agricultural production accounted for the remainder).[32] Additionally, Beijing ranked 2nd out of the 30 provinces in retail sales per

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[30] State Statistical Bureau of the People's Republic of China, China Statistical Yearbook 1990 (Beijing: China Statistical Information and Consultancy Service Center, 1990), p. 135-136.
Note: The industry attracting the highest wage is Transportation, Postal and Telecommunication Services (2,680 annual yuan), followed closely by Construction (2,638 annual yuan). Aside from the Energy sector, these two industries are also the ones which Beijing has the greatest need to expand.

[31] Ibid, p. 253-254.

[32] State Statistical Bureau of the People's Republic of China, China Statistics Abstract 1991, p. 100.
Note: The definition of "Retail sales" was not found in the 1991 Statistical Abstract. However, based on the skewed percentage towards the Consumer Goods sector, it appears that in addition to consumer sales to made to individuals, consumer goods sales include export shipments internationally and goods sold to businesses.

capita (1,981 yuan), behind only Shanghai (2,398).[33] This position is similar to other capital cities throughout the world which have higher average incomes and stable economies.

Preliminary statistics in 1992 also indicate that approximately 50% of the income earned by the average Beijing worker will be applied to basic living necessities, 5% will be spent on transportation, 30% on clothes, 5% on housing (rent), and 10% on social functions, hobbies and entertainment.[34] Retail sales will become a greater component of a household's spending in the future with the improvement in the quality of life and the rise in net income.

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[33] Estimated from two sources:
A) State Statistical Bureau of the People's Republic of China, China Statistics Abstract 1991, p.100.
B) State Statistical Bureau of the People's Republic of China, China Statistical Yearbook 1991, p.81.
Note: See Footnote #32 for caveats regarding the definition of "Retail Sales". In addition, the population figure used in the computation was not total population, which was unavailable, but social labor force totals. Social labor force was not defined but is considered to reasonably approximate the urban population.

[34] Interview with Tsinghua Associate Professor Mao Qizhi, July 11, 1992.

II. URBAN DEVELOPMENT CONSIDERATIONS

URBAN DEVELOPMENT CHANGES IN CHINA

In the 1960's and 1970's, China's cities grew moderately in population, income, economic activity and the stock of urban housing and infrastructure. This moderate growth had escalated in 1979 as a result of Deng Xiaoping's reform measures which began in 1978. In the cities, the administrative restrictions on light industry and services were relaxed. As a consequence, urban growth since 1979 has averaged 13% per year.[35] In addition, rising household incomes, which have grown approximately 10% per year,[36] have increased the demand for goods and services.

The momentum of the economic growth has placed a severe strain on the infrastructure of cities. The need for improved public services and housing are reaching critical levels because there is a strong link between the local economic base and the expansion of urban infrastructure. The demand for labor in the cities required a modest relaxation of migration controls. Thus, city growth rates were rising to levels not experienced

[35] World Bank, Urban Development in China (unspecified publisher, May 1989), p. 1.

[36] Ibid, p. 1.

since the 1950's. Once stagnated cities in the 1960's and 1970's were now growing at rates of 3-4% per annum,[37] though this pace would have been higher if housing shortages did not exist. In the 1980's, the local government had to reconsider its approach to planning, financing and managing urban development.

One method used by the local government to control the growth in cities, specifically in Beijing, was the use of permanent residence permits. Those with residence permits were allotted special privileges that were not granted to temporary residents, who were only allowed to stay in the city until their specific work duties were completed. The more important entitlements for permanent residents were priority status in obtaining housing and employment.

With modernization through reform, China further encouraged private economic activity, emphasized foreign trade and investment and established directives for state-owned enterprises and utilities to focus on profit-making strategies.

The key issue currently facing cities is how to balance sustained economic growth with a program of fiscal and policy measures to coordinate urban development investments and

[37] World Bank, p. 1.

management.

THE ROLE OF THE GOVERNMENT IN URBAN DEVELOPMENT

Prior to 1979, the Central Government retained the responsibility of urban development. Line ministries from the Central Government determined the standards and criteria for urban development initiatives directly at the local level or through provincial branches. This was done in a compartmentalized fashion to various departments at the local level and there was often little coordination between departments at every level.

Since 1979, the Central Government has generally limited itself to a role of encouraging urban development by establishing broad objectives and parameters. For example, one broad objective is to reallocate the large accumulation of household savings into the housing sector where the Central Government sees home ownership as a major solution to urban housing demands. However, the Central Government is still searching for long term solutions with other problems caused by urban growth such as the surge in temporary residents.

The Central Government strongly endorses the principle that local services provided by pubic utilities and municipal housing departments should be financed by the beneficiaries of such services. Nonetheless, it will involve itself in specific local urban development decisions if they: (1) affect industries and policy within the Central Government's domain (e.g. government factories), (2) place a roadblock on efforts to conserve water resources and water supply utilization, (3) involve local proposals to generate additional sources of tax revenues which will threaten revenues to Central Government and (4) relate to environmental protection such as air and water pollution (discussed in Environmental Factors section below).

Therefore, implementing urban development objectives is solely the responsibility of the local government unless a development is either specifically covered under the jurisdiction of the Central Government. The local government is also encouraged to use this power to experiment in new ideas and to devise its own systems to effect such policies. Two major problems exist for local governments in implementation: (1) Coordination, particularly within government departments and with public service utilities and (2) Severe infrastructure constraints, which have led to weak urban planning and management departments.

Coordination Problems

Unlike a market economy where divisions of responsibility exist for urban development, China's local urban planning departments have overlapping responsibility. Secondly, urban plans for expansion and infrastructure improvements must be coordinated with public utilities, which do not share the same autonomy that the local government enjoys. Thirdly, the local government must be able to separate its regulatory function from its management operation and to resolve conflicts from being the approval agency, the developer and the tenant at the same time. Not surprising, local governments are unlikely to promote projects in locations which will directly compete with their own stores. Finally, some coordination must be made between the social responsibilities (e.g. health plans) provided by both the local government and the employer such that both services are not duplicated. Unfortunately, most of the local governments are not equipped to properly coordinate development on more than an ad hoc basis.

Infrastructure Limitations

China's urban planning departments are constrained by limited financial resources and manpower and a shortage of individuals with urban development expertise and knowledge. The various demands on the department are becoming more complex in nature. Thus, city government authorities are overwhelmed by a long list of "priority" investments that either appear unrelated to an urban development strategy or can not be fulfilled given present or future budgetary constraints.

Key Issues to Address

During the 1980's, cities and towns have invested heavily to provide the necessary urban infrastructure and public services to accommodate growth. It is also foreseeable that additional large-scale infrastructure will be required in the coming years to match the expected growth and to alleviate the strain on urban resources. A sector study was performed in China which identified 5 basic issues[38] to address when accommodating urban growth:

1) Better overall planning and management at the local level
2) Planning and management practices of local line agencies
3) Efficient use and management of existing municipal assets
4) Resource mobilization
5) Control of negative externalities that accompany rapid economic growth, particularly environmental resource management

URBAN PLANNING ISSUES IN BEIJING

Beijing currently has a number of unresolved problems[39] in the urban planning area which affect the formation of the city

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[38] World Bank, p. 3-4.
Note: On these 5 issues, reference in the study was made to the report, "Zhejiang: Challenges of Rapid Urbanization", Report Number 6612-CHA, dated August 3, 1987.

[39] Lecture by Walter Bor, Urban Planning Consultant from London, England, July 7, 1992.

and the potential for retail real estate development. However, these issues are reversible. Beijing will be a more effectively-designed Capital and retail developments will be less risky ventures if these problems are properly addressed.

Inflexible Planning

Urban design is based on a master plan (discussed in the Master Plan section below) which essentially outlines the projected use and development of a metropolitan area at a future date. The reliance on public transportation has little influence on the location of commercial sites in the master scheme. Underground public subways are basically fixed and do not adjust to changes in the population nor growth trends. Instead, public transportation is variable and will be adjusted to fit the needs of the city. For example, an unanticipated growth in a certain section of Beijing will not affect the location of the planned future subway but new bus lines will be added or old lines will be altered to meet the needs of that certain area.

Lack of Coordinated Planning

There are coordination problems within the planning area. For example, in the transportation department, only at-grade components are considered and mapped. Subway sites and underground circulation patterns are not drawn but ignored, which is an egregious mistake since subway sites provide unique planning issues as well as immense potential for future retail development sites.

Coordination problems are not confined to the department itself. As discussed below, there is little communication between the transportation and urban planning departments, which function autonomously and on unequal terms.

Excessive Authority for Transportation Engineers

The transportation planning department is omnipotent with regard to making planning decisions. The section has the power to dictate its requirements (e.g. widths of roads) without regard to the issues and concerns of the urban planning department. This power imbalance continues in spite of traffic engineers who base their design schemes on very limited traffic studies, if any are prepared at all. The urban planning area is powerless to change such mandates and instead must adjust its plans to accomodate such decisions.

A coordination between both the transportation and the urban planning departments must be made to assure effective planning decisions, with both areas carrying the same level of authority in making urban planning decisions affecting Beijing. Unilateral decisions made by the transportation department will increase the risk and construction costs of such projects since the lifeblood of retail real estate development depends on effective traffic circulation and access.

Deficient Detailed Design

Beijing's planning process lacks sufficient detail to develop conceptual designs. There is therefore no basis nor sense as to what the planners are trying to achieve with a specific scheme. For example, not every road is drawn in the master plan. Therefore, when final planning decisions are made, road details may provide implementation problems which may consequently affect the quality of a retail location.

No Implementation Feedback

Beijing's urban planning process has a fundamental problem of being prepared in a vacuum without feedback or communication regarding the relative effectiveness of its implementation. Plans are designed and delegated as directives by the Economic Planning Committee while implementation (e.g. for site improvements) is usually monitored until completion by various government bureaus. Developers must therefore recognize that the implementation of an agreement may not always coincide with the original negotiated deal with the Economic Committee. Implementation must be coordinated with the planning process in order to make more effective planning decisions. Optimally, planners and implementers should either be the same party or in the same department.

Missed Opportunities

In the Beijing region, the city planning area has solid designs for the future: a 12 million maximum population in the area, with no more than 6 million people residing within the immediate urban vicinity. However, in its effort to limit rapid growth, Beijing has missed opportunities to selectively and strategically develop sites which will increase the effectiveness of the city, especially in green areas currently allocated for park uses. For example, almost all effective cities in the world have direct or indirect links (through a network of small towns which provide needed services along the route) to their airport systems. Beijing currently lacks this connection and service corridor. These missed opportunities may provide good areas for future retail development.

Insufficient Knowledge of Economics and Social Ramifications

The urban planning department currently lacks the proficient knowledge of real estate economics, the skills of financial analysis and the ability to determine the social ramifications of building projects. These deficiencies will impede the planning department's ability to effectively negotiate on even terms with real estate developers. This may be a short term advantage for developers, who within limits are able to construct any project they wish if they are able to raise the necessary capital. In the long term, training for urban planners will provide them with the necessary tools and knowledge to curtail the developer's edge. However, no training nor plans for such experience are presently considered.

Environmental Factors

China had instituted measures to conserve its precious resources, particularly water.[40] This is similar to the U.S. movement towards environmental preservation and protection. The impact on development is important. Resources are required to construct projects and buildings need to be serviced. If scarce resources are rationed, the location of a project, its height and its ability to fully function will be limited. Furthermore, pollution will reduce the expected duration of projects which need extensive servicing and maintenance to reach their maximum lives. Finally, conservation laws such as Environmental Protection and Urban Afforestation must be understood and factored into the cost of development.

Key Environmental Conditions Affecting Retail Development

Two of the most important infrastructure issues facing retail development in Beijing are: (1) Communications and (2) Energy

[40] Fresh water is arguably the scarcest resource in China, with only 2,800 billion cubic meters or a per capita amount of only one-fourth of the world average. About three-fourth's of China's cities want more water to meet the demands of their industries and residents. **Source:** Ma Zhiping, "Water law enforcement protects resources", China Daily, July 3, 1992, p. 1.

supply. In a growing economy, the priorities of providing communication infrastructure and related services can be reasonably accomplished without excessive harm to the local environment. However, obtaining sufficient energy sources and reserves are a more complex problem. Retail establishments are among the heaviest electrical users, particularly with their showcases, displays and air conditioning units and during critical evening business hours.

Currently, coal is used to supply the majority of the required energy uses for the city, both in the industrial (33.2% of the Beijing economy per **Exhibit A**) and residential sectors. This reliance on coal adversely affects the quality of air since its processing produces harmful emmissions and releases dust particles. The quality of air is a chief issue not only for Beijing but for the Central Government as well.

There are targeted goals to reduce coal reliance for residential users. However, industrial users, which possess political clout and financial muscle (in the form of tax revenues), will continue to use the mineral in the foreseeable future and the energy shortage is expected to ensue. This will adversely impact prospective retail real estate developments by reducing their scale, restricting their locations, requiring the installation of efficient but expensive building systems and curtailing critical store hours, especially during the evenings.

Air pollution from vehicles is another problem, specifically exhaust fumes and sulphur dioxide from trucks and cars. However, retail development is impacted by commuter traffic which in Beijing is dominated by bicycle and public transportation uses. Passenger vehicle ownership amounts to only .25% of the total Beijing population.[41] Therefore, air pollution from passenger cars will not have a significant effect on the location of commercial retail development sites unless a tremendous surge in private auto ownership occurs in future years.

FUTURE PATTERN OF RETAIL DEVELOPMENT

Urban Core of Beijing

The Master Plan does not identify new areas of retail development within the heart of Beijing, which presently has three notable shopping districts: Wangfujing, Xidan and Qianmen. The future pattern in this core is the redevelopment of existing shopping areas. Currently, the Wangfujing Shopping District has been contracted to be redeveloped by a joint venture between two Hong Kong businessmen and two Beijing companies.

[41] Lecture by urban planning consultant Walter Bor, July 7, 1992.

Outlying Areas of the City

As mentioned in the Beijing Municipality section, much of the new retail development opportunities will be between the Second and Third Ring Roads (and possibly beyond). The pattern of these developments will evolve in two ways. The first and most prevalent manner is from extremely small and small tenants who will cluster in a solid business location. This site is likely to service only the immediate community and the nearby rural areas since there is little automobile mobility in Beijing. When the local government realizes that sufficient opportunities are present, it will construct a department store in the same area but in the best location.

