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CFLD's Gu'an New Industry City: A New Kind of Public-Private Partnership





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The trend to build new satellite cities has been on the rise in China, but smaller municipal bodies often lack the financial resources and expertise to build out their towns. At the same time, increased regulations in the residential real estate sector have pushed developers to seek projects with mitigated regulatory risk. Urbanization of public-private partnership projects (PPP) have been the solution. They resolve immediate concerns on both sides. Long-term urban growth, however, depends on attracting economic investment to facilitate industrial upgrading, job creation, and quality of life improvements. By developing one of the largest investment solicitation and service teams in the real estate industry, The China Fortune Land Development Co. (CFLD) moves beyond the traditional capital and construction value proposition associated with public-private partnerships. Its award-winning Gu'an New Industry City shows that service provisioning can be a developer's path toward long-term financial returns on public projects.

Seeing the Road Ahead: A Brief History of CFLD

Wang Wenxue, CFLD's founder, has had an uncanny knack for being one step ahead of market trends. In 1992, he made the bold move to leave a government job to open a hotspot restaurant in Langfang City, Hebei Province. His 'jump into the sea' (*xiahai*) of commerce quickly proved successful. Not only did his restaurant business expand, but he learned of new business

opportunities through his customers. Soon after, he entered the construction industry, focusing on the renovation of government and state enterprise offices. In 1998, when the government announced that it would no longer provide free housing for its employees, Wang shifted into developing residential housing units.¹

Although CFLD was established successfully in 1998 as a traditional real estate developer, Wang also understood that his firm might not be able to compete long-term

¹ "CFLD Boss Wang Wenxue Background." June 13, 2017. Accessed January 4, 2018. <http://finance.sina.com.cn/chanjing/gsnews/2017-06-13/doc-ifyzfyz3716326.shtml>.

against large developers on construction and costs. He needed to differentiate CFLD in some way. Headquartered in Langfang city, and located equidistant between two major urban centers, Beijing and Tianjin, CFLD quickly found its niche by helping local governments to further urbanize and modernize their towns.

Emerging in the 2000s, the vacant overbuilt ghost towns of China provided an important lesson. Namely, successful urbanization projects are those able to attract investment from private business, and they often do so through specialized industry towns. To achieve this end, CFLD worked diligently to develop its own solicitation arm. By late 2016, it had close to 1,000 employees dedicated to inviting and servicing new businesses operating in their CFLD-built industry towns.

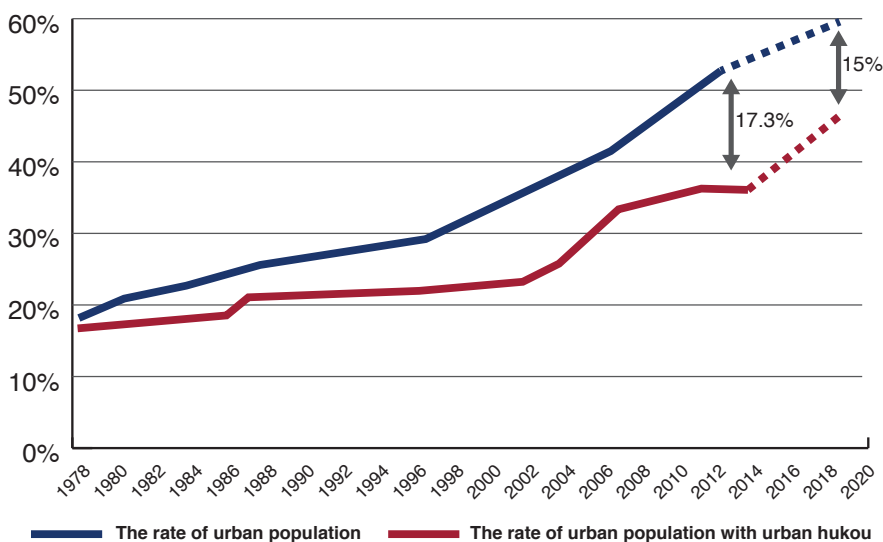
The CFLD solicitation team included more than 60 former executives from target industries (e.g. aerospace manufacturing), former government employees with expertise in urban development, and a database that tracked the resourcing needs of several hundred thousand prospective clients — all geared to ensure that any business operating in a CFLD-built town experienced top-notch service. In return, local governments agreed to pay a substantial commission to CFLD in the form of tax subsidies or land.

