Comparison of Real Estate Bubble from Florida to Hainan

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Abstract

My research aims to compare the housing and credit bubbles between China and the US by comparing real estate bubbles of Florida and Hainan. It took the US government 4 years to overcome 2008 financial crisis. Now China has entered the era of stock housing. In the early of 2016, China had 8.4 billion sq.ft stocking housing1. If the crisis is inevitable, how and where will it happen?

What’s more, I want to find out the role of financial innovations in securitization along with the incompleteness of real estate markets in the global financial crisis. Were "innovations" in securitization a common cause of the crisis of what was a global cycle? My paper will help readers to further understand the U.S. subprime mortgage crisis, as well as China's current problems faced by the real estate bubble.

By comparison, I hope that the United States before the problems faced by the U.S. government and the solution can be used for reference to the Chinese government and related companies in order to face the possible real estate bubble crisis.

Still, China’s property market looks relatively sane when compared to the peak of the Japanese residential property bubble in 1990 and Hong Kong’s current property market. During this period of Japan’s housing value-to-GDP ratio peaked at just under four and today Hong Kong’s ratio stands at around five.

As we can see, the housing and credit bubble in China is so huge now that China has never been before. As Wang Jianlin, the leader of the biggest real estate company in China, saying, “The Housing bubble in China is the biggest in history.”2

1 China National Bureau of Statistics
2 CNN, “Billionaire: Chinese real estate is 'biggest bubble in history'”
Key Assumptions

1. Most measurable attitudes are held strongly enough to direct behavior.
2. Statistically significant differences relate to the variables under consideration.
3. Only the current data analysis and prediction, without considering the impact of unexpected events.

Additional Requirements and Conditions

1. Methodological limitations usually result from some of the methodological factors such as unrepresentative sample, weak design, single setting, limited control over extraneous variables, poor data collection procedure, ineffective use of statistical analysis etc.
2. The study is limited to the situations of the United States and China.
3. The study will limited to the experience level of the researcher.
My client is Colliers International. It is a global real estate services organization, which has many branches around the world. And I have a work experience in its Beijing company last year. It is very famous for its market research reports. My purpose is to compare the two typical regions of China and the United States, and then find the common nature of the real estate bubble. It will reflect the different stages of development of these two countries, providing reference for the investment of international investors.

My paper will help Colliers International explain the U.S. subprime mortgage crisis, as well as China's current problems faced by the real estate bubbles, to their clients. By comparison, I hope that the United States before the problems faced by the U.S. government and the solution can be used for reference Colliers International in order to face the possible real estate bubble crisis.

Colliers International is a leading global real estate services organization, with excellent service and innovative business philosophy. Headquartered in Seattle, Washington, with 502 companies in the world, Colliers International is committed to providing the best service to the customers. In conjunction with local talent resources, we assist our clients in emerging markets such as Asia, Eastern Europe and Latin America.
Brief Introduction

The Florida Real Estate Bubble was a speculative property bubble that occurred in Florida in the early and mid-1920s. Then, the bubble exacerbated the economic crisis in the United States, resulting in the collapse of the Wall Street stock market, and ultimately led to the 1930s world economic crisis.

For those who have never experienced the real financial crisis in China, from the private to the decision-making level, everyone was lack of a systematic study of the bubble economy. And then the Hainan real estate bubble burst event has become a typical sample of China's local bubble economy, which occupies a special position in the history of 20 years of China's real estate.

As an old saying goes, “History repeats itself.”

The United States housing bubble was a real estate bubble affecting over half of U.S. states. Housing prices peaked in early 2006, started to decline in 2006 and 2007, and reached new lows in 2012. On December 30, 2008, the Case-Shiller home price index reported its largest price drop in its history. The credit crisis resulting from the bursting of the housing bubble is—according to general consensus—the primary cause of the credit default swap bubble of the 2007–2009 recession in the United States. Housing price boom was accompanied by a rapid expansion of financing — mortgage lending and mortgage securitization.