The local government will generally pay for the site improvements and construction costs of the department store but will recoup much of its investment over time by charging the existing smaller tenants higher taxes. As discussed in The Master Plan of the City section below, foreign investment in suburban retail locations like this will be difficult to attract unless the site is on a subway route.

The second way a shopping district evolves is the converse of the first pattern. The local government will preempt the smaller tenants by building at the site first since migration trends and housing relocation will generate sufficient critical mass in the specific area. This method is less common since the local municipality must pay for all building and site infrastructure costs without the benefit of an existing tax base from smaller tenants, who are expected to subsequently migrate into this area. A local government may not have the wherewithal to initially fund these construction costs unless the government is supported by taxes or by direct contributions from affluent farmers with their nearby factories.

In both of the above scenarios, the conventional shopping district will be the same, having a government-owned department store with smaller tenants within the immediate vicinity. These new shopping areas along the perimeter will appear similar to the old commercial downtown districts but on a smaller scale since they primarily service the local community. These retail districts are unlike the U.S. where suburban shopping areas consist of malls that are often larger than their downtown counterparts.

III. REAL ESTATE DEVELOPMENT PROCESS IN BEIJING

FACTORS AFFECTING THE DEVELOPMENT PROCESS

There are 5 items which should be discussed before a description of the process[42] is given. They are: (1) The Master Plan of the city, (2) Absence of zoning laws, (3) Lack of public participation, (4) Government jurisdiction in development process, and (5) Government role as developer.

The Master Plan of the City (Exhibit C)

Prior to initiating the real estate development process, developers should be aware that master plans for most major cities in China have already been designed as a basis for future development. The master plan is the **key** to what urban planners envision as the future growth patterns of the city, taking into account anticipated public transportation access and requirements, the types of commercial uses and the variety of public services needed to service the community. In general, developers should expect to build projects in accordance with this plan unless a modification could be made, as explained below.

[42] Interviews with Associate Professor Mao Qizhi and Yin Zhi, PhD, Architecture and Urban Planning Department of Tsinghua University in Beijing, July 1, 1992. Additional interview with Hong Wang, Land Administration Lecturer at People's University in Beijing, June 29, 1992.

The Beijing plan, which runs through the Year 2000, also stipulates general categories of uses for areas of the city. These classifications are discussed below and may be specific (industrial, warehouse) or very broad (working/residential). With the specific uses, the scale of the master plan is so small (1 centimeter = 100,000 meters) that exact boundaries may be difficult to discern. As explained in the previous Urban Planning Issues in Beijing section, the Capital's urban planning process (and by implication, the Master Plan) lacks sufficient detail to produce conceptual designs and to aid in implementation procedures.

Master plans are generated in 20-year cycles and are rather inflexible, with modifications in the general design made every 5 years and detailed changes incorporated every two years. However, master plans can be adjusted if there is a drastic shift in the amount, direction and quality of urban growth. Such trends are usually brought to the government's attention by a prospective developer or by local people living in the effected area. Changes will be included only following a lengthy procedure and sufficient public outcry and pressure.

"Use" Classifications

The Beijing Master plan has nine classifications for existing and projected use through the Year 2000:

1) Working/Residential
2) Industrial
3) Warehouse
4) Green Area (Park, Sports Facility)
5) Commercial/Service Center (Retail, Post Office)
6) Avenue, Street, Road
7) Railway
8) River, Lake
9) Public Facility

A substantial portion of the Beijing municipality is designated for "Working/Residential" use, an extremely broad category which can range from residential housing to retail shopping centers or commercial office buildings. Developers therefore have a wide latitude in determining the types of projects they wish to build. Undeveloped rural areas constitute the second most prevalent space in the city. No "use" classification is currently designated for these sites. However, it is expected that projected uses will be placed in some of these areas when the new Master Plan through the Year 2020 is completed. "Green Areas" constitute the third most common zones and are basically used for public parks and sports facilities. Generally, these sites are not available for further development. Industrial space and Warehouse-use identifications rank fourth and fifth, respectively, in the amount of reserved area in Beijing. These uses are evenly distributed along the municipal borders except in the east side of the city.

The remaining five classifications in aggregate total a miniscule percentage of the total Beijing municipality. Included in the remainder is the retail segment, which is categorized under the Commercial/Service Center classification. Although little has been specifically earmarked in the Master Plan for retail uses, retail projects can be built within the broad domain of "Working/ Residential" uses. Other categories in this remainder, particularly the Railway and the Avenue, Street and Road are very important for planning retail real estate development. Based on a review of the Master Plan, subway/underground transportation systems are not on the map, but these are arguably the most important considerations in retail development.

Projected Retail Sites for the Year 2000

Currently, the Beijing Master Plan through the Year 2000 designates at least 7 new sites for future retail development. All of these prospective sites are close to the "Third Ring Road", which is the outermost ring surrounding the municipality. These retail zones are strategically situated in locations that are central to planned residential areas, which are determined based on migration and growth patterns. If these trends are accurate, then the 7 centrally-located sites should fare reasonably well.

However, none of these prospective retail sites are on future subway routes because of uncoordinated transportation and urban planning functions. Thus, these locations are not ideal, particularly from an international investment standpoint. Consequently, securing foreign capital to fund all construction costs will be extremely difficult. Local district governments will have to be involved in the development of these areas although some may not have sufficient capital to absorb the required site infrastructure costs.

Absence of Zoning Laws

China does not have true "zoning" laws in the context which is prevalent in most of the United States (Houston, Texas is a notable exception). However, there is detailed plannning and "zoning-like" controls on sites. Such controls may be construed to be similar to zoning and cover allowances and restrictions on the following factors:

1) total site area
2) land use
3) residential capacity (number of housing units)
4) total building coverage on the site
5) building height limits
6) floor-area ratio (FAR)
7) green coverage (open green space)

The combination of the master plan and the above restrictions provide "zoning-like" functions even though there is no zoning classification that is common in the U.S. (e.g.M-1, C-2, R-3). All of the above 7 factors are considered by the Urban Planning Bureau in approving a large development proposal. In smaller site proposals, the above practice is still observed by the Bureau but not all factors may be applied.

The above controls are also troublesome to change. This is similar to the difficult experiences in the U.S. of obtaining higher re-zoning classifications. Only in special situations where the relative power between the developer and the local government is imbalanced will modifications be made. For example, if a developer with abundant capital offers to build needed projects in a poor community but makes it conditional upon securing higher density and other concessions, then it is likely that a successful deal with the local government will be negotiated.

Lack of Public Participation

The only public forum in the development process is in the housing sector, where residents are solicited for their personal opinions on the type of housing they feel is appropriate to improve their standard of living. In addition, they are sought for detailed suggestions as to the size of the living room, the number of bedrooms and the total square meters of housing they feel they need. The government is typically responsive to the needs of the people and in improving their quality of life.

In commercial developments, no such hearing exists. Once the government decides on the location of a commercial project such as a retail department store, there is little the public can do to cease the process. In general, local communities currently do not mind such developments since they feel that these are good signs of progress. In the future, citizens may insist on a forum for public discussion as they become more socially and environmentally aware of the drawbacks of such projects.

Government Jurisdiction in Development Process

The determination of which committee will be involved in the development process depends on the type, size and location of the project. If the urban project is a government factory or a public utility, the Economic Planning Committee of the Central Government participates in the process. If the urban project does not involve one with Central Government jurisdiction, then the Economic Development Committee of the local government will be involved. It is not unusual that both government committees are included in overlapping jurisdictional matters but the Central Government has higher authority in final decisions.

The Land Administration Bureau of the Central Government is also involved in the process if a proposed agricultural site development is situated in one of Beijing's 8 counties and consists of more than 1,000 'mu's, (approximately 658 hectares) of rural land or 2,000 'mu's (1,316 hectares) of 'other' land such as a mountainous region. The Land Administration of Bureau of the local government participates in the meetings if the subject land is 1,000 'mu's or less. Some conflicts may emerge between the goals of the two Central Government entities or between the two local authorities. A Committee has a higher standing than a "Bureau" in the hierarchy of government structures. Therefore, the Committee usually casts the final decision when an unresolved dispute arises.

The local economic planning committee will usually be the representative government authority because the Central Government is attempting to decentralize urban decision-making to local municipalities. Therefore, unless the situation requires its presence, the Central Government will not become involved in the approval process.

Government Role as Developer

In the U.S., the government has been increasing its participation in the development process, particularly in the housing and the retail segments (Horton Plaza in San Diego, California and Pike's Market in Seattle, Washington). These arrangements for retail projects have usually been structured using public/private partnerships because of the lack of development experience and the shortage of capital. The local government rarely, if ever is the sole developer. However, it is common in China for the government to be exclusively involved in such projects, particularly in medium and large scale retail shopping sites where a government store serves as the anchor tenant.

Most Beijing retail shopping areas with municipal-owned department stores are government-developed. Smaller tenants on the site are predominantly sole proprietors, who not only own the businesses but also the buildings adjacent to the anchor department store. The real estate development process (discussed below) tends to face fewer obstacles, a shorter review period and a faster construction schedule since the project is government-related.

In prior years, it was not unusual for new retail shopping areas to be developed under a domestic joint venture arrangement between the local government and the smaller indigenous Chinese retail tenants. The government currently welcomes such ventures because it may lack sufficient capital to solely provide both the site infrastructure and building improvements.

The more recent trend is for major retail shopping areas to be either developed or redeveloped by foreign joint ventures. For example, the popular Wangfujing shopping district will be redeveloped into a major tourist shopping destination by Hong Kong billionaire Li-Kai Shing, Chinese hotel developer Robert Kuok, and two Beijing companies.[43] In addition, the Pu Dong New Area on the east side of Shanghai will have two major foreign retail development projects involving funds from Hong Kong and Japan.[44] Finally, the Lufthansa Center (see below

[43] "Beijing commercial district to be redeveloped", China Business Review, (Beijing), June 28, 1992, p. 1.

[44] "More overseas cash pours in", China Daily, (Beijing), July 6, 1992, p. 2.

Example of Joint Venture Structure: Beijing Lufthansa Center section for details) containing the You Yi Friendship Store was recently completed and opened for business on July 1, 1992.[45]

DESCRIPTION OF DEVELOPMENT PROCESS IN BEIJING (Exhibit D)

Application Submission

The real estate development process for urban projects begins with an application submittal by a developer to the Economic Planning Committee, which may either be the Central Government or the local muncipality (see above Government Jurisdiction in Development Process section).

The application submittal is akin to a real estate development proposal or a business plan. A market study assessment and an economic analysis are required in the submittal and are prepared by either the developer or by a third party, usually a consulting firm or a university. It is difficult to determine their adequacy using U.S. standards since these reports are proprietary. The developer is responsible for the costs of these studies (unless the government itself is the developer), which will be reviewed by the government.

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[45] Interview with Ms. Li Hang Nan, Public Relations Department of the Lufthansa Development Project, July 12, 1992.

In addition to the market and economic reports, the conceptual design schemes, the specific site requested for the project, the type of use (which conforms to a master plan as discussed above) and the project financing scheme (e.g. structured as a joint venture with government participation) are required.

Meeting with the Economic Planning Committee

Once the complete application submittal has been reviewed by the appropriate government authority, a meeting will be arranged with the developer to discuss the final decision on the real estate development proposal. If successful, the developer is informed of the site the government has selected for his development and the constraints (e.g. height limitations, floor area ratio and green space requirements) placed on the chosen location. It is not uncommon for the actual site to be different from the site requested by the developer, who has the final option to accept the selected location or to proceed onto his next project.

If the developer agrees with the conditions set forth by the Economic Planning Committee, he/she then must solicit approval of the project from other government organizations and departments with a regulatory interest in the project. For example, the joint venture must be approved to conduct business in China by the Ministry of Foreign Economic Relations and Trade (MOFERT) if the entity used to finance the project is a foreign joint venture. It must be approved by the Environmental Protection Department for compliance with anti-pollution regulations if the project is a factory. It must obtain a business permit by the Department of Commerce if the project is a supermarket. In general, all new projects are filtered through approximately 50 departments[46] within the government to determine whether there is appropriate jurisdiction for their involvement.

Design Plans, Design Review and Site Assemblage

After all of the general approvals have been granted, the developer then contracts an architect to produce detailed design plans which will incorporate the constraints placed by the government. The completed detailed plans will then be submitted and discussed with the Urban Planning Bureau (Central or local government level, depending upon the type of project) for general review and compliance with restrictions. Once approved by the Bureau, the developer may then proceed with construction.

The government will be responsible for assembling the site parcels and providing the site improvements for the project. However, in reality, the extent of its commitment depends on its cash situation. In most instances, the municipality will pay for necessary site work in successful areas where it has

[46] Interview with Hong Wang, June 29, 1992.

a surplus of cash (e.g. Wangfujing Shopping District). But in other cases where the local government has little money, the developer will absorb the infrastructure cost.

Displaced residents in the effected area are relocated to other locations in Beijing and are indirectly compensated for this move by receiving a larger residence at no additional cost (the ratio of the amount of new to old living space is typically 2:1).[47] In general, this system appears to work well because most residents prefer additional space in an inferior location than less space in a better site. The physical relocation of residents is the responsibility of the local government. Nevertheless, like site improvements and assemblages discussed above, the party which bears the displacement costs is primarily determined by the cash situation of the local government. If the local government has sufficient cash resources, it will usually pay for the displacement. If not, the developer will then pay for the move. Current trends are for both the developer and the government to share the costs of relocation, with the ratio determined based on negotiation.

Project Construction

Once all design plans have been reviewed, approved and site infrastructure is in place, the physical construction will

[47] Interview with Yin Zhi, PhD, July 1, 1992.

begin. The actual construction of the project involves a process that is similar to one in the United States since permits are required for certain services provided (e.g. installation of elevators) and various departments of the local planning office will check for compliance with design plans and building codes. The Public Safety Bureau will oversee the project for health and safety code violations.

Internal mechanisms for control include inspectors representing the major tenant(s) (e.g. the government department store) as well as those representing the joint venture investors.