As of 2016, CFLD's solicitation arm was responsible for 100 billion RMB or USD \$15 billion of private investments in its PPP industry towns. Today, there are over 30 CFLD built-and-supported industry towns in China and overseas in operation. Dozens of new industry town projects are also underway. Gu'an New Industry City was CFLD's flagship development. It now stands as a model for the kinds of 'new type' urbanization that the Chinese government hopes to see develop across the country.

More Urbanization? The Push for Satellite Cities in China

As of 2016, more than 57.4% of China's 1.4 billion people are classified for statistical purposes as living in urban areas;² this means that, compared to 2012, more than 67 million people, equivalent to the population of France, have newly settled in China's largest cities. Moreover, a significant segment of this population does not hold a permanent urban household registration (or 'urban hukou'), which adds stress to existing infrastructure and related services as their provision is typically allocated according to official permanent population numbers.

Figure 1: China Urban Population and Permanent Resident (hukou) Growth Rates



Source: Xinhua News Agency

"2014-2020 Plan for New Industry Towns." March 16, 2014. Accessed November 31, 2017. http://www.gov.cn/zhengce/2014-03/16/content_2640075.htm.

Recognizing that job opportunities, better wages, and quality of life issues are important pull factors, the Chinese government is trying to address these demands and resulting overpopulation within China's major urban areas through the development of satellite

² "Bureau of Statistics: China urbanization reaches 57.4% in late 2016." July 11, 2017. Accessed November 31, 2017. http://finance.ifeng.com/a/20170711/15523424_0.shtml.

cities. Specifically, China plans to invest USD \$6 trillion to \$7 trillion in the next 20 years to support what it calls a ‘new type urbanization.’ Taking ‘human-centered development’ as its central idea, this new policy regards increasing levels of urbanization as necessary to China’s modernization, but seeks a more orderly urbanization process through balanced economic growth both within urban areas and across the entire country.

To get some sense of the economic significance of China’s major metropolitan areas, consider that China’s Beijing-Tianjin, Changjiang Delta, and Pearl-River Delta zones constitute 18% of the country’s population, create 36% of the country’s GDP, but cover only 2.8% of its landmass.³ Building industry towns near these metropolitan areas would help to offset unmet infrastructure demands in the largest cities through the promise of jobs, lower cost of living, and improved quality of life — urban living without the negative externalities associated with spontaneous urbanization (e.g. pollution, traffic jams, resource scarcity and waste management).⁴

Despite these supportive policies at the central level, smaller municipal governments often lack the financial ability and enterprise connections to further district-wide development projects. According to the Chinese Bureau of Statistics, China’s poorer provinces, such as Guizhou and Hainan, for example, have debt-to-tax-income ratios from 200% to 500%.⁵ In April 2016, in another round of central government efforts to deleverage local municipalities, the Ministry of Finance barred these government bodies from using land sales to repay debt.⁶

This constraint also precludes debt fundraising through the use of land as collateral. At the same time, smaller municipal bodies mostly find it difficult to attract private investments into their towns. Companies, after all, are searching for more than just tax breaks for their new headquarters. They want services both to support business activities and attract the best talent to their companies. All to say, China’s local public sector has been in need of a new strategy to overcome development roadblocks for some time.

Simultaneously, in both residential and commercial real estate, developers have been facing increasingly regulated and volatile markets in China. Prices of new residential buildings have risen 30% to 50% in the last 18 months in Beijing, Shanghai, Guangzhou, and Shenzhen.⁷ Real estate prices in major cities today had increased from 200% to 500% compared to 2012, driving up land costs for new projects.

In addition, local governments had begun imposing new housing quotas to cool the market.⁸ For example, as of March 2017, Beijing announced that all apartments bought under business entities must be held for a minimum of three years before sale. Divorced couples are also still bound by the “one-house-per-family” restriction within 12 months of divorce. Some experts, such as Peking University’s Jin Li, suggest that the “golden decade of Chinese residential real estate boom is now over.”⁹ As a result, China’s real estate developers have been in search of a new business model, and many have increasingly explored the public sector as an option.

3 “2014-2020 Plan for New Industry Towns.” March 16, 2014. Accessed November 31, 2017. http://www.gov.cn/zhengce/2014-03/16/content_2640075.htm.

4 “China Urban Development Report Calls out Major Urban Issues.” August 12, 2016. Accessed January 1, 2018. <http://news.163.com/16/0812/06/BU8HIFHL00014JB5.html>.

