

Analysis on Advantages and Disadvantages of China's Insurance Funds to Participate in the Affordable Housing¹

Zhao Zhifu

Luo Juan

School of Management
Shanghai University of Engineering Science
China

Abstract

With China's affordable housing construction process speeding up, the shortage of capital has become more and more serious. During the NPC and CPPCC, some representatives advocated to make insurance money involved in affordable housing construction. Thus, insurance funds in the Affordable housing construction became a hot issue. Some experts and scholars support the bill, but little detailed research has been done in analyzing the advantages and disadvantages of the involvement of the insurance funds in the security housing construction. This paper attempts to discuss on this topic and show my superficial view.

Keywords: Insurance Funds Affordable Housing Analyzing For Advantages And Disadvantages

Introduction

Since the ancient time, there has been a concept of “live and work in peace and contentment” in China. Practice shows that people believe living in peace is one of the basic requirements of people’s life and is also one of the prerequisites for people to be engaged in other activities and countries to maintain social stability. However, in modern society, Chinese people are facing serious housing problems, especially in low-income families, whose problem is more severe. Therefore, improving the living conditions of low-income residents is an important livelihood issues. Accelerating the construction of affordable housing is of great importance to people's livelihood and social harmony. Having built 5.9 million affordable housing in 2009, the Chinese government aims to construct 10 million ones during the "11th five-year plan" period of economic. Such a large-scale construction of affordable housing plan brings hope to millions of poor families but also puts much pressure on the government financial department.

It is difficult to effectively alleviate the pressure if we simply rely on traditional financing ways (financial allocation, value-added income housing fund, social security, social donations, etc.), which require the government to seek alternative sources of finance. According to the latest monthly statistics released by the China Insurance Regulatory Commission, up to the end of July 2011, the country's total assets is RMB 5.607362 trillion and insurance industry and insurance funds is up to RMB 5.170905 trillion. Currently, the low level of development of China's financial markets and the instability of international investment market also urge such a huge insurance fund balance to expand investment ways. Therefore, the China's insurance funds to participate in the construction of affordable housing is imperative.

Insurance funds that involved in the construction of affordable housing is of great significance to the government financial and social harmony. Mr. Ma, the chairman of China Ping An Group ,believes that the construction of affordable housing is different from the general commercial estate investments, with local governments responsible for the designation of land allocated and stipulate profit margins and require to repurchase commitments. For insurance funds, it is risk-control, long-term stability, security and reliable investment product, which also helps to reduce the insurance funds’ reliance on the capital market and effectively avoid the risk of market volatility.

¹ This subject is sponsored by Shanghai Philosophy and Social Science Planning on Youth Projects.ITEM NO.2013EJB003

Despite the affordable housing market was seen as a breakthrough innovation investment channels of insurance funds, but some experts pointed out that due to the current rules of real estate investment of insurance funds and the affordable housing construction policy is not clear, the risk of insurance funds to enter the housing market cannot be neglected.

In addition, experts indicate that compared with long-term debt and deposit agreement, the income of insurance companies' investment in affordable housing does not have much advantage, which means insurance companies don't have much motive to be involved in the construction of affordable housing.

Thus, the insurance funds to participate in the construction of affordable housing, on one hand, is beneficial to the country, on the other hand, it is a double edged sword. This paper is to discuss the pros and cons of insurance funds to participate in the construction of affordable housing, identify problems, analyze and solve problems.

Built in accordance with national policies and laws and regulated by the government of unified planning, affordable housing will be a particular type of China's urban housing construction. It is provided for specific populations, and the construction standards and sales prices or rents are limited. Generally speaking, affordable housing consists of low-rent housing, affordable housing and policy-related rental housing. At present, the lack of funds to construct the affordable housing puts great pressure on Chinese financial, insurance funds to participate in the construction of affordable housing will help to ease this pressure.

In 2011, during the NPC and CPPCC, the State Council proposed to build 36 million units of affordable housing during the "11th five-year plan" period of economy. Shortage of funds is the biggest obstacle in the construction of affordable housing. A growing number of local government wish to the institution funds to assist in the construction of affordable housing. The life insurance funds makes up more than 75% of Chinese insurance funds, of which over 70% are long-term funds. Being long-cycle and large-scale, these features are in line with the funds of affordable housing construction. Therefore, improving relevant laws, making responsibility clear and promoting affordable housing insurance funds is are urgent.