According to the data of the People's Bank of China, the new loans reached 11 trillion and 700 billion yuan in 2015, which was far exceeding the record set in 2009, when China had just announced a $4 trillion financial crisis relief program. Only in the first half of 2016, new RMB loans reached a high of 7 trillion and 500 billion.

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3 Standard & Poor's Case–Shiller Home Price Indices
Florida is a state located in the southeastern region of the United States. It is bordered to the west by the Gulf of Mexico, to the north by Alabama and Georgia, to the east by the Atlantic Ocean, and to the south by the Straits of Florida and Cuba.

In 1920s, Florida’s tourism industry began to boom, which caused land prices to rise. Florida’s population was soon growing exponentially and the state’s supply of houses could not satisfy the soaring demand. As Florida’s economy boomed, cheap credit became so plentiful that practically anyone could have invested in real estate, regardless of their net worth.
By 1925, Florida’s real estate prices had risen so high that they became very top-heavy. Soon after, prospective investors started to lose interest in Florida real estate and earlier investors started to sell their holdings to lock in their profits. Property prices fell under their own weight until the market began to panic, which caused Florida’s real estate market to crash. Prices plunged as heavily-indebted investors tried to liquidate their holdings to avoid going bankrupt.
The Case–Shiller Price Indices are repeat-sales house price indices for the United States. It is very clear that the index presented by Shiller appears to have a very strong downward bias for the 1920s.

A hurricane hit Florida in September 1926, which eventually led to the collapse of the housing bubble in Florida. This big hurricane swept through Florida at 125 miles per hour, the beaches immediately turned into ruins. In that disaster, 13000 houses were destroyed, while 415 people were killed.

The hurricane to blew up the Florida property bubble. But the essential cause is that local real estate prices were too high, and hurricanes was only an incentive. After the real estate bubble burst, it led to the rupture of the entire capital chain, a large number of real estate companies faced bankruptcy. And then it ultimately led to financial crisis. After the bursting of the housing bubble in Florida, many businesses and banks went bankrupt.

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4 Wikipedia, “Case-Shiller index”
Hainan is the smallest and southernmost province of the People's Republic of China, consisting of various islands in the South China Sea. The southern city of Sanya has many beaches that range from 22 km-long Sanya Bay to crescent Yalong Bay and its luxury hotels. Outside Sanya, the hilly hiking trails of Yanoda Rainforest Cultural Tourism Zone pass over suspension bridges and by waterfalls. Hainan is an island province of China and the nation’s southernmost point. It's known for its tropical climate, beach resorts and forested, mountainous interior.

As Justin Lin, the World Bank’s Chief Economist, said, “In 1992, there was a nationwide ‘development zone fever’ and ‘real estate fever’ in which real estate prices rose sharply and real estate speculation was widespread.”

Overheating

In early 1992, Deng Xiaoping, the leader of China at that time, toured the south of China and made some speeches, urging a quicker transition into market economy and more aggressive economic development. In the next two years, the economy was overheating, as the Figure 3 indicated, the GDP growth rate of 41.5% in 1992, while the whole country’s GDP growth is 14.2%. Additionally, the inflation rate increased to 27.7% in 1994. Hainan’s real estate market became the hot point suddenly.

A lot of money was invested to real estate, at the peak period, more than 20,000 real estate companies appeared on Hainan island with population of only 65,580,000, which means on average each 300 people matches a real estate company. According to the “China Real Estate Market Yearbook(1996)”, in 1988, the average price of Hainan commercial housing was 1350 yuan/square meter, in 1991 to 1400 yuan/square meter, in 1992 soared to 5000 yuan/square meter, and in 1993 reached 7500 yuan/square meter. In three years, the increase was more than 4 times.

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5 *China Real Estate Market Yearbook, 1996*
Then, in 1993, Zhu Rongji, the vice premier of the country, announced the termination of the IPO of the real estate companies and the control of loans to the real estate industry.

In 1994, as the Figure 5 shows, 600 unfinished buildings, 172,222,566 square of idle land, 80 million rmb backlog of funds, and more than 30 billion rmb bad debt left.

(China Real Estate Market Yearbook, 1996)
Comparison

1. Different systems

In the United States, real estate bubbles broke mainly because of booms in credit growth and reduction of quality of credit. While in China, bubbles ended by policies.