5 “2016 China Local Leverage Ranking.” August 28, 2017. Accessed September 8, 2017. <http://www.sinott.com/GB/News/1004/2017-08-28/3MMDAwMDI2NDQ3MA.html>.

6 “China Debt Squeeze Has Moody’s Awaiting First Local Default.” Bloomberg.com. June 26, 2017. Accessed October 17, 2017. <https://www.bloomberg.com/news/articles/2017-06-26/china-debt-squeeze-has-moody-s-awaiting-first-ever-local-default>.

7 “Property Index across 70 Major Chinese Cities in July 2017.” August 18, 2017. Accessed October 31, 2017. http://www.stats.gov.cn/tjsj/zxfb/201708/t20170818_1525124.html.

8 “2017 Residential Market Cooling Measures Overview.” August 24, 2017. Accessed September 9, 2017. <https://house.focus.cn/zixun/3c0c878eff19b5b8.html>.

9 “China’s Golden Decade of Real Estate is over.” June 30, 2017. Accessed December 08, 2017. <http://economy.china.com/zlpsym/11176434/20170630/30871652.html>.

Evolution and the rise of public-private partnerships

Since the 1980s, private business has played a role in the development of China's infrastructure. Most notably, China launched a series of BOT (build-operate-transfer) contracts to support construction of power and water processing plants, initially with foreign investors and later with local firms.¹⁰ The risks associated with these kinds of projects are significant, not the least as the legal framework for these partnerships often changes. For example, China's first privately financed PPP, the Citong Bridge located in Fujian Province, was constructed with high hopes of toll revenue commissions for decades to come as it came with a 30-year concession term. However, the municipal government quickly

commissioned several other toll-free bridges, making Citong a less attractive option for travelers.¹¹

By the early 2000s, China's economic boom called for further structural changes in infrastructure. In 2004, considering a new wave of PPPs for infrastructure projects, the Ministry of Housing and Urban-Rural Development (MOHURD) standardized partnership requirements, payment processes, and conflict resolution governance for PPPs.¹² Most importantly, MOHURD's milestone regulation emphasized that, without significant public interest in jeopardy, the public partner cannot intervene with the private partner's operations and contract terms. This change has important implications for urbanization projects. Table 1 illustrates some key differences between traditional non-partnership urban development models and a PPP development model.

Table 1: Comparison of Roles and Responsibilities in Urban Development Models

	TRADITIONAL DEVELOPMENT MODEL	PUBLIC-PRIVATE PARTNERSHIP (PPP) DEVELOPMENT MODEL
Land sourcing / ownership	<p>Developer: pay a premium to win land from auctions; construction timing depends heavily on when surrounding areas would be developed</p> <p>Government: uses land as incentives to attract private investments for long term economic development</p>	<p>Developer: acquires land at significant discount; transparency on the city's development plan to better time construction</p> <p>Government: land sold off only for one-time cash inflow</p>
Financing	<p>Developer: takes out debt to finance construction in small residential projects; market charges high interest to offset regulatory risk in private construction</p> <p>Government: towns finance infrastructure construction via debt</p>	<p>Developer: endorsements remove market uncertainty around regulatory roadblocks; developer acquires debt at a lower interest rate</p> <p>Government: shifts capital burden of development to private sector, but retains significant control over the city development's finances</p>
Construction	<p>Government: directly manages vendors and project timeline, placing strain on public servants</p>	<p>Developer: owns construction; experience in construction and vendor relationships help manage costs and timeline</p>
Attract private investment	<p>Government: municipal connections are likely limited; lacks manpower and experience to help private companies settle into new city</p>	<p>Developer: nationwide connections to attract private investments; large teams dedicated to helping private companies transition (e.g. labor recruitment, tax management with new local authorities)</p>

"China PPP Platform Overview." Accessed January 18, 2018. <http://www.chinappp.cn/LoreShare/NewsList?search=PPP%E6%83%85%E5%86%B5%E5%88%86%E6%9>

¹⁰ BOT typically covers an individual asset (e.g. power plant), while PPP flexibly covers a larger network or topic, such as urban revitalization.

¹¹ Nada Kakabadse & Nikolai Mouraviev 2017. Public Private Partnerships in Transitional Nations: Policy, Governance, & Praxis. Newcastle-on-Tyne, UK: Cambridge Scholar Publishing, pp. 165.

¹² "Regulations on City Partnership Operating Model." March 19, 2017. Accessed October 25, 2017. http://www.mohurd.gov.cn/fqjs/jsbgz/200611/t20061101_159064.html.