The biggest obstacle in the construction process is not in building the structure but in procuring the necessary raw materials at the most effective prices. The Central Government controls virually all of the domestic raw materials used in the construction of development projects.

Upon securing project approval, the Central Government gives rights to the developer to purchase specific quantities of selected raw materials in China at prices which are more favorable than imported rates (after taking into account shipping costs and customs tax assessments). The developer may then decide to buy the raw goods from the Chinese government and/or to import some or all material requirements.

Some goods are more scarce (steel) than others (concrete). The Central Government may therefore allocate purchase rights for quantities which will cover only a fraction of the total raw materials needed to complete the project. Generally, there is no appeal procedure to request additional purchase rights. Nonetheless, a developer with substantial capital in a large scale project may successfully negotiate an agreement with the Central Government to purchase more than his/her share of the raw materials allocation at favorable prices.

Post-Construction Development Functions

In retail construction projects throughout China, it is common for the developer to be solely responsible for providing the basic building shell and for securing an anchor tenant, which is usually the local government (e.g. Friendship Store). Tenant fit-out and regular operating functions such as maintenance is the responsibility of the lessee. This is similar to retail arrangements made in the U.S. which are often on a net lease basis, where the tenant is responsible for certain expenses such as real estate taxes, insurance and maintenance (triple net lease) or for all expenses (absolute net lease).

FOREIGN INVESTMENT

Business Investment

In general, foreign investment in China reflects diametrically opposite goals between the investors and the Chinese Government. International investors generally want to establish a base in China to sell goods domestically. They also need to freely convert Chinese currency into foreign exchange for profit repatriation. However, the Chinese prefer to have foreign companies invest their capital in the PRC to tap the industrious people of the country and to produce and sell goods for export in the international markets. It is the friction between these divergent goals and political factors which until the 1980's have made investment in China sluggish.

As a major breakthrough, the Lufthansa Center development was able to successfully merge these conflicting goals into an agreement which was beneficial for both the Chinese government and the foreign investors. The local government had achieved its goal of attracting foreign capital (one billion German Marks) and the German joint venture partner was able to exploit the lucrative domestic retail business in China and receive convertible foreign exchange. The structure of this joint venture is discussed in more detail in the below Example of Joint Venture Structure: Beijing Lufthansa Center section.

As of 1990, U.S. companies entered into agreements for more than 1,300 equity joint ventures, contractual joint ventures and wholly foreign-owned enterprises in China. In 1990, there were U.S. business contracts for 357 new projects or 29% more than the number of 1989 contracts. However, the total value of those contracts amounted to $357 million (U.S.), or 44% lower than the total value in 1989.[48] Although investment figures are not available in 1992, a survey of U.S. firms has indicated that one-third of those without a China presence will make an initial investment in the next five years, while two-thirds of those already there will expand their operations, particularly in Guangzhou and Shenzhen.[49]

Real Estate Investment

Real estate foreign investment in China during the 1980's has originated primarily from two sources: (1) Hong Kong/Macao and (2) Taiwan. The investments involved a number of commercial project types, ranging from hotels to mixed-use office complexes. More recently, Hong Kong/Macao and Taiwan investments have been increasing with the relaxation of land lease sales and terms to foreign investors. Many of these funds have been in the housing sector within the Guangdong province and within the Special Economic Zones of Xiamen and

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[48] USC International Business Education & Research (IBEAR) Program, p. 54.

[49] "U.S. firms upbeat on presence in China", China Daily, (Beijing), June 26, 1992, p. 2.

Shenzhen.

Other countries which have participated in the real estate arena include those investors from Europe (Germany and Italy), the Far East (Japan and South Korea) and North America (Canada and United States). Most of these developments have been in the hotel and office segments. The U.S. investment in China has been light, with only limited amounts mainly in the franchise hotel sector (e.g. Beijing Sheraton, Guangzhou Holiday Inn) and in branch office developments.

Currently, China's real estate business is the hot-selling investment for foreign investors. In 1991, there were 280 foreign-funded property firms in the Shanghai municipality and in the Guangdong, Hainan and Fujian provinces, which are considered the major areas of overseas investment in real estate.[50] China also saw $216 million of foreign investment placed in commercial building development during the same year, earning $203 million from commercial building sales to foreigners.[51]

There are no data statistics specifically kept on retail real estate development although it is evident that investment in retail projects is growing (e.g. the Lufthansa Center and

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[50] Ling, p. 1.

[51] Ibid, p. 1.

Wangfujing District in Beijing, and the Pu Dong Area in Shanghai).

Foreign investment in China real estate and specifically in retail development is expected to escalate in the 1990's given the foreseeable formal trade relations with Korea, the predicted improvement in banking services and the imminent relaxation of laws and regulations, specifically with land lease reforms throughout China. The Guangdong province and the Special Economic Zones are currently the only areas undergoing such land reforms. Land leases to foreigners will be of particular interest to the PRC since more than 1,500 tracts of land covering 3,000 hectares were leased to various overseas enterprises during 1992 (through June 25) and the government had gained a record 3.1 billion yuan ($574 U.S. million) of income from land-use rights leasing.[52]

The trend in real estate development will not only be confined to commercial buildings in the coastal regions of China but will include vast mixed-use land development (including retail) in such inland regions as the Hubei and Henan provinces[53] and in Beijing (Daitianshuijing area of Wangufujing commercial district)

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[52] "China pins hopes on land-lease reforms", China Daily, (Beijing), June 26, 1992, p. 1.

[53] Ling, p. 1.

FOREIGN BUSINESS ARRANGEMENTS

In general, foreign real estate entities can be categorized in one of the two following forms:

1) Joint Venture: Equity and Contractual
2) Wholly Foreign-Owned Venture

As of 1985, joint ventures were by far the most popular form of business contracts signed. However, with the relaxation of restrictions on wholly foreign-owned ventures, the fastest growing business arrangements (not all real estate-related) are foreign-only capital enterprises, which had doubled the number of contracts in only one year: 931 for $1.654 U.S. billion in 1989 and 1,860 for $2.444 U.S. billion in 1990.[54]

Joint Ventures

Joint ventures with foreign companies are probably the most desired form of international business arrangement in China. It allows the Chinese to learn real estate development with minimum cost since the capital and technology are brought into the venture by the foreign firm. From 1979 to 1985, $3.4 U.S. billion had been committed to 2,301 joint ventures (general

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[54] State Statistical Bureau of the People's Republic of China, China Statistical Abstract 1991, p. 111.

business and not all real estate).[55]

In 1990, there were 4,091 projects under contract (not all real estate) for a total value of approximately $2.7 U.S. billion, most of which were not from the U.S.[56] The American share of the total has decreased during the past few years. This is in spite of the increasing levels of foreign investment in China due to economic reforms.

The laws and regulations governing all joint ventures are substantially developed but they are still evolving. The entire legal system continues to undergo reform. Therefore, these codes should be considered nothing more than guidelines since policies continue to change and regulations are arbitrarily applied.

Currently, a standard joint venture contract (equity joint ventures only) is available to establish such a partnership. However, important details are missing and an attorney is required to tailor the contract to the specific arrangement and to incorporate appropriate protective language. This process is therefore time consuming. Some foreign companies prefer to immediately set up a temporary branch while the

[55] Chu Baotai, Foreign Investment in China: Questions and Answers (Beijing: Foreign Languages Press, Inc., 1986) p. 66.

[56] State Statistical Bureau of the People's Republic of China, China Statistical Abstract 1991, p. 111.

contractual arrangement is in process. This is done to bridge the time frame between establishing the joint venture and initiating operations. Once finalized, operations from the branch will be transferred to venture.

There are two basic forms of a joint venture: contractual and equity.

Equity Joint Venture

In an equity venture (see **Exhibit E** for a sample standard contract), a joint enterprise is initially created for the specific purpose of developing a single property. Both the Chinese and the foreign partner contribute equity and as general partners they share in the investment, management, operations, risks and profits/losses. Earnings are distributed according to the respective equity contributions of each partner.

The type of equity contribution differs for each party. The Chinese normally contribute land, site infrastructure, some machinery, materials and labor. The foreign partner is expected to contribute the technology, capital equipment and machinery, marketing and management expertise and working capital.

A limited liability corporation is then formed to hold the investment and to manage the property if it is not sold following completion. Risk and profits/losses are then shared according to a negotiated formula.

Minimum foreign investment is set at 25% of the total capital although in some instances the percentage can be negotiated as high as 100%. Generally, there is a joint board of directors with a Chinese person holding the title of Chairman. These joint ventures typically range between 5 and 30 years in duration, with the preferred term of 10 years. In rare cases are agreements greater than 50 years allowed. The property reverts to the control of the Chinese upon the expiration of the joint venture contract.[57]

Foreign investors have been able to cope with these time frames, particularly mortgage lenders such as banks which as a standard practice use "bullet" loans that amortize (i.e. reduce the principal owed with each payment made) over 30 years but have outstanding balances due in 10 years ("balloon"). Yields to lenders are increased to account for the possible payoff uncertainty (no cash to pay balloon) or refinancing risk (no lender to re-loan the amount of the balloon) at the time the note matures. Equity investors adjust to shorter terms by requiring additional returns on a shorter contract life. For example, the original Lufthansa

[57] Arthur Andersen & Co, p. 168.

offer (details are provided below in the Example of Joint Venture Structure: Beijing Lufthansa Center section) by the German joint venture partner called for a 17 year term with rent payments substantially in excess of 47 million yuan per year. When the Chinese government balked at the bid, the final agreement was negotiated to 47 million yuan per year but over a 30 year term.[58]

Deal structuring can take many forms: mortgage debt, equity, or a combination of both. Equity investors also are known to finance a portion or all of their investment using mortgages that mature at or near the end of the joint venture contract term.

Joint equity ventures are also subject to minimum registered capital requirements ratios. The table listed below[59] represents the total minimum registered capital as a function of the total investment.

[58] Interview with Ms. Li Hang Nan, Lufthansa Development Project, July 12, 1992.

[59] Arthur Andersen & Co, p. 169.

	Total Investment ($ U.S.)	Required Minimum Capital
1.	Less than 3 million	70% of total investment
2.	Between 3 and 10 million	Higher of 2.1 million or 50% of total investment
3.	Between 10 and 30 million	Higher of 5 million or 40% of total investment
4.	Greater than 30 million	Higher of 12 million or 33 1/3% of total investment

Under the Law of Joint Ventures, three reserve funds are required to be established and funded based on after-tax earnings. The three funds are: (1) Joint Venture Reserve Fund, to buffer potential operating losses and accidents, (2) Incentive and Welfare Fund, for joint venture employees to reward commendable work and (3) Enterprise Fund, to reserve for future expansion. The actual amounts placed in each fund are decided by the Board of Directors and are usually based on a fixed percentage of profits.[60]

As discussed in the above Revamping the Commercial Code section, some trade regulations and tax laws were amended in

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[60] Guide to Joint Equity Ventures (Beijing: The External Services Department of the Economic Daily, 1986), p. 35-36; Michael J. Moser, Foreign Trade, Investment & the Law in the People's Republic of China (London: Oxford University Press, 1989), p. 134.

1990 (e.g. a foreign person may become Chairman, the duration of joint venture arrangements may be extended beyond the general 30 year limit) to relax the stringent restrictions placed on foreign joint ventures.

Contractual or Cooperative Joint Venture

Another form of partnership is the contractual or cooperative joint venture. This arrangement has many characteristics that are similar to the equity structure but it also has a number of differences. First, the contractual arrangement is governed by separate laws (Contractual Joint Venture Laws rather than the Joint Venture Laws), which are vague and unfamiliar to the Chinese, who are more comfortable with the equity joint venture arrangement.

Secondly, the contributions of the foreign partner into a contractual venture are not considered "equity" shares, which entitle the partner to a share of the real estate profits as a percentage of the capital invested. Instead, such investments receive profit distributions based on the terms of the joint venture contract, which may or may not be in proportion to the amounts contributed. For example, a typical contractual arrangement may function in the following manner. A foreign partner's non-monetary (land, machinery and equipment, labor) and monetary contributions are initially inventoried and valued at the time of investment. The total valuation is then considered the base from which a priority rate of return ("preferred return") is assessed and distributed from profits earned in later years. The priority distribution is paid first in any year where profits are made by the joint venture. Any earnings in excess of the amounts initially distributed are then allocated to each partner based on percentages negotiated in the joint venture contract. This ratio may or may not be relative to the proportion of investment contributions made by each party.

Thirdly, a contractual joint venture is not bound by the 25% minimum foreign capital requirement that is required under an equity arrangement. There is therefore more flexibility to structure innovative contracts.

Fourth, this business arrangement is not restricted to a finite legal life (generally 30 years under a standard equity joint venture). Instead, the duration of the venture is stipulated within the contract, which may run longer than the maximum legal limit for equity joint ventures.

Furthermore, unlike its equity counterpart which requires three types of reserve funds to be funded based on after-tax earnings, no reserve fund is required under this form.

Finally, this arrangement allows for the recovery of initial capital invested during the term of the contract. The equity venture arrangement is rigid: the initial capital invested must remain in the partnership as long as it is in existence. In both types of venture, the hard assets (developed real estate project, machinery and equipment) must remain in the hands of the Chinese at the end of the contract term.

With its limited liability and preferred return characteristics, the above form is similar to a limited partnership entity used to structure many real estate transactions in the United States. The capital-contributing foreign joint venture partner is akin to a limited partner, who is initially given a preferred distribution before both partners[61] are allowed to share in the remaining proceeds.

Most if not all foreign partnerships are structured as equity joint ventures because the Chinese are not familiar with this form of arrangement and the contractual joint venture laws are vague and undeveloped.