In the U.S., there are third parties to assist in the sale of housing in many of the house-sale process. In the U.S., each institution in the process of the sale has their functions: valuation company, inspection company, the notary company, bank and title insurance company, broker system, etc., to ensure the sale of housing is fair and reasonable. So that the real estate industry can be fair, transparent, healthy and vigorous.

China's real estate industry has just started in recent years, which is not completed. There are a lot of problems, whether in the intermediary system or in the buying and selling process.
Government’s macro-control in different periods are unpredictable. The speculative behavior of the real estate market is far more than the actual demand of real estate.

2. Different stages

China and the United States respectively belong to different stages of development of national industrialization and globalization. There is still a huge gap in their total economy.

The United States real estate has periodic law inherent in the market economy. Since 1923, the U.S. real estate market bubble appeared 3 times, especially the recent subprime mortgage crisis, which triggered a global financial crisis. The United States has a very market-oriented land system, as well as a more complete system of affordable housing and real estate tax system. But the United States still can not get rid of the real estate cycle fluctuations, and population, interest rates, credit, tax policy are very important factors.

China's real estate market started late, but still has very strong cyclical fluctuations. In 1992 the government abolished the welfare housing distribution system, and the market began to transfer to the commercial housing market. Housing provident fund system was fully implemented. In 1993 housing project started. After 1992, the real estate industry grew rapidly. The highest growth on investment was as high as 146.9%. The real estate market in the local region was a chaotic situation in the individual areas of the more obvious real estate bubble. After the end of 1993 macroeconomic regulation and control, real estate investment growth rate fell sharply. The
real estate market began to recover after a period of depression. With the deepening of the reform of the housing system and the improvement of the income level of residents, housing has become a new hot spot of consumption. In 1998, with the cancellation of the housing distribution system and the implementation of the mortgage policy, real estate investment has entered a period of steady and rapid development, the real estate industry has become one of the pillar industries of the economy.

3. Different solutions

The Chinese government is good at using policy tools. The U.S. real estate market is more mature and transparent. The U.S. is good at using “invisible hand”, the market.

Chinese government use economic, legal, and policy means to guide, supervise, and adjust Chinese real estate market. As the ministry of housing construction said, the government will keep regulate and control Chinese real estate market to balance the total supply and demand, to optimize the overall real estate market, and finally achieve the coordinated development of real estate and national economy. As the 1992 Hainan’s real estate bubble, the bubble was finally bursted and solved by government. In June 1993, Zhu Rongji, the vice premier of the country, announced the termination of the IPO of real estate companies and the control of bank funds to the real estate industry. However, in the U.S., it allows laws of supply and demand to direct the market. Government will not intervene and central plan much in the market development. The market will guide the development direction, recognize the problems, and solve the problems mainly by itself.

In this comparison, the 1920s Florida’s bubble exacerbated the economic crisis in the United States, resulting in the collapse of the Wall Street stock market, and ultimately led to the 1930s world economic crisis. While, the 1992 Hainan’s bubble was just stopped by the government in 1994. Chinese government stopped the potential huge loss quickly.
As a result, the market mechanism performs better at the resilience and flexibility of resources allocation, but it performs weaker at macro structural adjustment and it will not foreseen the fall and take measures as quick as the government will. For the real estate bubbles, the policies, regulations and economic tools used by government performs better.
Recommendations

1. Don’t invest reckless securitization

Excessive asset securitization will enlarge credit risk. In 2008 the bankruptcy of Lehman Brothers, for example, it was too involved in the financial derivatives CDS (credit default swap). CDS seriously amplified the credit risk, so that lenders did not have to worry about whether the loan can recover the illusion. At the time of the crisis, the CDS market was 48 times larger than the subprime mortgage market, which is equivalent to 4 times of the US GDP.