1. The Shortage of Construction Capital for the Affordable Housing

According to the estimated number of low- income families in China's urban cities , the gap between actual demand and supply is about 40 million units. The State Council and the Urban Planning and Construction Bureau (hereinafter referred to as the Ministry of Housing) plans to build 10 million units of affordable housing in 2011, reaching 20% of the national housing market investment , with a total investment amount of more than RMB 1 trillion . However, with the affordable housing construction operating for a long time and being low-profit, not only do companies have few motive to participate in the construction of affordable housing, but also the funds are facing severe difficulty. Even some local governments allocate land premium of 20%, while the housing provident increments of 70% (equal increments of affordable housing), there exists RMB 546.2 billion gap at least.

2. Huge Investment of Insurance Funds Seeks Outlet

CIRC statistics show that at the end of December 2010, RMB 5.04 trillion of the insurance funds is available. Since 1st October, 2009 the Insurance Law has been secondly revised, after which the gate of real estate investment of insurance funds opens, a huge venture capital has been looking for suitable investment outlet. Introduction of insurance funds and commercial mode of operation will not only help to fill in the huge construction of affordable housing funding gap, but also contribute to improvement of the long-term profit on investment of insurance funds.

With China's urbanization process accelerated, housing problems have become increasingly prominent. Solving the housing problem properly will help alleviate and reduce social instability. The above objective requirements demand our government do a good job of housing construction, insurance funds in case of lack of protection of housing construction funds put into use is timely helpful. This practice has broad and long-term effects.

3. Impact on National at Macro-level

(1)Relieve the Financial Pressure on Countries

Our country is a big one with a population of 1.3 billion, which means the country needs a lot of money in administrative expenses, defense spending, culture SCISAT spending, agricultural spending, infrastructure spending, basic industry spending, financial subsidies and other expenditure areas, etc.

The construction of 10 million units affordable housing (each counts 50 square meters) a year requires RMB 1.38 trillion expense. If all types of fiscal investment accounted for 30%, 70% of the funds need to resolve through the market and the annual financing needs RMB 9660 billion. Thus, China's insurance capital to participate in the construction of affordable housing will be in favor of expanding the scale of financing and relieving the financial pressure on country.

(2)Regulating the Inflated Housing Prices to Satisfy the Housing Needs of Citizens

Experience around the world proves that any civilized country cannot deprive citizens of the right to housing, so does China. However, our current prices artificially high especially in first-tier cities, such as Beijing, Shanghai and Guangzhou, a common house cost hundreds of millions., the housing problem has seriously affected people's economic and social life. The 11th five-year plan suggests the government enhance responsibilities at all levels to increase the construction of affordable housing projects and accelerate the shantytowns and the development of public rental housing. Increasing the supply of housing for low-income residents will help to regulate the high housing prices and to meet the housing needs of citizens to some extent. Therefore, China's insurance capital to participate in the protection of housing construction is timely.

①To promote the Urbanization Process and to Maintain Social Harmony

The pace of China's urbanization process is accelerating. Five hundred million people will be urbanized in 20 years at conservative estimation. Supposing four people live in one house, the demand for housing units should be 20 billion in 5 years. Under the pressure of this strong demand, increasing small units and low housing supply, although will work at certain level, housing prices is still difficult to be suppressed. It is urgent to improve housing security system. China's insurance capital to participate in the construction of affordable housing, will help China improve housing security system as soon as possible, in which way , people can truly live and work in harmony.

②Beautify Our City and Reduce the Spread of Disease and Crime

With China's urbanization process accelerated, a large number of foreign workers, college students and other cities rush into big cities, adding pressure on housing in low-income families .It is so difficult for low-income families to purchase suitable house that many of them have to dwelling in some of the "old building" and other slums .The poor management and infrastructure in these places result in overcrowding, which makes the environment extremely harsh. People there can easily get infected with diseases. China's insurance capital to participate in the affordable housing construction funds will be propitious to unify centralized government planning so that more standard residential housing can be built, which will reduce the spread of disease and crime and beautify our city.

4. Effects on China's Insurance Companies

(1) Help Broaden the Investment Channels for Insurance Funds

Investing affordable housing construction will help broaden the investment channels of insurance funds. Compared with other countries, China's channels of insurance funds is too narrow, which is not conducive for the insurance company to balance investment portfolio, assets and liabilities. That put much pressure on the increasing of insurance funds value. Allowing insurance funds to invest in real estate will broaden the channels of insurance funds and be benefit to portfolio of the company's assets and avoid the risk of being too concentrated, however ,which plays an important role in the decentralizing and risk-control of insurance industry, so that the safety of funds can be guaranteed.