<u>Example of Joint Venture Structure: Beijing Lufthansa Center</u>
The You Yi Shopping City/Beijing Lufthansa Center is a Sino-German <u>equity joint venture</u> (called Beijing Lufthansa Center Co. Ltd) between the local government of Beijing and a German

[61] The Chinese partner corresponds to the general partner in a limited partnership while the foreign partner is parallel to the limited partner.

partnership consisting of two entities: a majority German partner comprised of various German companies and a minority South Korean partner (see **Exhibit F**). The joint venture contract was signed in 1985 and opening day occurred over 7 years later on July 1, 1992. The project is not wholly retail but is a three part mixed-use development consisting of a 5-star 540-room hotel (Kempinski Hotel), a 6-story plus basement government-owned Friendship department store (You Yi Shopping City) and a multi-story office/apartment complex.[62]

The center does not have either on-site or underground vehicular parking but relies on availability along the street and temporary zones to accommodate autos. Since the retail store and the hotel began their operations in July 1992 (the office/apartment complex is complete but not fully functional), the retail has been in need of parking space to accommodate approximately 500 cars during rush hour. Additionally, there are no separate areas for bicycles, which may be stationed only along the nearby Liangma River. These are issues that were not originally anticipated in the original design scheme. No plans currently exist to address the bicycle problem although underground parking is currently being proposed to rectify the vehicular situation.

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[62] Interview with Ms. Li Hang Nan, Lufthansa Development Project, July 12, 1992.

Terms of Joint Venture Contract:

The terms of the Beijing Lufthansa joint venture are summarized in **Exhibit G.** The structure of the venture required an investment by the foreign partner of one billion German Marks to fund the total building construction costs. Of the one billion investment, $30 U.S. million was contributed by a Korean minority partner, whose percentage of the foreign partner's interest was not disclosed.

The Chinese joint venture partner was the Beijing local government which contributed land, site improvements, labor and some raw materials. The local government borrowed 120 million yuan (about $22 U.S. million) on favorable terms from the Bank of China to finance its equity share. Even though the exact details were not disclosed, the Beijing municipality was loaned the sum at very low interest rates and paid interest on only 90 of the 120 million yuan owed. There were no other equity partners on the Chinese side of the venture.

The local government department store signed a contract with the German Joint Venture partner to remit minimum annual lease payments of 47 million yuan per year plus a percentage of gross sales (.2% for the first three years, .4% for the remainder of the term). These lease payments are payable in Foreign Exchange Certificates (FEC), the official exchange currency of China which is readily convertible into other foreign denominations. The payment to foreign investors in readily exchangable currency was specifically negotiated with the local government and bypassed the Central Government's system of keeping domestically earned profits within China's domain. Methods used to remove profits from China are discussed in more detail in the below Profit Repatriation Issue section.

The foreign partner's pretax cash-on-cash return on an allocated retail investment base of 912 million yuan was calculated to be between 5.3% and 5.4%, with an internal rate of return of 3.4%. This assumed that rent overages (.2% or .4% of gross sales) were computed based on daily gross store receipts of 1.5 million yuan.

These investor yields appear low but it is inappropriate to dissect mixed-use developments into their component parts for analysis unless all portions of the financial scheme are understood. It is therefore possible that the remaining unexamined segments of this development may yield well in excess of 25%, thereby increasing the overall yield above 15%, a normal rate of return expected by real estate development investors.

The Chinese joint venture partner annually receives any excess over the amounts initially paid to the foreign partner. In addition, at the end of the contract term, the Beijing local government receives the whole development project as reversion. It is difficult to determine the approximate yields to the Chinese partner because information is either unavailable or contingent upon results.

Early Results:

The You Yi Department Store has only been opened since July 1, 1992 but it has already shown solid signs of success. Its first Sunday following Opening Day grossed 2.2 million yuan and it averaged daily visitations of 50,000 people. The majority of these customers were local residents although there was also a good mixture of foreign tourists.

There have been complaints that the store hours (9:00am to 9:00pm) were too short and that no parking was available. Beijing has a miniscule percentage of passenger car ownership but apparently many car owners shop at the You Yi Friendship Store. This parking problem will remain as a short term issue but thus far the results of this store have been impressive.

Future Joint Venture Structures

The Central Government is currently easing regulations on wholly foreign-owned real estate investments. Thus, more of these structures will be formed because of greater profits earned by the foreign partner. The important and value-added "guanxi" (i.e. China's synonym for local business and government contacts) that Chinese partners provide in a joint venture arrangement can be "bought" since consultants can be hired and retained throughout the development process.

Wholly-owned enterprises (see below Wholly Foreign-Owned Ventures section) will be difficult to negotiate with the local government, which has reversion rights to the developed property at the end of the land contract term and will want possession at an earlier date. The choice for the foreign partner in a retail development project will probably be between a standard equity joint venture arrangement for the maximum term (30 years) as one option and a wholly foreign-owned entity with a shorter period to reversion as the other alternative.

<u>Selection of Appropriate Joint Venture Partner</u>

The selection of a partner is critical to the success of any business as well as a joint venture. There are many factors to consider in the selection process but the most important consideration is the <u>honesty</u> of the Chinese partner. There can be no trust without a candid partner and there can be no sustainable partnership if there is no confidence.

Another major factor to consider is the power and the local influence of the Chinese partner ("guanxi"). Much money and time will be saved if the Chinese partner is able to smoothen differences with the political forces and is capable of streamlining the business process.

Other critical factors to weigh are: (1) Financial capability of the Chinese partner, (2) Compatibility of the goals between each partner, (3) Quality of the Chinese partner's workforce and management and (4) Ability of the Chinese partner to secure vital raw materials and supplies.

Even though most of the above factors are intuitive, it is important to form a partnership that will fill voids in the current organization and will accomplish both parties' objectives. It is easier to form a joint venture with any Chinese organization than it is to find an appropriate and compatible Chinese partner.

Profit Repatriation Issue

This is probably the most significant factor discouraging investment in China. Profits earned outside of its legal domain are free from any restrictions and controls. However, all earnings within the jurisdiction of the PRC must stay within its borders if the foreign exchange account is deficient.[63] This requirement is a measure by China to

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[63] A foreign exchange account is deficient when a company's cumulative profits repatriated are greater than its cumulative foreign investment or when total imports exceed total exports.

prevent capital from leaving the country and to insulate the price of its currency from international influences. Therefore, a joint venture with positive net income but a deficient foreign exchange account (total RMB is greater than total foreign currency) may not repatriate its earnings back to its domicile country.

The ramifications of the above restrictions on joint ventures: foreign exchange accounts must be properly balanced and consistently maintained to substantiate allowable profit repatriation.

The restrictions on earnings exportation are cumbersome but they may be circumvented by real estate companies in four ways. First, a foreign retail development investment partner with deficient foreign exchange (i.e. cumulative gains repatriated are greater than cumulative foreign investment) but is profitable may remove net income by entering into a transaction with a foreign currency swap center. This center will match the subject company having deficient foreign exchange with any company possessing excess foreign exchange. The transactions for these swaps are made at market prices and the center makes a small fee (approximately .15%).[64] The results of these centers as judged by foreign exchange investors have been mixed since some centers have been more

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[64] Arthur Andersen & Co, p. 124.

responsive (Hainan) than others (Beijing) in consummating transactions. Important in receiving responsive treatment from foreign exchange swap centers are size (the larger the transaction, the stronger the influence on the center) and "guanxi" (strong business contacts).

Secondly, as mentioned in the above Example of Joint Venture Structure: Beijing Lufthansa Center section, if the retail joint venture partner is the local government, the business arrangement may be structured such that rent payments to the foreign joint venture partner will be paid in Foreign Exchange Certificates (FEC) rather than Reminbi's (RMB). FEC's are the official exchange currency of China and they are freely convertible into any foreign denomination without restrictions or controls by the Central Government.

Thirdly, regulations allow companies (such as international real estate firms) with deficient exchange to invest their Reminbi profits in other joint ventures (not required to be real estate in nature) which have the capacity to generate excess foreign currency balances. Such investments are given preferential tax treatment and the re-investing party is allowed to enjoy priority access to the new enterprise's foreign exchange income for the repatriation of earnings. However, the above arrangement must be approved by (1) foreign economic relations and trade and (2) exchange control authorities.[65]

Finally, this popular method is not directly related to retail development partnerships but may have undiscovered applications in future retail joint ventures, particularly those that cater to foreign tourists. Currently, if the real estate project is a four or five-star international hotel, the hotel corporation's ability to collect credit card balances outside of China (by the hotel corporation's accounts receivable department situated in another country) allows it to legally siphon profits from its China franchise operations. Most revenues are collected in this manner and the hotel corporation must redirect an allocated portion of collections back to the franchise in the PRC to sufficiently cover the hotel's operating and general and administrative expenses. The unallocated excess or the residual profits will remain in the hotel corporation's domicile country free from China's control.

This loophole for international hotels has been ignored by the Central Government, which prefers more to attract and benefit from business generated by foreign tourists than to lose this commerce by placing encumbering restrictions on such lodging franchises.

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[65] Guide to Joint Equity Ventures, p. 51-52.

Dispute Resolution

The Chinese prefer to settle business disputes through friendly means rather than adjudication since using the legal process is considered distasteful and would alienate critical business associates. Legal avenues are available for the settlement of conflicts and the following three "friendly" methods are preferred: (1) Settlement by friendly negotiation, (2) Consultation and (3) Conciliation.

Under the settlement through friendly negotiations, the parties engage in direct negotiations without involving an arbitration official. With the consultation method, the dispute is brought to the attention of either the Foreign Trade Arbitration Commission (FTAC) or the Maritime Arbitration Commission (MAC), depending upon the nature of the disagreement. The third party will not recommend any solution but instead will mediate the deliberation such that the parties will work out the problems themselves. The final "friendly" method is the conciliation process. Under this formula, the same two organizations will be chosen to assist in the resolution process. Unlike the second method where the organization plays no active role, this method involves "concrete suggestions" made by the third party in a written format to both parties. However, these suggestions are not binding on either party.

Most joint venture disputes that are unresolved through friendly means or by compromise are usually settled through binding arbitration. Standard joint venture contracts include an arbitration clause (see **Exhibit E**, Article 59 of Chapter 22 in the Standard Joint Venture Contract). The arbitration agency in China is the Foreign Economic and Trade Arbitration Commission of the China Council for the Promotion of International Trade unless both parties mutually agree to use another source.

There is the general belief that a fair decision will be made by a Chinese judge who is impartial but the fact is that an arbitrator will have Chinese conventions and acquired convictions which may affect his/her ultimate decision. In some cases, national arbitration laws expressly require the arbitrators to observe local justice and customs.

China will accept the procedures used by an organization in arbitration cases that are determined by a foreign agency. However, the PRC may not bind the final arbitration decision since a Chinese-Foreign joint venture is deemed to be a Chinese "legal" person, which is subject to jurisdiction by Chinese law only.

As an alternative to arbitration, the U.S. established an Embassy-based working group in 1989 to raise specific investor concerns with China's Ministry of Foreign Economic Relations and Trade (MOFERT). This group meets quarterly to discuss U.S. investment problems in China. As of May 1991, over 40 company problems were raised at these working group meetings and most were resolved.[66]

A second alternative to arbitration is through the judicial process. Usually the People's Court in China is not involved in any dispute resolution process unless both parties agree to such a procedure and there is no binding arbitration clause in the joint venture contract. If such a clause exists, the court either will not hear the case or in those instances where a decision has been made, will not re-open a final decision determined through the binding arbitration process.

Very seldom do joint venture disputes ever go to arbitration. There is currently no record of any existing arbitration case involving foreign retail development joint ventures.

Wholly Foreign-Owned Ventures

This business arrangement does not require any Chinese involvement in either management or profit-sharing. In addition, the foreign company has complete control over its captive enterprise.

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[66] "Foreign Economic Trends and Their Implications for the United States", U.S. Embassy Annual Publication, (Beijing), May 1992, p. 12.

However, this structure has the operational burden of locating the following two scarce resources: (1) Trained local manpower and (2) Domestic raw materials. It must also face the prospect of dealing with local authorities without the benefit of having a Chinese partner to smoothen differences. Thirdly, except in Special Economic Zones and in the 14 Coastal Port Cities, equity joint ventures get better income tax treatment than wholly foreign-owned ventures.[67] Finally, it is subject to the same general approval and registration process required of joint ventures as well as compliance with the many rules and regulations applicable to foreign enterprises operating in China.

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[67] Though not promulgated in the regulations, this drawback is expected to be alleviated since a unified tax system is likely to replace both laws.

IV. RETAIL MINI CASE STUDIES

LONGFUSI TEMPLE SHOPPING DISTRICT

Location

The Longfusi Temple is an existing shopping district that is located in the eastern section of the Beijing Downtown core. The site runs along an east/west pedestrian road with limited vehicular access for taxis and loading trucks. Unlike other shopping districts in the city that are situated along prominent street corridors, this one is of the "back street" or "back alley" variety, which establishes its success away from major streets. This shopping area is bounded by West Dongsi Street to the south, Qianliang Street to the north, North Dongsi Street to the east and East National Gallery Street to the west.

The focal point of the retail area is the Longfusi Department Store, an 8-story building situated at the center core of the site and in the same location as the Longfusi Temple, which had burned down in 1901. The religious aspects have diminished but the vitality of the commercial vein has increased over the years.

Target Customers

This district thrives predominantly on business from community residents and is well-known locally for its fine dining. This shopping area also attracts some tourists. The Longfusi department store estimates that approximately 30% of its gross receipts is derived from international visitors.[68]

Current State of the Site

The redevelopment of the Longfusi Shopping District is presently in limbo. The government is generating sufficient profits from the department store to provide only some (a small radius around the "T" axis) but not all of the infrastructure requirements of the commercial area. Additional and substantial capital is needed to fund further improvements throughout the retail site. Cash reserves are also needed for site infrastructure (sewage and utility systems) along the neighboring streets and in the adjacent housing areas, which the government hopes will be funded by the same developer who is granted this commercial redevelopment project.

Evaluation from Foreign Developer's Standpoint

<u>Site Analysis</u>

The Longfusi Shopping District is a unique retail shopping

[68] Interview with Ren Jie, Vice Manager of the Longfusi Department Store, June 20, 1992.

area since its retail concentration is not along a major thoroughfare like Wangfujing (discussed as a mini-case study below) but is situated along a "back alley" away from normal vehicular traffic. The pockets of open space along the uneven east-west spine give the corridor a mysterious but inquisitive element that encourages shoppers to explore. The mixture of modern and traditional shops, new and old buildings and structures of various heights give Longfusi a unique and eclectic character.