Today, the scope of China's asset securitization pilot has been expanded, in addition to bank credit assets, many industrial assets have also realized the securitization. China's asset securitization will be added gradually about securitization of assets based on the true meaning of
the ranks. The REITs is expected to appear in the capital market of our country. Strict standards for basic assets, which is the most important asset securitization risk management. To strictly regulate the promoters, we must have sufficient time to hold the underlying assets. To strictly control the non-performing assets of banks, Internet banking asset securitization. And we must be cautious about re-securitization of securitization products.

2. Don’t invest where has insane per-capita living space

In 1992, the per-capita living space In Hainan was over 538 sq ft, while that number in Shanghai was just 43 sq ft at that time. 6

The real estate bubble has obvious negative effects: the rising prices deteriorate income distribution, increase the social atmosphere of speculation and restrain enterprise innovation enthusiasm. Real estate is non productive property, too much credit to invest in real estate will be out of the real economy investment. High prices increase in social life and production cost easily lead to industrial hollowing. The measures should be taken to avoid rising prices from the fundamentals bubble trend, and it can be considered in the form of law to clear: living oriented housing system design, the establishment of long-term mechanism to curb speculative investment demand. Strengthen the supervision of banks on the excessive mortgage. Housing credit policy of long-term stable and avoid sharp adjustments and the proportion of loans the interest rates of overdraft residents' ability to pay, to stabilize the market is expected to take a neutral. Prudent monetary policy. Promote fiscal reforms to change the local government financial dependence on land, and gradually establish a unified urban and rural collective construction land market and housing development mechanism. Chinese economic and residential investment has bid farewell to the era of high growth, the real estate policy should adapt to the "total slowdown, structural differentiation" new development stage, to avoid the risk

6 David Green-Morgan, Global Capital Markets Research Director in JLL, based in Singapore
of a bubble in the hope of stimulating the real estate return to high growth. China's real estate is still expected to have a moderate growth in the economy, there is a certain space for urbanization and other favorable factors, if properly regulated, there is still a turn for the better.

In the 2014-2016 years of economic recession, excessive currency and low interest rates stimulated a new round of land prices soaring. In top 12 global cities China accounted for 4 seats (Hongkong, Shenzhen, Shanghai, Beijing), residents are buying real estate crazily. Most of the new loans are real estate mortgages, and it shows a bubble trend. Judgment on the future trend of prices can be translated into the future urbanization, income, monetary flexibility and interest rates to determine the level. The current fundamentals have a certain space, such as urbanization rate in 2015 56.1%, there are more than and 10 percentage points in the space, will increase the urban population of about 200 million people, but the obvious regional differentiation, a second tier three or four line high prices, high inventory.

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7 China National Bureau of Statistics
References


Ruoyang Yang, wechat message to author, February 10, 2017.

Jiajie Cao, wechat message to author, February 13, 2017.
Appendix

Interview 1

Research theme: Comparison of Real Estate Bubble-From Florida to Hainan
Interviewee: Raine Zhang, Manager of Valuation & Advisory Services, Colliers International (Beijing)
Date: Feb-10-2017
Communication: chat software (Wechat)
Q1: Would you please talk about the development of the real estate market in Beijing in 2016?
Raine: According to the policies announced by the end of September, the volume of housing transactions and price growth rate in the Beijing residential property market have both decreased in the 4th quarter. Purchasing demand for Beijing’s housing market was subdued due to new tightening policies. Residential buyers have quickly adopted wait-and-see attitude and have a more rational expectation towards price. As a result, the transaction volumes of Beijing’s overall residential market decreased by 35.8% QOQ or 29.2% YOY by the end of Q4 2016. In the high-end market including luxury apartments and villas, despite the transaction volume's increase of more than 100% YOY, it declined by 10% compared with last quarter. (YOY: year over year, QOQ: quarter on quarter)
In light of the new policies, Beijing increased the land supply for the development of ordinary and affordable housing. Developers remained active in purchasing land plots for their land reservation in Beijing and eight residential land plots were transacted in Q4 2016. Notably, four land sites were zoned for ordinary housing development which will be held and leased by developers. This was reflected by Vanke’s purchase of two residential land plots in the Haidian District.
Q2: Could you predict the future of Beijing's real estate market?
Raine: China's real estate market rose sharply last year, and the government was aware of the problem. So the government had issued a series of measures to limit the rise in real estate. According to the Central Economic Working Conference held on 14 December, it clarified that “houses are for living in, not for speculation”. It is worth noting that the national government
intends to establish a long-term mechanism and give flexibility to individual cities to adjust housing policies at local level. As a result, Colliers expects tightening measures in the Beijing's residential property market to remain in place in 2017. The transaction volumes should go down in the short-term and prices should correct at a reasonable rate.

