



This article is an excerpt of the book “**Financial, Administrative and Trade Management in China: A crash course for executives for a successful and compliant business operation**”, available e.g. on [Amazon Kindle](#), [Google Play](#) and [Apple Books](#).

4.5. Construction and Real Estate leasing projects

Introduction

Construction projects are one of the main drivers in the Chinese economy and new buildings seem to pop up everywhere all the time, therefore it is not surprising that the realization of new construction can be very quick. At the same time, building quality tends to be problematic and local regulations can influence your construction project tremendously.

This chapter focuses mostly on the construction project itself, keep in mind that other steps might be required beforehand, e.g. finding the right location or the setup of a new company. It might be worth to check the China Contract Law, Chapter 14, which includes some special articles for construction projects. While real estate leasing projects will render some of the following aspects as irrelevant, this chapter can still give you an overview on the relevant aspects the lessor should go through and you can use it as a simplified checklist to find out, if the lessor fulfilled all the legal requirements.

Planning conditions & Land Use rights

In China for companies or natural persons it is not possible to own land, all you can do is acquire the land use rights for construction projects. Regarding the size of the land use rights, you should not only consider the net area that you want to use with your production and/or office, but you should also consider the local planning conditions. Depending on the area, these planning conditions e.g. describe requirements regarding

- the ratio of the building to the whole plot size;
- the amount of parking spaces you have to provide;
- the ratio of greenery in relation to the whole plot size;
- the colors that have to be used;
- how fences have to look like, etc.

These conditions can have a big influence on how many Mu (1 Mu = 666.667 square meters) you want to acquire and how you can use it.

Due Diligence and Soil Investigation

Before really purchasing the land use rights, be sure to go through a thorough due diligence process to identify possible risks. A proper due diligence could include – amongst others - the following points:

- Property and area survey: Describing and checking the general area, the site history, the neighboring plots and the traffic and infrastructure;

- A check if the planned construction matches the planning conditions as mentioned above;
- A legal due diligence to check if the organization selling the land use rights has the rights to do so;
- Site utilities to check if the required utilities are available and if the emissions and wastes of the planned construction and the ongoing operations afterwards can be handled by the infrastructure and are allowed;
- If the property you want to lease or rent fulfills your specific operational requirements, e.g. regarding layout for logistics, strength of floors for heavy machinery and infrastructure access like the size and location of the gate.

If not part of the due diligence, a soil investigation by a specialized company to check for the load-carrying capacity, the groundwater level and possible contamination, e.g. from previous usage of the land, is highly recommended.

A due diligence and pre-qualification for the general/prime contractor and the designers should also be concluded, including but not limited to checking their business license and their business scope, checking with references, etc.

Investigations related to Environment, Health and Safety

Depending on the project and region, several investigations might be required to get the permission for construction. Even if not all of them might require an approval of the local authorities or the support of a specialized company:

- Feasibility study to demonstrate an economic sustainability of the business;
- Energy Saving Report;
- Environmental Impact Assessment Report;
- Safety Facility impact pre-assessment report;
- Occupational disease pre-assessment report.

In the past years, there seems to be a trend regarding reduced required pre-approvals before realization of the project towards stronger post-realization check-ups including penalties. Even if these reports might not be required, it is strongly recommended to work out strong concepts beforehand: The correction of fundamental issues after realization can be very costly.

Roles in a construction project

Some common roles within a construction project are the following:



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Local Design Institute (LDI)

The LDI provides services in the area of architecture and engineering and does the planning of the whole structure. They are semi-public organizations and are comparable with the European “general planners”. Their services include architecture, statics, technical building equipment, etc.

Even while they have a big range of services, the detail-level is often quite limited and the executing companies have a lot of wiggle room which not only brings flexibility but also potential risks to the principal.

Project Manager (PM)

The project manager is the main coordinator of the construction project regarding time, cost and quality, he also supports and represents the principal towards the general contractor and the local authorities. Due to this central role, it is highly recommended to take a project manager with technical background: They often reconcile different requirements, plans and planners and can approve plan changes and adjustments.

General Contractor (GC)

The general contractor is the organization that executes the whole construction project according to the plans. He might be using subcontractors to fulfill this task but remains the main contact to the project manager and the principal. This choice can be the most critical since it will strongly influence the quality and cost of the total construction project.

Experts recommend to use a pre-qualification before the tender to also avoid too many, partly unqualified bidders and to use a weighted decision matrix or scorecard during the tender, to consider as many aspects as possible.