There appears to be a symbiotic relationship within the district between the 8-story Longfusi Department Store that anchors the retail area and the small local boutiques, stores and restaurants that align the narrow corridors of the "T" axis. Customers who prefer the convenience of shopping in one store and the wide selection of merchandise purchase goods at the Longfusi department store. Those who prefer lower prices (and in some cases, better personal service) buy at the smaller shops. The increase in traffic and business activity from both types of customers is mutually advantageous for both, thereby creating value-added for the whole site.

Another symbiotic relationship exists between the day and night markets. The brisk daytime business in this area is complemented by the vibrant night market which carries a different life of its own. There are portable food stands on the west side of the horizontal corridor, clothing stands along the north-south stem of the "T" axis and three theaters and a karaoke bar along the eastern spine. With the night market, this shopping district has overlapping time zones which make the site appear to be open for business even when many of the daytime shops are closed. The uniqueness of Longfusi therefore offers an unusual retail real estate development opportunity.

<u>Development Issues</u>

This redevelopment suffers from three major problems. First, the commercial area is encumbered with the responsibility of having to provide major utility, sewage and service lines to the adjacent streets and throughout the neighboring residential courtyard area. This burden is in addition to providing the required infrastructure for the commercial site. Unless the housing redevelopment is self-sustaining, the retail area must be developed with sufficient density to support the site improvements in the adjacent areas and to fund expected losses from housing relocation. This increase in density may destroy the fabric which has given Longfusi its unique charm and popularity.

Secondly, financing the development project will require a structured joint venture scheme with the local municipality as one partner because the Longfusi department store is government-owned and operated. This is a difficult partnership for a prospective joint venture partner since the government, which controls the site, wants to preserve the integrity of the existing small shops. This restriction provides an additional constraint that may render the project unprofitable, especially in light of the increased density requirements as discussed above.

Finally, the shortage of energy is a general issue which exacerbates Longfusi's infrastructure deficiencies. Although the energy problem is not confined only to this site, developers must realize that their desire to recapture enormous construction costs will be constrained by shorter night market hours and a more limited selection of retail uses.

Retail Joint Venture Options

A joint venture partner consisting of a consortium of the current small shop owners will not have the financial wherewithal to carry the whole project through its completion. In addition, "piecemeal" redevelopment of the district with numerous small joint ventures between the government and individual tenants is not recommended since (1) constructing infrastructure improvements will not be cost effective overall, (2) the best areas will be developed first at a profit while the least desirable sections will be developed later at a loss (theory of "adverse selection") and (3) the character of the retail site may ultimately result in development which is motley and contrary to the government's original intentions.

The government may be forced to concede its desire to maintain the current programming and the character of the Longfusi area to attract joint venture capital, especially foreign funding. In addition, to make the project financially viable, the "deep pockets" partner(s) should be responsible for funding needed infrastructure in the commercial section of the site only, with additional capital for <u>limited</u> adjacent road and utility improvements. The housing infrastructure requirements should be kept as a separate matter, with redevelopment of the commercial site providing some linkage money to fund such improvements. Future special tax assessments from the existing retail tenants and the neighboring business community should provide supplemental funds for the housing redevelopment efforts.

If the housing component is tied to the commercial redevelopment, then the retail density must increase and the programming altered to a level which will make the project financially attractive to an investor. Whether this can be successfully accomplished without destroying the fabric of the district is still an unanswered question. Much economic and social data needs to be compiled and analyzed to make this determination.

WANGFUJING SHOPPING DISTRICT

Location

The Wangfujing Shopping District, called the "Window to the Capital", runs along a north/south corridor in the Dongcheng District and is approximately 1,600 meters in length. Its location is roughly 800 meters east of the Forbidden City and Tian'anmen Square and is bounded in the north end by Dongsi Xidaj and bordered in the south end by Xichang'an Jie/ Jianguomen Dajie, the major east-west boulevard in Beijing. Wangfujing is unique to other comparable shopping districts in the city since it is situated near expensive international hotels such as the Beijing Hotel, Palace Hotel, Taiwan Beijing Hotel and Peace Hotel. This area is almost exclusively retail in nature, with limited office space on multi-levels (other than first floor) which service the commercial establishments.

Target Customers

This shopping district caters to both tourists and local residents and attracts a phenomenal 300,000 to 600,000 visitors daily.[69] Tourists are able to enjoy a wide

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[69] Pei Jianfeng, "A clean sweep of busy Wangfujing", China Daily, (Beijing), July 14, 1992, p. 6.

selection of familiar retail shops, fast food outlets and franchise clothing stores. Well-known establishments include: Carl's Jr, Kentucky Fried Chicken (two stores), Dairy Queen, McDonald's (the only store in China), Seiko (watch store), Bennetton's (upscale shop for young urban professionals) and Stefanel (French clothing boutique).

This shopping district is also a favorite for residents in the community. It is versatile to accommodate those upscale shoppers who enjoy purchasing goods at international boutiques and those who desire inexpensive local goods at The Number One Department Store, one of China's most prosperous retail establishments. There are characteristics of other local shopping districts such as small clothing boutiques and booths. Unlike other commercial areas observed, this had an automatic teller machine that serves the local residents (but may also serve foreigners who are registered with international cash debit systems).

Current State of the Site

On June 26, 1992, a Beijing urban real estate developer (consisting of two Beijing companies) signed a letter of intent with the Hong Kong-based Kerry Trading Co Ltd. (comprised of billionaire Li-Kai Shing and hotel developer Robert Kuok) to jointly redevelop the Wangfujing Shopping District. Their intentions for this 3.37 hectare area will be to develop it into a world-class shopping location. Land leases on this site were purchased but for an undisclosed amount.[70]

Evaluation from Foreign Developer's Standpoint

Site Analysis

Its proximity to famous icons and hotels as well as its variety of local and international establishments makes Wangfujing the best known and busiest commercial area in Beijing and a perfect site for retail development.

Additionally, the positive features of this district include (1) wide streets along the main corridor, which has sufficient space to accommodate four lanes of traffic (or a double-lane in each direction), (2) limited vehicular access, which provides a measure of safety for the heavy pedestrian traffic circulating in the area, (3) narrow but sufficient space along smaller side streets to accomodate one lane of traffic and pedestrian walkways and (4) rows of shady trees, which enhance the enjoyment of shopping as well as provide a measure of relief from heat and other weather conditions.

No market information or economic analysis was available to review but the existence of well-known stores such as

[70] Liang Chao, "Overseas companies sign more land leases", China Daily, (Beijing), June 29, 1992, p. 1.

McDonald's and Kentucky Fried Chicken proves that the prospects for business in the area have been evaluated and were considered satisfactory.

However, according to conversations with local residents, one major drawback of the district is that certain Chinese goods that are usually found in other small community shopping areas are not carried in any of the Wangfujing stores.

Development Issues

This district has two specific problems: (1) Building setbacks and (2) Parking. Building setbacks represent a constant struggle between the local government and the retail tenants. The government wants deeper setbacks to accommodate the heavy pedestrian traffic the area constantly endures. Retail tenants do not like setbacks since they limit street visibility, signage and ultimately their economic well-being. The site currently has various setbacks for each building, resulting in unique but awkward architecture and creating bottlenecks in the pedestrian flow. This problem presently does not have a satisfactory solution. It is hoped that this issue will be addressed in the current redevelopment scheme.

Parking may ostensibly appear to be an unimportant issue given the heavy reliance on the public transportation system and the prevailing use of bicycles. However, the experience of the

You Yi Shopping City-Beijing Lufthansa Center proves that automobile parking can become a major issue if not adequately planned. To illustrate potential problems, in the Lufthansa example the mixed-use development provided for only temporary zones near the hotel entrance and no long-term parking for the shopping area. Despite the fact that only .25% of the people in Beijing own automobiles,[71] it appears that much of that percentage shop at the Lufthansa Center. The Center needs space for 500 cars based on preliminary estimates.[72] It is the present thought than some underground parking will be considered but this is very expensive and cumbersome since the retail store is in full operation. In addition, bicycle considerations were completely ignored. Bicycle parking should have been addressed given the Center's proximate location to the Third Ring Road and possible site as a future subway station.

In the Wangfujing District, two vehicular garages were originally planned on adjacent streets and scheduled for construction in 1990. For unknown reasons they were never built. Speculation was that in the stratification of important developments for the Government to finance, this project was not considered a priority and financing was

[71] Lecture by urban planning consultant Walter Bor, July 7, 1992.

[72] Interview with Ms. Li Hang Nan, Lufthansa Development Project, July 12, 1992.

therefore never arranged.

Currently, the potential parking problem has yet to materialize. However, as the redevelopment progresses in the next few years and as more international and tourist shops are added to the district's programming, the type of customer in the Wangfujing area will likely change and the more upscale shopper with an automobile will have to be accommodated.

Foreign Business Arrangement Options

The Wanfujing Shopping District is considered to be a retail real estate developer's dream project. It has the advantage and flexibility of adapting to any entity proposed because of its ideal location, critical mass and financial potential. The key decision on the type of foreign business arrangement to use depends primarily on price and negotiated concessions, which will be based on the relative bargaining power between the local government and the developer.

The land lease rights of this prized retail site were sold only to developers with financial wealth and power, as evidenced by the recent redevelopment contract signed by the Hong Kong team of billionaire Li-Kai Shing and Robert Kuok and the two Beijing companies. The type of foreign business entity chosen is not known but it is believed that an equity joint venture is the probable arrangement.

V. CONCLUSION

The current trends in China provide a favorable investment climate for prospective investors. Led by Deng Xiaopeng's assertive move towards economic reform, more barriers to foreign investment are expected to be removed and the modernization and economic gains are likely to accelerate in the future. Although its stated political stance has remained the same, the PRC will not be able to separate its existing economic reforms with its governmental obstinance. As explained by Hong Kong developer Ronnie Chan, "In communist countries, economic decisions are made to serve the political party... but economic development will lead to political openness".

The demographic patterns in Beijing are beneficial to retail real estate developers. The local economy is well-balanced, individual prosperity is increasing and the growth in tertiary industries will require the services of additional commercial establishments.

Retail developers in China should be aware that they will likely become long term investors in the construction and operational aspects of their projects unless they can sell their interests. Additionally, if their project is large in scale, they should expect to be in a joint venture with the local municipality since the government usually provides the anchor tenant. It is extremely difficult to secure occupancy from a large domestic private retailer or a foreign commercial franchise which does not fall within import restrictions and import taxes.

Foreign retail developers will tend to seek large projects because of scaled economies and for added bargaining power with the local government. Chinese retail developers with a more limited financial capacity will build smaller projects which are predominantly build-to-suit space for their own operations.

The Beijing municipality must improve its urban planning process if it expects to efficiently create a rational system of retail development. For example, city planning maps should be coordinated with underground subway and at-grade transportation networks. The capabilities of the planning department should also be upgraded. In sum, if this process is not adequately planned, Beijing will become a less effective city and retail developers will either suffer losses or be left with less than ideal locations. All parties stand to lose if the urban planning issues discussed in this thesis are not solved.

Despite the above limitations, there are opportunities in Beijing for retail real estate developers to exploit. The nature of these prospects heavily depends on the financial capacity of the developer. The city is currently in need of new or improved infrastructure for most if not all of its projects. Therefore, a capable builder with nominal funds will have little negotiating clout in site selection and in the bureaucratic approval process. "Guanxi" will help to a large extent, especially if a Chinese joint venture partner is selected. However, **substantial capital** will allow developers to quickly and efficiently capitalize on the best opportunities in Beijing since it will allow them to:

1) Negotiate the best terms with the government. The power in bargaining shifts towards the party with financial strength. As illustrated by the successful Wangfujing site, only a billionaire developer was able to negotiate a successful deal with the affluent district government. Since the government often plays three roles in the retail real estate development process (regulatory agency, joint venture development partner and anchor tenant), greater negotiation power will lead to a "package" of benefits: quicker approvals, better joint venture terms and efficient procurement of an anchor tenant.

2) <u>Choose the prime locations in the city for development</u>. These sites are on the existing and projected subway routes, along major transportation corridors and directly in the paths of commercial growth and residential migration. As discussed in this thesis, the Master Plan for Beijing is very flexible, with the broad "Working/Residential" classification as the primarily category for these ideal retail locations. Presently, the best short term locations for development are between the Second and Third Ring Roads and in the non-rural eastern and western sections of the city. Long term prospects are situated in the northern and southern Beijing areas.

3) <u>Purchase domestic raw materials in large bulk and at favorable prices</u>. This will reduce the dependency on imported unrefined goods which are more expensive because of shipping costs and import taxes. Total construction costs will therefore be lower.

There are a number of risks associated with developing retail real estate in Beijing. The biggest issue is <u>sovereign risk</u>. The current reform movement is gaining momentum and is unlikely to slow in the next few years. However, Deng Xiaopeng's advancing age is a lingering concern and the present political hard-liners are still resisting his push for accelerated economic growth. There is probably little that developers can do to protect themselves against the potential nationalization of retail projects other than to demand higher rates of return and to remain as active and vital partners in any joint venture established with the government.

Another significant risk is foreign exchange risk. This hinders profit repatriation for foreign developers since domestically earned profits must remain within the country's borders. The best method to circumvent this problem is to structure the joint venture with the local government on terms that require payments to the foreign partner in exchangeable currency, as illustrated by the Lufthansa Center partnership. Using swap centers to provide liquidity are also a viable alternative although transaction fees are assessed.

A third danger is financial construction risk. The inner city core offers a number of tempting development and redevelopment possibilities. But these "pockets" are tightly-controlled by local governments which may require new site improvements, linkages, and existing buildings to be conserved. These "hidden" costs can easily render any development project infeasible, as discussed in the Longfusi example. Development in rural areas that preempts growth and migration patterns is also an inviting opportunity since these locations have fewer restrictions (e.g. height) than the center city and less competition. However, these sites probably do not have existing service infrastructure if they are remote from current development boundaries. In addition, telecommunications, sewage and utility lines may not be available in certain rural areas of Beijing.

The problem of recovering high construction costs is further compounded by curtailed retail business hours due to the existing energy shortage and regulatory matters such as water pollution and urban afforestation laws. Developers should therefore use their bargaining power to negotiate at minimum some local government assistance for the above costs. If this is not available, affluent rural farmers or their factories benefiting from the site infrastructure should be requested to share in the costs.