Q3: How do you think China's real estate bubble?

Raine: I would say China property market need to cool down, but won't crash like US in 2008. Though most observers believe China's real estate market is not in a bubble just yet, making sure it doesn't reach that point is one of the biggest challenges facing Beijing today. The localization of Chinese real estate market is very serious, different city has different situation. I think Beijing has no bubble, but because supply exceeds demand in many cities of China, so it is hard to say there is no bubble.
Interview 2

Research theme: Comparison of Real Estate Bubble-From Florida to Hainan

Interviewee: Ruoyang Yang, staff of Valuation & Advisory Services, Colliers International (Beijing. He studied in USC for 2 years)

Date: Feb-10-2017

Communication: chat software (Wechat)

Q1: What do you think of this research direction?
Ruoyang: I think you ought to study to focus on a few cities. There is no bubble in big cities, as the real estate market in New York, where housing prices were not a slump even in financial crisis.

Q2: What do you think of the bubbles in real estate of China?
Ruoyang: I always believe that China's real estate bubble exists in the third-tier cities the cities of lower level, some of the real estate industry in the fever, some places are still very cold. This clearly shows the regional differences in the real estate market. But I think China's real estate bubble is very serious, our real estate vacancy rate is very large. Some media estimates the national vacancy rate is 20%-25%.
On the other hand, the high price of real estate has seriously affected China's industrial structure. Some companies reduce their losses or even make profits just by selling investment properties. Many manufacturers are reluctant to invest in the production of money, but to enter the field of real estate investment. Local governments are also suspected of collusion with developers to push up prices.
So I think the risk Chinese real estate risk mainly comes from the Chinese industrial structure. While the risk of credit system is not very serious, the main reason is the personal credibility of money is very high.

Q3: What do you think of the real estate market in the USA?
Ruoyang: I don't know much about the real estate market in the United States, but I know the information in the United States is more transparent than that in China. I think you can go to the company's web site to find the answer.
Interview 3

Research theme: Comparison of Real Estate Bubble-From Florida to Hainan
Interviewee: Jiajie Cao, General manager assistant, China Spring Investment Company, Hainan Province (The most south province of China, and this company is committed to becoming China's high-end holiday health care provider.)
Date: Feb-13-2017
Communication: chat software (Wechat)

Q1: Could you introduce the current situation of the real estate market in Hainan briefly?
Jiajie: Hainan is a tourist city, so it is affected by the season. Winter is the golden age of real estate in Hainan.
In December 2016, the Hainan property market sold 11428 units, up 34%, with total area of 1002791 square meters, up 30%. Residential average price is 13708 yuan / square meters, up 18.1%, and they sold 13 billion 747 million yuan in total, up 54%. But Hainan's real estate inventory is still very large

Q2: Do you think there is a bubble in the real estate market in Hainan?
Jiajie: I think there is a bubble in the real estate market in Hainan. Hainan is the southernmost province, where the climate is very good, and very suitable for the winter. So for a long time, the government has always wanted to develop Hainan into an international tourist island. But in 90s the Hainan property market bubble burst, resulting in a long period of depression. The past few years have changed a lot, but the problem is still huge. Hainan's infrastructure is very poor, you can even not find a taxi in many cities.

Q3: What do you think of the future of Hainan real estate market?
Jiajie: Many of Hainan's real estate is supported by tourism real estate and investment. In the overall market downturn in the market situation, the task is difficult to reduce inventory in Hainan. But I believe the government, I think the government will come out in time to avoid the collapse of the real estate bubble.

Q4: If you are an investor, would you consider buying a house in Hainan?
Jiajie: I will only buy a house in some one or two places, but not too much emphasis here.