(2) Help to Improve the Stability of the Insurance Funds Investment Income

Investment in the construction of affordable housing can be used as an alternative tool for fixed-income products. The reasons why it can improve the stability of the insurance funds investment income are as follows. First, great demand of affordable housing makes good investment prospects. Second, the majority of projects are supported by the government. Real estate investment projects regulated by CIR, on which the government put emphasis, are relatively of low risk and can have a stable rental income. According to the rent level of operating property, the insurance rate of return on investment in real estate in 6% -10%, which is much higher than currently invested in bonds with average yield of 3.5%, while total investment of insurance can increase the rate of return by 0.1% - 0.3% .So we can concluded that affordable housing insurance investment could increase the return on investment of insurance funds whether at present or in the future.

(3) Enhance the Image of the Insurance Company to Obtain Intangible Assets

Currently, public rental housing construction is one of the fields that the government and the community concern. Insurance company investment in affordable housing construction is related to people's livelihood.

Investment in affordable housing, pension and other commercial real estate entity, can relieve the stress of aging and social housing. It not only provide useful services to enhance the image of the insurance company, but at the same time, the insurance company can take advantage of the market economy and the capital structure of naturally urban space to get the intangible assets in cities . What's more, through the purchase of government auctions and leasing existing urban (public) infrastructure, intangible assets can be transformed into tangible assets.

(4) Help to Improve the Ability of Insurance Companies Against Inflation

In the long term, the insurance invest in real estate can withstand inflation in a certain degree. As for investment bank deposits of insurance funds or fixed interest products, such as bonds, the real rate of return equal to the nominal yield minus the inflation rate, in the case of high inflation and real yields, the result may be negative, which may increase the value of insurance funds or even lead to devaluation. However, the value of real estate will increase with the rising in prices. The nominal rate of return is equivalent to the rate of inflation, Namely, real yields will maintain stability. Therefore, under the high inflation environment real estate investment is an important means against inflation hedge.

5. Impact on China's Low-Income Families

Being a special commodity, housing has two prominent characteristics: First, housing is a complex and expensive commodity. Residential consumption accounts for the large proportion of household consumption and residential construction investment is also a major part of the national annual investment; Second, in modern society, housing is the basic needs of people's normal life for individuals and families. As a residential living space, housing is irreplaceable. Whether rich or poor, people need residential facilities. Faced with China's artificially high prices, a low-income family can hardly afford children's education and weddings fees. Under this circumstance, a low-rent housing or affordable housing will give people hope. Insurance funds participate in affordable housing contributes to the development of society. In this case, the government is able to use funds on great things and to build more houses to meet the citizen's needs of housing.

Insurance funds investing affordable housing has very important significance to society. And in the long run, this practice not only is good for expanding investment channels for insurance funds but also helps to improve the stability of investment income, which has a positive impact on insurance companies' ability to resist inflation. However, establishing a long-term mechanism of insurance funds to invest in affordable housing construction, we still face some challenges.

(1)Difficult to Meet the Insurance Funds to Pursuit Optimal Investment

Every coin has two sides. Simply allocated by the market, affordable housing resources will certainly be out of control. Lower yields of affordable housing make it difficult to achieve the purpose of increasing the value of insurance assets. International experience shows that investment yield of affordable housing is not high and the return is generally difficult to meet the requirements of the insurance funds. Though during the investment period, the insurance industry is capable of meeting the needs of asset-liability matching, low investment yields is a great challenge for insurance funds to participate in affordable housing.

(2)Lack of Necessary Regulation to Ensure the Reasonable Use of Insurance Funds

From regulatory perspective, although CCIRC has staged the "Interim Measures for the insurance of real estate investment funds," opening the gate for the insurance funds to participate in construction of affordable housing. However, when it comes to the specific implementation, problems occur. The insurance funds to have the access to the construction of affordable housing, as well as the uses of land, lack necessary implementing rules for the proportion of investment in specific patterns and regulations, which makes it difficult for the insurance funds to participate in the construction of affordable housing.

(3)Insurance Capital to Participate in the Construction of Affordable Housing Lacks Seasoned Channels

As a quasi-public goods infrastructure, development of affordable housing is completely different from ordinary commercial housing.

Contrary to ordinary commercial housing, which is of high profit margins and short cycle, the construction of affordable housing operates long and has lower rates of return. Therefore, effective mechanism and patterns for investment are needed. The current investment is nothing more than a little fund allocated from the government's financial, housing fund and the land fund, while the subsequent funding sources are not clear, making operating funds of affordable housing can't be sustained.