The final issue is <u>operational risk</u>. Retail projects may be completed and fully functional but they must be monitored for efficiency. This may be a problem since workers are usually government employees who do not receive incentive pay. Furthermore, maintenance and sanitary procedures are generally deficient although in newer Beijing commercial developments this problem has been uneven.

Beijing offers excellent retail real estate development opportunities to both foreign and domestic investors. But like all major cities throughout the world, each location is unique and prospective sites should be individually evaluated based on their own merits and analyzed using a cost/benefit approach. A solid work ethic, a knowledge of the local procedures, an understanding of local conventions and laws and an ability to predict future demographic trends are all essential to assure success in such developments.

This thesis is intended to provide a basic framework for determining the real estate development prospects for commercial retail uses in Beijing. Further research is necessary to identify specific sites within the city to pursue.

VI. EXHIBITS

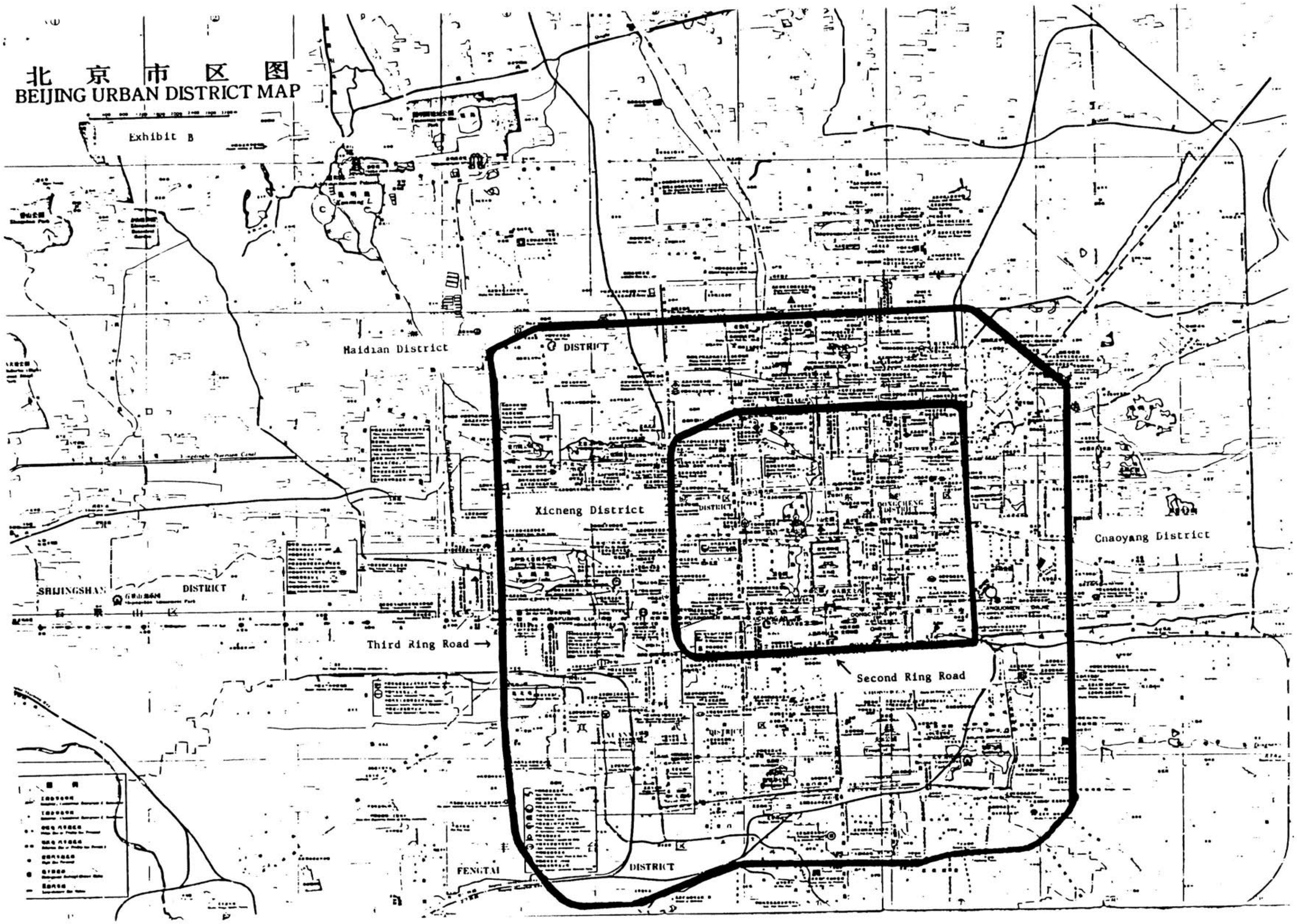
LIST OF EXHIBITS

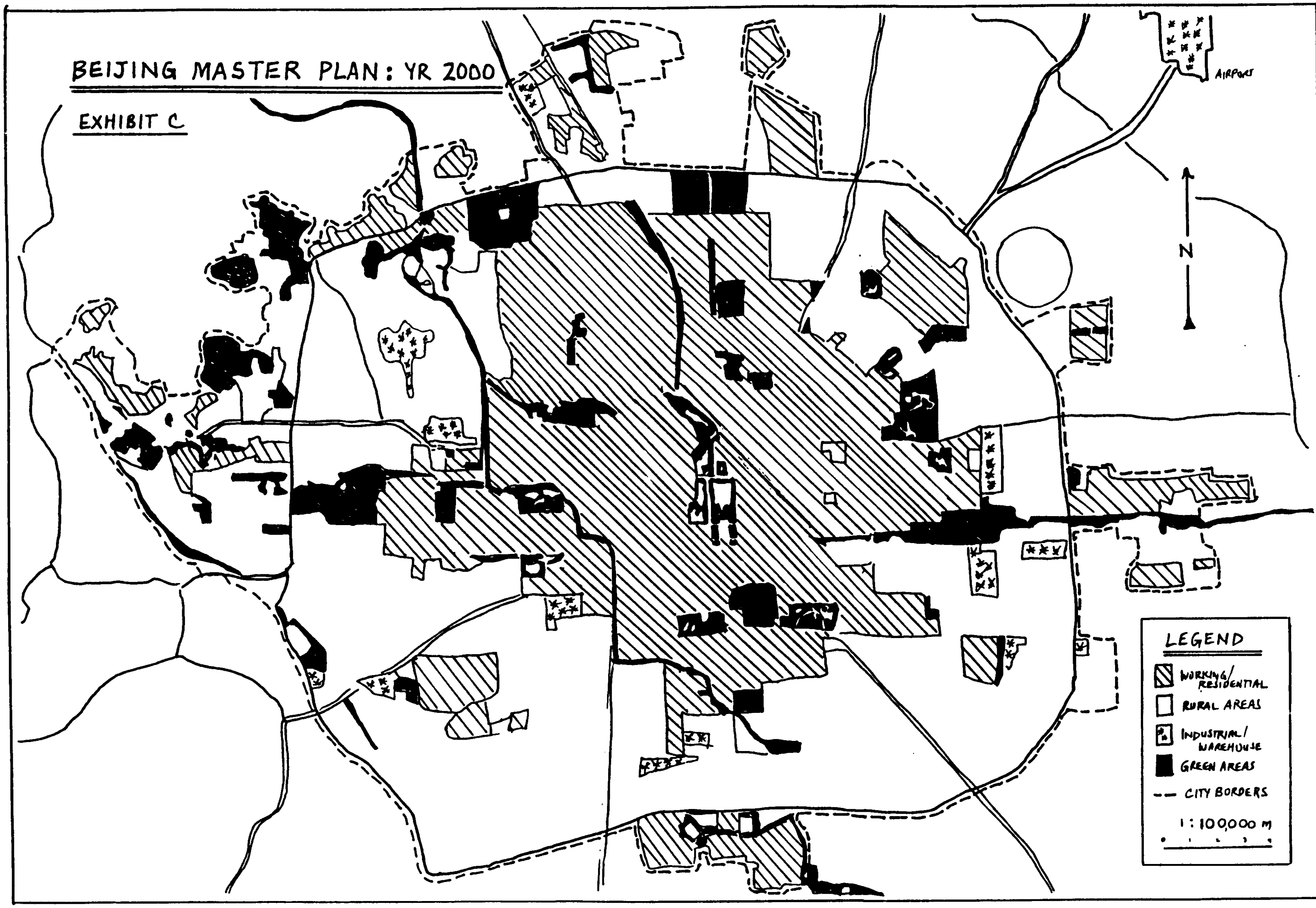
Beijing Demographic Analysis
Two-Year Analysis of Social Labor Force by Industry (in 000's)
Comparison of Beijing with National Totals and Province-Status Municipalities
Exhibit A

Sources: 1991 and 1990 China Statistical Yearbooks	(1) Farming, Forestry, Animal Husbandry, Fishery, and Water Conservancy	(2) Industry	(3) Geological Survey and Prospecting	(4) Construction	(5) Transport., Postal and Telecommun., Services	(6) Commerce, Food Servce, Mat'l Supply and Marketng, and Storage	(7) Real Estate Management, Public Srvs, Resident. and Consultancy Services
1990 National Total	341,770	96,970	1,000	24,610	14,690	29,370	6,370
1990 % of Total	60.23%	17.09%	0.18%	4.34%	2.59%	5.18%	1.12%
1989 National Total	332,834	95,677	1,042	24,437	14,322	28,607	5,913
1989 % of Total	60.16%	17.29%	0.19%	4.42%	2.59%	5.17%	1.07%
Total Annual % Change	2.68%	1.35%	-4.03%	0.71%	2.57%	2.67%	7.73%
1990 Beijing Total	907	2,141	6	669	253	684	371
1990 % of Total	14.05%	33.17%	0.09%	10.36%	3.92%	10.60%	5.75%
1989 Beijing Total	910	2,079	7	577	243	596	316
1989 % of Total	14.91%	34.07%	0.11%	9.46%	3.98%	9.77%	5.18%
Total Annual % Change	-0.33%	2.98%	-14.29%	15.94%	4.12%	14.77%	17.41%
1990 Shanghai Total	897	3,993	5	338	337	664	356
1990 % of Total	11.74%	52.28%	0.07%	4.43%	4.41%	8.69%	4.66%
1989 Shanghai Total	908	3,975	4	338	344	660	349
1989 % of Total	11.92%	52.20%	0.05%	4.44%	4.52%	8.67%	4.58%
Total Annual % Change	-1.21%	0.45%	25.00%	0.00%	-2.03%	0.61%	2.01%
1990 Tianjin Total	936	1987	37	296	210	424	135
1990 % of Total	20.33%	43.15%	0.80%	6.43%	4.56%	9.21%	2.93%
1989 Tianjin Total	934	1968	36	313	201	425	136
1989 % of Total	20.29%	42.75%	0.78%	6.80%	4.37%	9.23%	2.95%
Total Annual % Change	0.21%	0.97%	2.78%	-5.43%	4.48%	-0.24%	-0.74%

Note: The largest disparities are in the Farming and Industry sectors, where Beijing and the two municipalities are less reliant on Farming and more committed to the Industry, Commerce, Real Estate Management, Education and Scientific Research sectors. Beijing has devoted a greater percentage of its economic efforts on the Construction, Education, Scientific Research and in the Government Party Agencies areas than either Shanghai or Tianjin. These greater ratios are not unexpected since Beijing is undergoing much new construction, is the Chinese center for higher learning (Beijing University and Tsinghua University), a leader in computer technology (Haidian District) and the nerve center of all political decisions.

Sources: 1991 and 1990 China Statistical Yearbooks	(8) Health Care, Sports and Social Welfare	(9) Education, Culture and Art, Radio and TV Broadcasting	(10) Scientific Research and Polytechnical Services	(11) Banking and Insurance	(12) Government Party Agencies and Social Organizations	(13) Others	(14) Grand Total
1990 National Total	5,360	14,580	1,730	2,180	10,790	17,980	567,400
1990 % of Total	0.94%	2.57%	0.30%	0.38%	1.90%	3.17%	100.00%
1989 National Total	5,173	14,267	1,654	2,057	10,220	17,090	553,293
1989 % of Total	0.93%	2.58%	0.30%	0.37%	1.85%	3.09%	100.00%
Total Annual % Change	3.61%	2.19%	4.59%	5.98%	5.58%	5.21%	2.55%
1990 Beijing Total	139	417	262	43	358	205	6,455
1990 % of Total	2.15%	6.46%	4.06%	0.67%	5.55%	3.18%	100.00%
1989 Beijing Total	128	395	244	39	347	221	6,102
1989 % of Total	2.10%	6.47%	4.00%	0.64%	5.69%	3.62%	100.00%
Total Annual % Change	8.59%	5.57%	7.38%	10.26%	3.17%	-7.24%	5.78%
1990 Shanghai Total	159	343	118	36	168	224	7,638
1990 % of Total	2.08%	4.49%	1.54%	0.47%	2.20%	2.93%	100.00%
1989 Shanghai Total	162	343	116	34	165	217	7,615
1989 % of Total	2.13%	4.50%	1.52%	0.45%	2.17%	2.85%	100.00%
Total Annual % Change	-1.85%	0.00%	1.72%	5.88%	1.82%	3.23%	0.30%
1990 Tianjin Total	83	210	44	26	139	78	4,605
1990 % of Total	1.80%	4.56%	0.96%	0.56%	3.02%	1.69%	100.00%
1989 Tianjin Total	83	221	44	24	136	82	4,603
1989 % of Total	1.80%	4.80%	0.96%	0.52%	2.95%	1.78%	100.00%
Total Annual % Change	0.00%	-4.98%	0.00%	8.33%	2.21%	-4.88%	0.04%


北 京 市 区 图
BEIJING URBAN DISTRICT MAP
Exhibit B
Haidian District
Xicneng District
Cnaoyang District
SHIJINGSHAN DISTRICT
石 景 山 区
Third Ring Road →
Second Ring Road
FENGTAI DISTRICT


BEIJING MASTER PLAN: YR 2000
EXHIBIT C
AIRPORT
N
LEGEND
WORKING/RESIDENTIAL
RURAL AREAS
INDUSTRIAL/WAREHOUSE
GREEN AREAS
CITY BORDERS
1:100,000 m