As of late 2016, the China PPP Platform reports that more than 10,000 PPP projects were underway, up 50% compared to early 2016.¹³

As illustrated above, public-private partnerships help to address capital constraints at the municipal level, and make it possible for developers to have a direct role in the ongoing success of an urbanization project. As the famous ‘ghost town’ of Kangbashi in northern China reminds us, physical infrastructure upgrades alone cannot fuel growth and in-migration.¹⁴ Only a healthy inflow of private investment that creates employment opportunities will pull individuals toward newly urbanizing areas. Moreover, to attract such investment, new-style PPPs have to develop a host of ancillary services (e.g. expedited tax and administrative support) that are tailored to the particular needs of a given industry. Getting this right not only helps a given industry town or satellite city to thrive, but also increases the brand value of a developer. CFLD got this right, serving the needs of business, but so as to help local governments in the race to develop modern, urban municipalities.

The CFLD Difference: PPP via Investment Solicitation and Services

CFLD was years ahead of others in executing this new style of the PPP business model. Its highly successful investment solicitation and services arm has allowed the company to develop a reputation as an expert in developing specific types of industry towns (e.g., high-tech chips, aerospace engineering), and such that it is now a market leader relative to its peers. Moreover, earnings from these value-added services are in addition to project commissions that CFLD acquires in the form of tax subsidies or land from its municipal partners.

The financial implications of CFLD’s PPP model are significant. Residential units built on land provided to CFLD, for example, benefit from rising housing prices once urbanization trends deepen in a given town. This only incentivizes CFLD’s solicitation arm to work quickly to draw business investors to a given site and to ensure their continued satisfaction. As illustrated in Table 2, CFLD’s solicitation arm brought a 96% gross margin to the company, with the solicitation arm earning 60% of its gross margin. Given this, CFLD is no longer a traditional real estate developer. It is a service provider whose primary client is local government (see Table 2).

Gu’an’s location also well-positioned it to become the satellite city of its nearby metropolises. Beijing’s population has reached 30 million in 2016, while Tianjin’s population had grown from 10 million to 15 million between 2010 and 2015, placing significant strain on infrastructure and housing affordability on their residents.¹⁵ Gu’an’s proximity meant that it might benefit from nearby talent, but only so long as the town could draw in business to its area.

Table 2: Breakdown of CFLD Revenue Stream Profitability (2016)

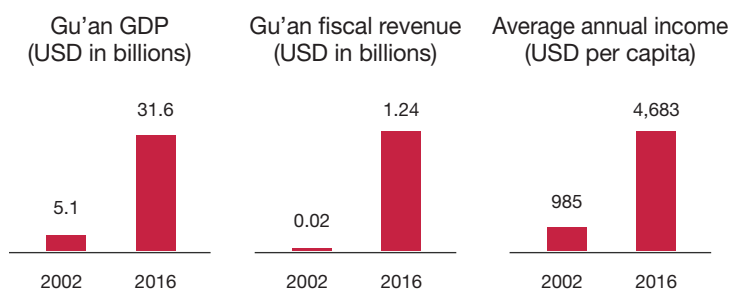
	REVENUE (USD IN MILLIONS)	GROSS MARGIN %	GROSS PROFIT (USD IN MILLIONS)	% OF TOTAL FIRM GROSS PROFIT
Investment solicitation commission (consultation)	1,646	95.8%	1,576	60%
Residential unit sales	4,003	20.6%	824	30%
Others (e.g. land sale, maintenance)	2,369	11.0%	261	10%
Total	8,018	33.2%	2,661	100%

Source: CFLD 2016 Annual Report

13 “China PPP Platform Overview.” Accessed January 18, 2018. <http://www.chinappp.cn/LoreShare/NewsList?seach=PPP%E6%83%85%E5%86%B5%E5%88%86%E6%9E%90>.

14 “Inside China’s largest ghost town.” CNN. November 21, 2016. Accessed September 14, 2017. <http://www.cnn.com/style/article/china-ordos-ghost-town/index.html>.

15 “Beijing sees slower population growth.” January 20, 2016. Accessed November 17, 2017. http://www.chinadaily.com.cn/china/2016-01/20/content_23160880.htm.