Jianli

The Jianli service is a service purchased from an official provider who checks if the executed construction matches the approved plan. This check is mostly regarding construction, static and security, it does not check in regard to optical quality.

Handover of the construction and approval

The Jianli service will check if the executed construction matches the approved plan. This check is mostly regarding construction, static and security, it does not check in regard to optical quality. You might additionally have to prove you followed your pre-reports regarding Environment, Health and Safety. Aside from regulatory approvals, you also should check if the realized project fulfills your requirements e.g. regarding cosmetics and quality.

For a fire safety approval, a third party will be contracted to create a report which then will be uploaded to a government website. In a lottery some of these reports get selected for a second level check by fire marshals. Even if at first your construction does not need the approval of the fire marshal since it was not selected in the lottery, the fire marshal will still come rather regularly to check fire safety related equipment, e.g. fire alarm systems, emergency power supplies, etc.

In the end, the Quality Inspection Bureau will do the final approval and will issue the property certificate. This can take several months after the construction has been finished.

Depending on local regulations, different or additional approvals might be required.

Common pitfalls and tips

- As mentioned in the introduction: Construction projects can be executed very quickly but the quality can be below the standards you are used to. Even while the project manager can be supportive in that area, this topic should not be completely given out of hand by the principal. A strong quality control should be implemented and ideally staff of the principal should be present during the ongoing project not only to support in the area of quality but also regarding the control of the progress according to milestones.
- Quality can especially be an issue if you require some fancy things that might be not the norm in China. If the result does not match your expectations, it can happen that it gets torn down and rebuilt. If after several tries it still did not work out, you might have to consider of changing your requirements or investing additional money to change the (sub-)supplier.

Due to the independence of the subcontractors of each other, it can easily happen that one subcontractor team which is responsible for one part of the project will damage another item. When this item is being repaired by a subcontractor team, they again damage something else.



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- A salary labor insurance might be required in some areas of China to prevent that the general contractor or subcontractors do not pay the wages including all social insurance. The value can depend on the total contract value with the general contractor with a varying, sometimes very high percentage, e.g. up to 25 % of the contract value, binding a lot of cash. It also depends on the local regulations if the general contractor or the principal have to pay this insurance. It is possible that the principal has to pay that and the money will be frozen for several months after receiving the final property certificate. That means that principal has to bind more cash than the actual construction is worth for a long time period.
- Not ensuring that you get all the required licenses and permits before or during the construction project will leave you with long-term legal risks that sometimes cannot be solved anymore. This even can lead to your whole construction being technically illegal.
- According to chapter 8 of the contract law, which focuses on construction projects, the building cannot be used until it was handed over. If you do not ensure the quality during the construction adequately, the contractor can use this handover as leverage for any warranty cases and delay your project on purpose.
- It is highly recommended to make a contract excluding VAT, especially since construction projects usually last for several months and have a high value.
- Many small, independent companies use the name and logo of big construction companies to win projects. These big construction companies are often not interested in comparably small projects and simply get a license fee or franchise fee from the small companies for the usage of the logo. Do not be fooled by big names and references since neither quality, performance nor liability of these small companies have any relation with the big company.
- The general golden rule of project management, that you have to find a trade-off between Time/Cost/Quality applies. If you are trying to contract a general contractor with limited information to speed up the construction process, you might be successful. At the same time, be prepared for heavy discussions - up to the open threat of not handing over the building - when the construction project comes to an end. Consider if a bit longer time in the planning phase might be worth it to smoothen the execution.
- There seem to be not too many legal requirements regarding insurance, except that statutory insurance for construction workers must be paid. Often chosen insurances include Construction-all-risks insurance, third-party liability insurance and professional liability insurances.
- it is recommended to keep a contractual defined amount, e.g. a common 5 per cent of the whole contract value, for warranty obligations from the General Contractor until the warranty period is over. Some General Contractors prefer using warranty bonds but this can put the principal in a harder position since the bond giving company, e.g. an insurance or bank, are very strict regarding payments from this bond which can damage your strength in negotiations regarding possible liabilities or warranty issues. For the principal it should be easier to keep the pressure for rectification higher, if you still have the cash yourself.
- Try to keep up-to-date with development plans of the local government for the area in which you realize your real estate project, especially if you plan to do manufacturing. Otherwise you might be forced to relocate due to rededication of the area, e.g. from production to commercial or housing, disallowing your business.