If there is no mechanism for follow-up funds, market-based financing would be insufficient to support the government to promote the realization goals of affordable housing. Investment of this type can't guarantee the insurance companies to get a good return.

①**Certain Security Risk on Investments**

Nowadays, investment in affordable housing are primarily in the form of debt, while as a debtor, the government has not properly dealt with the old debt and where the investment income of affordable housing goes is not clear. Under this situation, the risk of investment shouldn't be neglected. In addition, the low-rent housing and public rental, whose return is long and low, account for a larger proportion of the construction of affordable housing plan. All in all, the risk of investment ought to be taken into consideration.

②**Certain Risk on Pension of Chinese Residents**

Pension of Chinese residents faces three serious problems:

First of all, before our country getting rich, the aging of the population is speeding up. China will step into the aging peak by 2030. It just takes 18 years for our country to transform the population age structure, while for developed countries, the procedure may be decades or even centuries. Currently, more than 153 million of China's population is over 60 years old and the aging rate is up to 11.6%. Rural elderly population makes up about 75% of the total elderly population. However, China's rural old-age insurance system has not been fully established. Our country's pension issue still has a long way to go.

Secondly, as previously mentioned, the life insurance funds makes up more than 75% of Chinese insurance funds, of which over 70% are long-term funds. Investment channels of insurance funds have long been deposited in the bank. According to the experts, if taken inflation and the time factor into account, China's insurance funds investment income is only 2%.

Last but not least, the implementation the system of basic old-age insurance in the 1990s combines social pooling with individual accounts of funds, many problems, such as idling, pension historic debt, arise during the conversion of old and new systems. In the planned economy period, the pension of state-owned enterprises staff almost runs out of the basic old-age insurance.

All in all, China's future pension fund can hardly make ends meet. If substantial pension funds are used to invest affordable housing, long payback period would increase the risk of pension funds and endowment of residents.

Conclusion

As mentioned above, to promote China's insurance capital to participate in the construction of affordable housing is significant. However, the insurance companies are for profit, therefore how to ensure its profit is the key to the implementation of this initiative. As far as I am concerned, I propose the following measures:

Firstly, China's insurance companies set up the special investment fund, operated with the model of government-led and commercial operation, namely that construction of affordable housing is guided by the government and managed by commercial companies. So that high efficiency, low cost, highly transparent operation mechanism will be set up. The government should cooperate with insurance companies to promote the development of affordable housing projects.

Secondly, considering the long period of payback and low investment yield, I recommend that the government publish some policies to support insurance funds, which will not only inspires the Insurance companies to participate, but also ensures its investment income, decreasing the risk of pension.

Third, on account of nonprofit, long-term, stability of affordable housing, I suggest CIRC participate in the insurance fund and classify investment according to debt level and allow the insurance fund to invest in the form of fund, equity, debt, etc.

Finally, I believe it is essential to train professionals in real estate investment area. Insurance funds to participate in the construction affordable housing needs staffs that are equipped with knowledge and skills and understand the real estate technology. Only by training versatile personnel, can we effectively prevent the risk of insurance funds to invest in the construction of affordable housing and develop the best investment strategy to gain high return.

References

- Hu Limin. The Balance of Insurance Funds in China is More Than 5 Trillions[N]. Financial times, 2011.9.11
- Liu Xinqi. Discussion on Insurance Funds Investment in Affordable Housing[N]. China Insurance News, 2011.3.30
- Zhao Man. Social Security[M]. Higher Education Press, 2010.1
- Li Bo, Wang Penghe, Hou Lina. Problems and Countermeasures on Chinese Insurance Funds Investment[J]. Economic Research Guide , 2009, (4) : 42.
- Zhang Yan, Liu Lihua. Research on Long-term Mechanism of Insurance Capital to Participate in the Construction of Affordable Housing[J], Exploration of Economic Problems, 2009, (9).
- Qian Linyi, Fan Qian, Han Tianxiang. The Reflections of Chinese Insurance Funds Investment in Real Estate[J]. Shanghai insurance December, 2008, (12).
- Zhou Shufen. Analyzing for the Prospects of China's Insurance Funds Investment in Real Estate[J] , Northern Economy, 2010, (2).
- Lan Dongjuan. The Risk Prevention of China's Insurance Funds Investment in Real Estate [N]. China Insurance News, 2010.9.29.