Figure 2: Change in Gu'an City Key Performance Indicators

Source: Gu'an government

"China Fortune Land Development Co Ltd." China Fortune Land Development Co Ltd (600340) Annual Report (10K) Quarterly Report (10Q). December 31, 2016. Accessed September 18, 2017. <http://quicktake.morningstar.com/stocknet/secdocuments.aspx?symbol=600340&country=chn>.

Seeking Mutual Benefit: The Gu'an New Industry City PPP Agreement

With such slogans as "1+1 > 2" and "the government leads, the enterprise executes, and both parties benefit," CFLD markets itself to local governments as a partner and facilitator of value-added collaboration.¹⁶ Nonetheless, this is a partnership wherein CFLD carries considerable start-up risks, including regulatory risks, operational risks, and of course, debt.

In the case of the Gu'an New Industry City, CFLD assumed responsibility for city planning and design, infrastructure and public facility development, administration of city operations, and industry investment solicitation. The local government only had responsibility for approval and supervision of the project within the contract period, acquiring full ownership of an industrial park only when a given contract expired.¹⁷ This structure incentivized CFLD to work hard to attract industry to Gu'an. It also placed the company into something similar to a revenue-sharing arrangement with the town government, thereby allowing CFLD to earn a substantial commission on its committed investments from industry. As no Chinese government can transfer

tax revenue directly to private businesses, revenue sharing took the form of consultancy fees.¹⁸ In the case of Gu'an specifically, CFLD is reported to have earned commissions, in the form of consultancy fees, equivalent to 45% of new industry investment.

To support this arrangement, CFLD created what it calls a 'regional company' for each of its PPP projects. This regional company, a CFLD subsidiary, is a special purpose vehicle (SPV) tasked with the operational objectives of the PPP (see chart below). It is, above all else, the SPV's competency in investment solicitation that underpins the success of the Gu'an New Industry City.

Figure 3: Location of Gu'an New Industry City (Gu'an County)

Source: CFLD

"CFLD and the PPP Model." CFLD-Core Business PPP Model. Accessed December 4, 2017. http://en.cfldcn.com/core_business/ppp.html.

¹⁶ "CFLD and the PPP Model." CFLD-Core Business PPP Model. Accessed December 4, 2017. http://en.cfldcn.com/core_business/ppp.html.

¹⁷ Some industry parks are under 50-year contracts. The newer ones are often under 30-year contracts.

¹⁸ "China Fortune: the biggest company you've probably never heard of." Wheel of Fortune. July 7, 2017. Accessed January 28, 2018. <https://www.week-inchina.com/2017/07/wheel-of-fortune/>.

The CFLD Way: The Business of Investment Solicitation

CFLD's Gu'an SPV developed an array of services to attract investments.¹⁹ These include:

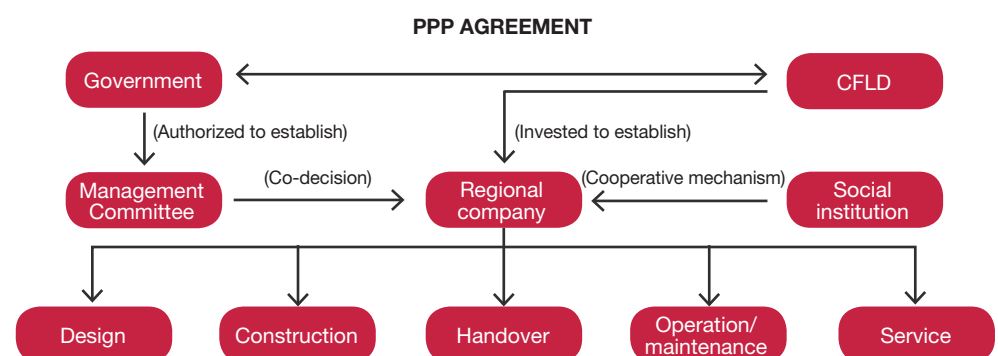
- Administration: Support companies in fulfilling administrative needs (e.g. tax registration, patent applications, legal and financial consulting).
- Policy: Advise companies to optimize for local policies and incentives; negotiate with local government to accommodate company needs.
- Add-on services:
 - Supply chain and talent management: Help companies to source and build out supply chain and talent in Gu'an.
 - Accelerator: Provide operational support from industry experts to grow SMEs.
 - Financing: Connect a business's financing needs with other institutions.
 - Infrastructural support: Ensure logistical needs are met (e.g. building workers' residence for factories).