BEIJING

DIAGRAM OF REAL ESTATE DEVELOPMENT PROCESS

EXHIBIT D

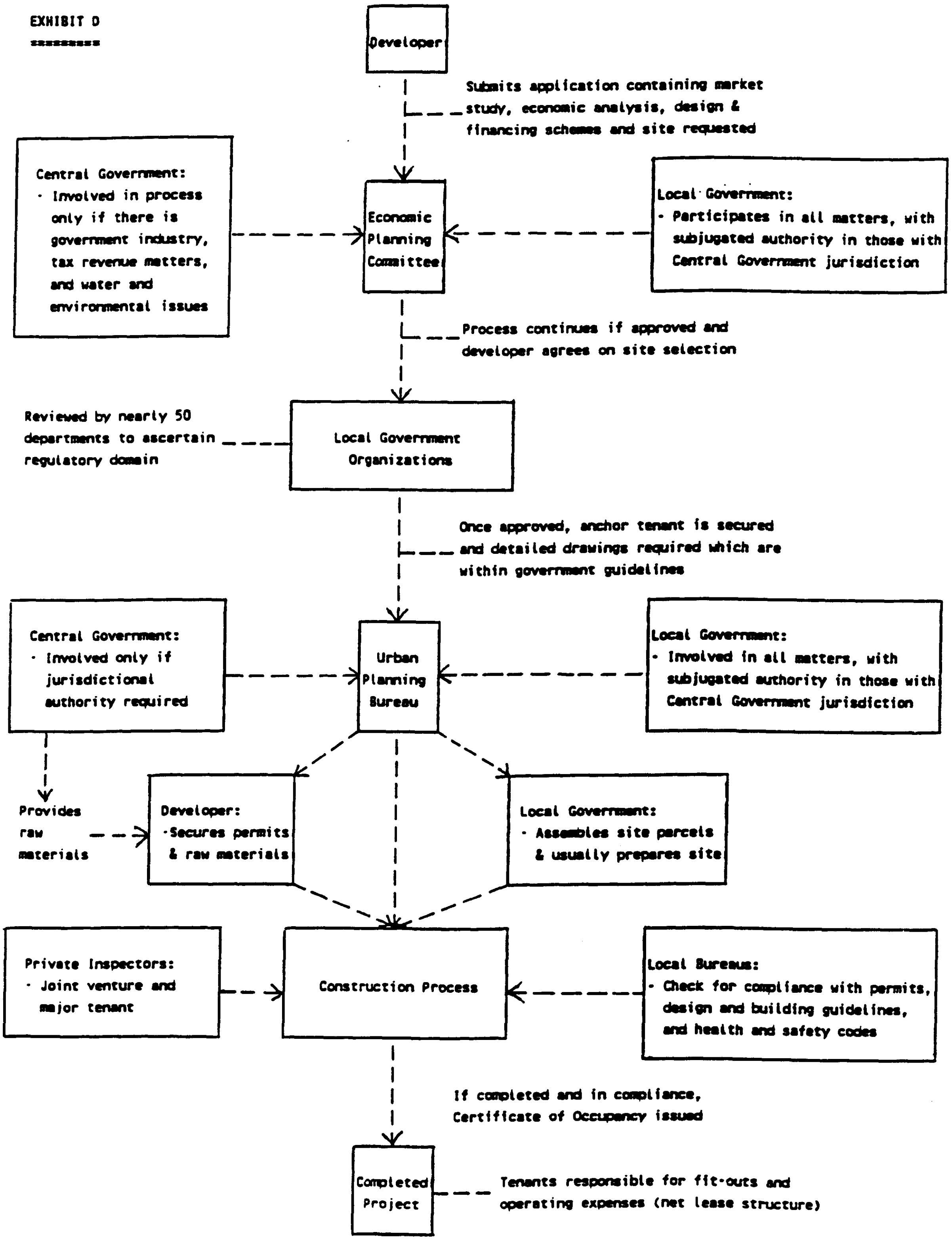


EXHIBIT E

SAMPLE CONTRACT FOR JOINT VENTURES USING CHINESE AND FOREIGN INVESTMENT

Sample Contract*

Chapter 1 General Provisions

In accordance with the "Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment" and other relevant Chinese laws and regulations, ______ Company and ______ Company, adhering to the principle of equality and mutual benefit and through friendly consultations, agree to jointly invest to set up a joint venture enterprise in ______ the People's Republic of China. The contract hereunder is worked out.

Chapter 2 Parties of the Joint Venture

Article 1

Parties of this contract are as follows: ______ Company (hereinafter referred to as Party A), registered with __________ in China, and its legal address is at __________ (street) ________ (district) (city) ________ China.

Legal representative: Name:
Position:
Nationality:

* *This "Sample Contract for Joint Ventures Using Chinese and Foreign Investment" was drafted by the Laws & Regulations Bureau of the Ministry of Foreign Economic Relations and Trade to serve as guidelines for enterprises. A review of this draft contract is worthwhile as it will give the reader the opportunity to understand the basis which his counterparts are probably using in their discussions. A "Sample Set of Articles of Association for Joint Ventures Using Chinese and Foreign Investment", which is not reproduced here is also available.*

______ Company (hereinafter referred to as Party B), registered with __________. Its legal address at ________________________.

Legal representative: Name:
Position:
Nationality:

(Note : In case there are more than two investors, they will be called Party C, D... in proper order.)

Chapter 3 Establishment of the Joint Venture Company

Article 2

In accordance with the "Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment" and other relevant Chinese laws and regulations, both parties of the joint venture agree to set up ______ joint venture limited liability company (hereinafter referred to as the joint venture company).

Article 3

The name of the joint venture company is __________ Limited Liability Company.

The name in foreign language is ____________________.

The legal address of the joint venture company is at ______ street ________ (city) ______ province.

Article 4

All activities of the joint venture company shall be governed by the laws, decrees and pertinent rules and regulations of the People's Republic of China.

Article 5

The organization form of the joint venture company is a limited liability company. Each party to the joint venture company is liable to the joint venture company within the limit of the capital subscribed by it. The profits, risks and losses of the joint venture company shall be shared by the parties in proportion to their contributions of the registered capital.

Chapter 4 The Purpose, Scope and Scale of Production and Business

Article 6

The purpose of the parties to the joint venture is in conformity with the wish of enhancing the economic corporation and technical exchanges, to improve the product quality, develop new products, and gain competitive position in the world market in quality and price by adopting advanced and appropriate technology and scientific management methods; so as to raise economic results and ensure satisfactory economic benefits for each investor.

(Note: This article shall be written according to the specific situations in the contract)

Article 7

The productive and business scope of the joint venture company is to produce ______ products; provide maintenance service after the sale of the products; study and develop new products.

(Note: It shall be written in the contract according to the specific conditions)

Article 8

The production scales of the joint venture company are as follows:

1. The production capacity after the joint venture put into operation is ______ .

2. The production scale may be increased up to ______ with the development of the production and operation. The product varieties may be developed into ______ .

(Note: It shall be written according to the specific situation.)

Chapter 5 Total Amount of Investment and the Registered Capital

Article 9

The total amount of investment of the joint venture company is Rmb ______ (or a foreign currency agreed upon by both parties.)

Article 10

Investment contributed by the parties is Renminbi ______ , which will be the registered capital of the joint venture company.

Of which: Party A shall pay ______ Yuan, accounts for ______%; Party B shall pay ______ Yuan, accounts for ______%.

Article 11

Both Party A and Party B will contribute the following as their investment:

Party A: cash ______ Yuan
machines and equipment ______ Yuan
premises ______ Yuan
the right to the use of the site ______ Yuan
industrial property ______ Yuan
others ______ Yuan, ______ Yuan in all.

Party B: cash ______ Yuan
machines and equipment ______ Yuan
industrial property ______ Yuan
other ______ Yuan, ______ Yuan in all.

(Note: When contributing capital goods or industrial property as investment, Party A and Party B shall conclude a separate contract to be a part of this main contract.)

Article 12

The registered capital of the joint venture company shall be paid in _______ installments by Party A and Party B according to their respective proportion of their investment.

Each installment shall be as follows:

(Note: it shall be written according to the concrete conditions.)

Article 13

In case any party to the joint venture intends to assign all or part of his investment subscribed to a third party, consent shall be obtained from the other party to the joint venture, and approval from the examination and approval authority is required.

When one party to the joint venture assigns all or part of his investment, the other party has preemptive right.

Chapter 6 Responsibilities of Each Party to the Joint Venture

Article 14

Party A and Party B shall be respectively responsible for the following matters:

Responsibilities of Party A:

Handling of applications for approval, registration, business license and other matters concerning the establishment of the joint venture company from relevant departments in charge of China;

Processing for applying the right to the use of a site to the authority in charge of the land;

Organizing the design and construction of the premises and other engineering facilities of the joint venture company;

Providing cash, machinery and equipment and premises ..... in accordance with the stipulations in Article 11;

Assisting Party B for processing import customs declaration for the machinery and equipment contributed by Party B as investment and arranging the transportation within the Chinese territory;

Assisting the joint venture company in purchasing or leasing equipment, materials, raw materials, articles for office use, means of transportation and communication facilities etc;

Assisting the joint venture company in contacting and settling the fundamental facilities such as water, electricity, transportation etc.;

Assisting the joint venture in recruiting Chinese management personnel, technical personnel, workers and other personnel needed;

Assisting foreign workers and staff in applying for the entry visa, work license and processing their travelling matters;

Responsible for handling other matters entrusted by the joint venture company.

Responsibilities of Party B:

Providing cash, machinery and equipment, industrial property ..... in accordance with the stipulations in Article 11, and responsible for shipping capital goods such as machinery and equipment etc contributed as investment to a Chinese port;

Handling the matters entrusted by the joint venture company, such as selecting and purchasing machinery and equipment outside China, etc;

Providing needed technical personnel for installing, testing and trial production of the equipment as well as the technical personnel for production and inspecting;

Training the technical personnel and workers of the joint venture company;

In case Party B is the licensor, it shall be responsible for the stable production of qualified products of the joint venture company in the light of design capacity within the stipulated period;

Responsible for other matters entrusted by the joint venture company.

(Note: It shall be written according to the specific situation.)

Chapter 7 Transfer of Technology

Article 15

Both Party A and Party B agree that a technology transfer agreement shall be signed between the joint venture company and the party B (or a third party) so as to obtain advanced production technology needed for realizing the production and operation purpose and the production scale stipulated in Chapter 4 in the contract, including products designing, technology of manufacturing, means of testing, materials prescription, standard of quality and the training of personnel etc.

(Note: It shall be written in the contract according to the concrete conditions.)

Article 16

Party B offers the following guarantees on the transfer of technology:

(Note: article applies only when Party B is responsible for transferring technology to the joint venture company.)

1. Party B guarantees that the overall technology such as the designing, technology of manufacturing, technological process, tests and inspection of products (Note: The name of the products shall be written) provided to the joint venture company must be integrated, precise and reliable. It is to meet the requirement of the joint venture's operation purpose, and be able to obtain the standard of production quality and production capacity stipulated in the contract;

2. Party B guarantees that the technology stipulated in this contract and the technology transfer agreement shall be fully transferred to the joint venture company, and pledges that the provided technology should be truly advanced among the same type of technology of Party B, the model, specification and quality of the equipment are excellent and it is to meet the requirement of technological operation and practical usage;

3. Party B shall work out detailed list of the provided technology and technological service at various stages as stipulated in the technology transfer agreement to be an appendix to the contract, and guarantee its performance;

4. The drawings, technological conditions and other detailed information are part of the transferred technology and shall be offered on time;

5. Within the validity period of the technology transfer agreement, Party B shall provide the joint venture company with the improvement of the technology and the improved information and technological material in time, and shall not charge separate fees;

6. Party B shall guarantee that the technological personnel and the workers in the joint venture company can master all the technology transferred within the period stipulated in the technology transfer agreement.

Article 17

In case Party B fails to provide equipment and technology in accordance with the stipulations in this contract and in the technology transfer agreement or in case any deceiving or concealing actions are found, Party B shall be responsible for compensating the direct losses to the joint venture company.

Article 18

The technology transfer fee shall be paid in royalties. The royalty rate shall be ______% of the net sales value of the products turned out. The term for royalty payment is the same as the term for technology transfer agreement stipulated in Article 19 of this contract.

Article 19

The term for the technology transfer agreement signed by joint venture company and Party B is ______ years. After the expiration of the technology transfer agreement, the joint venture company shall have the right to use, research and develop the imported technology continuously.

(Note: The term for a technology transfer agreement is generally no longer than 10 years, and it shall be approved by the Ministry of Foreign Economic Relations and Trade or other examination and approval authorities entrusted by the Ministry of Foreign Economic Relations and Trade.)

Chapter 8 Selling of Products

Article 20

The products of joint venture company will be sold both on Chinese market and on overseas market, the export part accounts for ____%, ____% for domestic market.

(Note: An annual percentage and amount for outside and inside selling will be written out according to practical situations, in normal conditions, the amount for export shall at least meet the needs of foreign exchange expenses of the joint venture company.)

Article 21

Products may be sold on overseas market through the following channels:

The joint venture company may directly sell its products on the international market, which accounts for ____%.

The joint venture company may sign sales contract with Chinese foreign trade companies, entrusting them to be the sales agencies or exclusive sales agencies, which accounts for ____%.

The joint venture company may entrust Party B to sell its products, which accounts for ____%.

Article 22

The joint venture's products to be sold in China may be handled by the Chinese materials and commercial departments by means of agency or exclusive sales, or may be sold by joint venture company directly.

Article 23

In order to provide maintenance service to the products sold both in China or abroad, the joint venture company may set up sales branches for maintenance service both in China or abroad subject to the approval of the relative Chinese department.

Article 24

The trademark of the joint venture's products is ______________ .

Chapter 9 The Board of Directors

Article 25

The date of registration of the joint venture company shall be the date of the establishment of the board of directors of the joint venture company.

Article 26

The board of directors are composed of ________ directors, of which _______ shall be appointed by Party A, _______ by Party B. The chairman of the board shall be appointed by Party A, and its vice-chairman by Party B. The term of office for the directors, chairman and vice-chairman is four years, their term of office may be renewed if continuously appointed by the relevant party.