For many new companies, the SPV's full-service package was key to the decision to relocate to Gu'an. For example, Eternal Material Technology, a large OLED manufacturer, was particularly concerned with cleanroom manufacturing standards. And, whereas competing industry towns offered land and tax subsidies to attract EMT, SPV brought in cleanroom manufacturing experts from its existing aerospace clients to secure EMT's new investment. An EMT executive later remarked that the SPV "understood [EMT's] unique technical needs and reservations in building new factories."

In addition to providing functional support, the SPV solicitation team was also strategic in selecting its investment targets. In the case of Gu'an, the industry town was initially anchored by BOE Technology Group, a world-class leader in both R&D and panel manufacturing. Once BOE was settled in Gu'an, CFLD reached out to more than 30 companies along BOE Technology's supply chain, drawing Linde Group, Tianmahui LED, ROIT, MagicMed, and others, to make investments in Gu'an.

To diversify the growth potential of Gu'an and enhance its capacity for innovation, CFLD also established a multi-stage financing system, which includes industry-specific venture funds, as well as partnerships with multiple universities, research institutes, and business incubators. By acting as investor or shareholder, CFLD plays a role in both determining a company's location, while offering solutions to bolster the company's growth. For early stage firms, this kind of mentorship and support is very appealing, leading companies of varying scale to settle in the industrial parks of Gu'an New Industry City. CFLD also recently established a strategic alliance with Techcode to establish an innovation incubator to aid high-growth entrepreneurial businesses.

Figure 4: Gu'an Public-Private Partnership Model



Source: CFLD

CFLD-Core Business-PPP Model. Accessed January 17, 2018. http://en.cfldcn.com/core_business/ppp.html.

¹⁹ "Xianghe New Industry Town Services." Accessed November 28, 2017. <http://xianghe.cfldcn.com/chanyefuwu/>.

To increase the effectiveness of these investment solicitation activities, CFLD's SPV has a CRM system that includes data on the operational and resource needs of close to one million Chinese companies. The SPV then selectively targets leading downstream manufacturers in its target industries. As the BOE Technology Group example suggests, incentivizing downstream manufacturers to move to Gu'an encourages smaller upstream players in the same value chain to relocate to support its downstream client. When the SPV convinced BOE Technology Group, a leader in panel manufacturing, to build a new production base for mobile display in Gu'an, 30 of BOE's suppliers and partners also relocated to Gu'an, making the park one of China's premier mobile display bases.²⁰

CFLD has also reached collaboration agreements with more than 30 national leading universities and established several R&D Institutes to boost the transformation of scientific research achievements, including Tsinghua XIN Center, Tsinghua University Pilot Incubation Industry Park of Major Projects, CAS pilot incubator base, etc. By late 2016, 36 innovation projects have been registered in Gu'an.²¹ In addition, CFLD has established strategic alliances with technology companies like Yiguang, Huadian Tianren, etc., and jointly formed several research houses to encourage innovation and thereby increase the overall innovation level in the industry park.

Today, Gu'an is Hebei Province's second wealthiest county. Beijing, in turn, has consistently cited the Gu'an PPP as testament to the success of a new type of urban development model, one that moves beyond traditional benefits of shifting capital risk to private parties toward one that includes focus on services and long-term execution plans to ensure overall project sustainability.

Looking Ahead: Potential Risks and Challenges

CFLD has begun to expand its 'Gu'an model' to other areas in China and overseas, raising the question of whether this success story can be replicated elsewhere. The demand is certainly there. In recent months, CFLD has signed dozens of new contracts to develop new towns in other localities. With this, added pressure to identify private businesses that might be willing to establish operations in these new areas exists.²² At issue is whether the geographic location of Gu'an aided in CFLD's success at least as much as its innovative 'new town' development model. Gu'an, after all, offered businesses that had been operating in Beijing and Tianjin a chance to continue production at a lower cost, and without losing their competitiveness, given Gu'an's close proximity to both cities, and the Beijing Capital International Airport. It is also likely that the central government will continue to keep close watch on the financing strategies of local governments, and with this, policy risks inevitably remain for this developer and as well as others. ■

²⁰ Beijing, March 2017, interview with CFLD CEO Ye Qun

²¹ CFLD collaboration : <http://www.egouz.com/topics/14715.html>

²² No byline 2017. "Wheel of Fortune: China Fortune: The Biggest Company You've Probably Never Heard Of." The Week in China (brought to you by HSBC), July 7. <https://www.weekinchina.com/2017/07/wheel-of-fortune/> Accessed January 3, 2017.