Article 27

The highest authority of the joint venture company shall be its board of directors. It shall decide all major issues (Note: The main contents shall be listed in the light of the Article 36 of the Regulations for the Implementation of the Joint Venture Law) concerning the joint venture company. Unanimous approval shall be required before any decisions are made concerning major issues. As for other matters, approval by majority or a simple majority shall be required.

(Note: It shall be explicitly stipulated in the contract.)

Article 28

The chairman of the board is the legal representative of the joint venture company. Should the chairman be unable to exercise his responsibilities for some reasons, he shall authorize the vice-chairman or any other director to represent the joint venture company temporarily.

Article 29

The board of directors shall convene at least one meeting every year. The meeting shall be called and presided over by the chairman of the board. The chairman may convene an interim meeting based on a proposal made by more than one third of the total number of directors. Minutes of the meetings shall be placed on file.

Chapter 10 Business Management Office

Article 30

The joint venture company shall establish a management office which shall be responsible for its daily management. The management office shall have a general manager, appointed by party _______, ________ deputy general managers, _______ by party _______; _______ by party . The general manager and deputy general managers whose terms of office are _____ years shall be appointed by the board of directors.

Article 31

The responsiblity of the general manager is to carry out the decisions of the board meeting and organize and conduct the daily management of the joint venture company. The deputy general managers shall assist the general manager in his work.

Several department managers may be appointed by the management office, they shall be responsible for the works in various departments respectively, handle the matters handed over by the general manager and deputy general managers and shall be responsible to them.

Article 32

In case of graft or serious dereliction of duty on the part of the general manager and deputy general managers, the board of directors shall have the power to dismiss them at any time.

Chapter 11 Purchase of Equipment

Article 33

In its purchase of required raw materials, fuel, parts, means of transportation and articles for office use, etc, the joint venture company shall give first priority to purchase in China where conditions are the same.

Article 34

In case the joint venture company entrusts Party B to purchase equipment on the overseas market, persons appointed by Party A shall be invited to take part in the purchasing.

Chapter 12 Preparation and Construction.

Article 35

During the period of preparation and construction, a preparation and construction office shall be set up under the board of directors. The preparation and construction office shall consist of ____ persons, among which ____ persons will be from Party A, ____ persons from Party B. The preparation and construction office shall have one manager recommended by Party ____ , and one deputy manager by Party ____. The manager and deputy manager shall be appointed by the board of directors.

Article 36

The preparation and construction office is responsible for the following concrete works: examining the designs of the project, signing the project construction contract, organizing the purchasing and inspecting of relative equipment etc, working out the general schedule of project construction, compiling the expenditure plans, controlling project financial payments and final accounts of the project, drawing up managerial methods and keeping and piling documents, drawings, files and materials, etc, during the construction period of the project.

Article 37

A technical group with several technical personnel appointed by Party A and Party B shall be organized. The group, under the leadership of the preparation and construction office, is in charge of the examination, supervision, inspection, testing, checking and accepting, and performance checking for the project design, the quality of the project, the equipment and materials and the imported technology.

Article 38

After approved upon by both parties, the establishment, remuneration and the expenses of the staff of the preparation and construction office shall be covered in the project budget.

Article 39

After having completed the project and finishing the turning over procedures, the preparation and construction offices shall be dissolved upon the approval of the board of directors.

Chapter 13 Labor Management

Article 40

Labor contract covering the recruitment, employment, dismissal and resignation, wages, labor insurance, welfare, rewards, penalty and other matters concerning the staff and workers of the joint venture company shall be drawn up between the joint venture company and the Trade Union of the joint venture company as a whole, or the individual employees in the joint venture company as a whole or individual employees in accordance with the "Regulations of the People's Republic of China on Labor Management in Joint Ventures Using Chinese and Foreign Investment and its Implementation Rules."

Article 41

The appointment of high-ranking administrative personnel recommended by both parties, their salaries, social insurance, welfare and the standard of travelling expenses, etc shall be decided by the meeting of the board of directors.

Chapter 14 Taxes, Finance and Audit

Article 42

The joint venture company shall pay taxes in accordance with the stipulations of Chinese laws and other relative regulations.

Article 43

Staff members and workers and workers of the joint venture company shall pay individual income tax according to the "Individual Income Tax Law of the People's Republic of China."

Article 44

Allocations for reserve funds, expansion funds of the joint venture company and welfare funds and bonuses for staff and workers shall be set aside in accordance with the stipulations in the "Law of the People's Republic of China on Joint Venture Using Chinese and Foreign Investment". The annual proportion of allocations shall be decided by the board of directors according to the business situations of the joint venture company.

Article 45

The fiscal year of the joint venture company shall be from January 1 to December 31. All vouchers, receipts, statistic statements and reports shall be written in Chinese.

(Note: A foreign language can be used concurrently with mutual consent.)

Article 46

Financial checking and examination of the joint venture company shall be conducted by an auditor registered in China and reports shall be submitted to the board of directors and the general manager.

In case Party B considers it is necessary to employ a foreign auditor registered in another country to undertake annual financial checking and examination, Party A shall give its consent. All the expenses thereof shall be borne by party B.

Article 47

In the first three months of each fiscal year, the manager shall prepare previous year's balance sheet, profit and loss statement and proposal regarding the disposal of profits, and submit them to the board of directors for examination and approval.

Chapter 15 Duration of the Joint Venture

Article 48

The duration of the joint venture company is ____ years. The establishment of the joint venture company shall start from the date on which the business license of the joint venture company is issued.

An application for the extension of the duration, proposed by one party and unanimously approved by the board of directors, shall be submitted to the Ministry of Foreign Economic Relations and Trade (or the examination and approval authority entrusted by it) six months prior to the expiry date of the joint venture.

Chapter 16 The Disposal of Assets After the Expiration of the Duration

Article 49

Upon the expiration of the duration, or termination before the date of expiration of the joint venture, liquidation shall be carried out according to the relevant laws. The liquidated assets shall be distributed in accordance with the proportion of investment contributed by Party A and party B.

Chapter 17 Insurance

Article 50

Insurance policies of the joint venture company on various kinds of risks shall be underwritten with the People's Republic of China. Types, the value and duration of insurance shall be decided by the board of directors in accordance with the stipulations of the People's Insurance Company of China.

Chapter 18 The Amendment, Alteration and Discharge of the Contract

Article 51

The amendment of the contract or other appendices shall come into force only after the written agreement signed by Party A and Party B and approved by the original examination and approval authority.

Article 52

In case of inability to fulfil the contract or to continue operation due to heavy losses in successive years as a result of force majeure,the duration of the joint venture and the contract shall be terminated before the time of expiration after unanimously agreed upon by the board of directors and approved by the original examination and approval authority.

Article 53

Should the joint venture company be unable to continue its operations or achieve the business purpose stipulated in the contract due to the fact that one of the contracting parties fails to fulfil the obligations prescribed by the contract and articles of association, or seriously violate the stipulations of the contract and articles of association, that party shall be deemed as having unilaterally terminated the contract. The other party shall have the right to terminate the contract in accordance with the provisions of the contract after approved by the original examination and approval authority as well as to claim damages. In case Party A and Party B of the joint venture company agree to continue the operation, the party who fails to fulfil the obligations shall be liable to the economic losses thus caused to the joint venture company.

Chapter 19 Liabilities for Breach of Contract

Article 54

Should either Party A or Party B fail to pay on schedule the contributions in accordance with the provisions defined in Chapter 5 of this contract, the breaching party shall pay to the other party ____% of the contribution starting from the first month after exceeding the time limit. Should the breaching party fail to pay after 3 months, ____% of the contribution shall be paid to the other party, who shall have the right to terminate the contract and to claim damages to the breaching party in accordance with the stipulations in Article 53 of the contract.

Article 55

Should all or part of the contract and its appendices be unable to be fulfilled owing to the fault of one party, the breaching party shall bear the responsibilities thus caused. Should it be the fault of both parties, they shall bear their respective responsibilities according to actual situations.

Article 56

In order to guarantee the performance of the contract and its appendices, both Party A and Party B shall provide each other the bank guarantees for the performance of the contract.

Chapter 20 Force Majeure

Article 57

Should either of the parties to the contract be prevented from executing the contract by force majeure, such as earthquake, typhoon, flood, fire and war and other unforeseen events, and their happening and consequences are unpreventable and unavoidable, the prevented party shall notify the other party by cable without any delay, and within 15 days thereafter provide the detailed information of the events and a valid document for evidence issued by the relevant public notary organization for explaining the reason of its inability to execute or delay the execution of all or part of the contract. Both parties shall, through consultations, decide whether to terminate the contract or to exempt the part of obligations for implementation of the contract or whether to delay the execution of the contract according to the effects of the events on the performance of the contract.

Chapter 21 Applicable Law

Article 58

The formation of this contract, its validity, interpretation, execution and settlement of the disputes shall be governed by the related laws of the People's Republic of China.

Chapter 22 Settlement of Disputes

Article 59

Any disputes arising from the execution of, or in connection with the contract shall be settled through friendly consultations between both parties. In case no settlement can be reached through consultations, the disputes shall be submitted to the Foreign Economic and Trade Arbitration Commission of the China Council for the Promotion of International Trade for arbitration in accordance with its rules of procedure. The arbitral award is final and binding upon both parties.

Or

Any disputes arising from the execution of, or in connection with the contract shall be settled through friendly consultations between both parties. In case no settlement can be reached through consultations, the disputes shall be submitted to ______ Arbitration Organization in ______ for arbitration in accordance with its rules of procedure. The arbitral award is final and binding upon both parties.

Or

Any disputes arising from the execution of, or in connection with the contract shall be settled through friendly consultations between both parties. In case no settlement can be settled through consultations, the disputes shall be submitted for arbitration.

Arbitration shall take place in the defendant's country.

If in China, arbitration shall be conducted by the Foreign Economic and Trade Arbitration Commission of the China Council for the Promotion of International Trade in accordance with its rules of procedure.

If in ______ the arbitration shall be conducted by ______ in accordance with its rules of procedure.

The arbitral award is final and binding on both parties.

(Note: When formulating contracts, only one of the above-mentioned provisions can be used.)

Article 60

During the arbitration, the contract shall be observed and enforced by both parties except for matters in dispute.

Chapter 23 Language

Article 61

The contract shall be written in Chinese version and in ______ version. Both languages are equally authentic. In the event of any discrepancy between the two aforementioned versions, the Chinese version shall prevail.

Chapter 24 Effectiveness of the Contract and Miscellaneous

Article 62

The appendices drawn up in accordance with the principles of this contract are integral part of this contract, including: the project agreement, the technology transfer agreement, the sales agreement ......

Article 63

The contract and its appendices shall come into force beginning from the date of approval of the Ministry of Foreign Economic Relations and Trade of the People's Republic of China (or its entrusted examination and approval authority).

Article 64

Should notices in connection with any party's rights and obligations be sent by either Party A or Party B by telegram or telex, etc, the written letter notices shall be also required afterwards. The legal addresses of Party A and Party B listed in this contract shall be the posting addresses.

Article 65

The contract is signed in ______ , of China by the authorized representatives of both parties on ______, 19____.

For Party A
(Signature)

For Party B
(Signature)

....

BEIJING
ILLUSTRATION OF BEIJING LUFTHANSA CENTER PARTNERS
EQUITY JOINT VENTURE
EXHIBIT F

Beijing
Lufthansa
Center Co,
Ltd.

Joint Venture Partner:
Local Government

Beijing Municipal
Commercial Corporation

Joint Venture Partner:
German Partnership

German Partner: Majority

Deutsche Lufthansa AG
Philipp Holzmann AG
Bilfinger + Berger Bauaktiengesellschaft
Kempinski Hotels S.A.
DEG - Deutsche Investitions- und
Entwicklungsgesellschaft mbH

Korean Partner: Minority

Network Development Corporation (BMC)

Note: The You Yi Shopping City/Beijing Lufthansa Center is a Sino-German joint venture consisting of two partners: the Beijing local government and a German Partnership consisting of 6 companies as the majority partner and a Korean development firm as the minority partner. See Exhibit G for financial structure of this equity joint venture.

You Yi Shopping City
Beijing Lufthansa Center
Analysis of Foreign Joint Venture Financial Structure
Exhibit G

Total Initial Investment in German Marks	1,000,000,000
Assumed Allocation to Friendship Store (Based on Estimated Square Meters)	25.00%
Net Investment in Retail Site Only	250,000,000
Assumed Conversion Rate to Yuan (Buy Rate as of July 9, 1992)	3.6478
Converted Investment in Yuan (Foreign Exchange Certificate)	911,950,000

			Daily Sales (in yuan)	Assumed Annl Payment in FEC (1st 3 Years)	Assumed Annl Payment in FEC (Next 27 Years)
Annual Lease Payments from Chinese Government				47,000,000	47,000,000
% Gross Sales Clause:	1st 3 Years	0.2%	1,500,000	1,095,000	
:	Next 27 Years	0.4%	1,500,000		2,190,000
Total Estimated Annual Lease Payments				48,095,000	49,190,000
Projected Undiscounted Cash-on-Cash Return Before Taxes				5.3%	5.4%
Estimated Payback Period (In Years)					19
Computed Pretax Internal Rate of Return					3.4%

Foreign Investment Components:

		Ex Rate	Investment	
Total Investment in German Marks				1,000,000,000
Allocation of Foreign Partner's Investment:				
(1) German Co. Majority Partner	in German Marks			953,500,000
(2) Korean Co. Minority Partner	in $ U.S.	1.55	$30,000,000	46,500,000
				1,000,000,000

Terms of Joint Venture Contract:

(1) 30 year contract with ultimate reversion to the Chinese government at end of term; no nenewal clauses or options during the term of the contract.

(2) Any excess profits earned from the government department store over the contractual payment to the foreign joint venture is retained by the Chinese government.

(3) Terms of the joint venture agreement state that foreign partner will absorb total building construction costs while the Chinese government will prepare the site for construction, some raw materials and labor.

(4) The Korean Partner is a minority partner within the foreign partner's share; the structure of this arrangement is unknown.

(5) The contract stipulates annual payments to the foreign joint venture partner of 47,000,000 yuan, payable in Foreign Exchange Certificates (FEC) plus a percentage of gross sales: .2% for the first 3 years and .4% during the last 27 years. FEC paid to avoid foreign exchange restrictions which do not allow for profit repatriation.

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