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# *Comparative Analysis of Risk Allocation in Advance Sales of Commercial Housing Between Hong Kong and Mainland*

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***Abstract.*** While the pre-sale system of commercial housing accelerates housing supply, it also poses unfinished construction risks due to frequent loopholes in implementation. This article compares the differences in pre-sale risk allocation between mainland China and Hong Kong, and finds that while the relevant institutional forms in the two regions are similar, the risk-bearing entities, control points, and constraint mechanisms are distinctly different: Mainland home buyers essentially bear the main construction risks, and the resolution of risks relies on post-event guarantees; Hong Kong controls risks proactively through strict access control and prudent lending practices by banks. The fundamental difference in risk allocation between the two lies in the government incentive structure -- Local governments in the mainland possess dual identities as both regulators and stakeholders; whereas the Hong Kong government exhibits stronger regulatory rigidity. Based on this, this article proposes suggestions such as improving the legal system, drawing on Hong Kong's pre-control approach, strengthening the project approval process, enhancing the rigidity of fund supervision, and improving the judicial system, providing a reference for the optimization of relevant systems in the mainland.

***Keywords:*** Pre-sale of commercial housing, risk allocation, uncompleted residential buildings, land law, government incentives

## 1. Introduction

The pre-sale system of commercial housing is essentially an institutional arrangement that possesses dual attributes of both transaction and financing. Based on the relevant laws and regulations in China, its legal foundation can be manifested from three aspects: the nature of the contract, the allocation of rights and obligations, and the principles of risk allocation.

Firstly, from the perspective of contract law and current regulations, pre-sale contracts for commercial housing exhibit typical attributes of forward sales contracts. The provisions on sales contracts in Article 595 and subsequent articles of the Civil Code of the People's Republic of China provide a general legal basis for commercial housing transactions, while Article 45 of the Urban Real Estate Administration Law clearly establishes the legality of the pre-sale system for commercial housing. On this basis, the "Administrative Measures for the Presale of Urban Commercial Housing" further stipulates that developers may only presell after meeting certain conditions and entering into a presale contract with homebuyers. Since the house had not been built

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at the time the contract was signed, the subject matter did not exist yet, and the delivery obligation would be fulfilled in the future, it essentially belongs to a forward-performance sales contract.

Secondly, in terms of the allocation of rights and obligations among the parties involved, the pre-sale system of commercial housing involves three parties: developers, home buyers, and regulatory authorities. According to the Urban Real Estate Administration Law and relevant administrative regulations, developers enjoy financing rights and project operation rights, while also bearing the core obligation to complete and deliver the housing on schedule. The buyer assumes the obligation to pay the purchase price and enjoys the expectancy right to obtain ownership of the house. Regulatory authorities, in accordance with the "Administrative Measures for the Presale of Urban Commercial Housing" and local regulations, fulfill their duties of maintaining market order and public interests through administrative licensing and continuous supervision. This structure determines that the pre-sale system is not merely a private law transaction relationship but possesses distinct intertwined attributes of public and private law.

Finally, in terms of the legal principle of risk allocation, the pre-sale system of commercial housing should adhere to the basic principles of "the producer of the risk bears the burden" and "protecting the vulnerable under information asymmetry". As the leader in project development and capital operation, the developer is the main creator of risks and should bear the primary responsibility for risks such as project delays and broken capital chains. Meanwhile, home buyers are in a vulnerable position in terms of their ability to obtain information and bargain, and preferential protection should be provided through institutional design [1]. Therefore, a reasonable pre-sale system should lock the main risks within the developer and its financing system through mechanisms such as fund supervision, information disclosure, and access review, rather than allowing them to spill over to home buyers.

The pre-sale system for commercial housing can effectively lower the initial development threshold for real estate enterprises and accelerate housing supply. However, due to the cumulative impact of multiple implementation loopholes, issues such as project halts and delayed deliveries frequently occur, leading to widespread concern about the risk allocation of pre-sale commercial housing.

Practice has shown that while the forms of pre-sale systems in different jurisdictions may be similar, their operational effectiveness largely depends on legal and institutional designs such as fund supervision, information disclosure, and the role of the government. Based on this, this article focuses on comparing the differences in relevant laws and systems between mainland China and Hong Kong, exploring how different laws and systems affect the allocation of risks in the presale of commercial housing, and aims to provide an analytical perspective for the improvement path of relevant laws and systems.

## 2. Risk allocation under the pre-sale system of commercial housing in the mainland

### 2.1. Arrangement of the pre-sale system for commercial housing in the mainland

Under the pre-sale system for commercial housing in mainland China, the government serves as the designer of the system, the financial backer, and the guarantor of policies. Firstly, the government formulates rules for real estate development, pre-sale, and fund supervision, which places it at the core of the entire pre-sale system [2]. Secondly, in the past, local finance heavily relied on land transfer fees to support infrastructure and economic development, thus having a high dependence on the model of using pre-sale of commercial housing to drive land development. Currently, many regions are optimizing the structure of fiscal revenue and reducing the proportion of land-based

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finance. Again, when a housing project is left unfinished, the government will intervene through policies such as "ensuring the delivery of completed residential buildings" to provide a certain degree of support against risks.

According to the Chinese Constitution and the Land Administration Law, urban land in mainland China is owned by the state. The Urban Real Estate Administration Law further stipulates that land use rights are transferred through "bidding, auction, and listing". Developers need to acquire land at a high price first, obtain the immovable property right certificate for the state-owned construction land use right, and then develop the project - this places high demands on developers' own funds.

According to the "Administrative Measures for the Presale of Urban Commercial Housing" and the "Administrative Measures for the Sale of Commercial Housing" and other institutional designs, the presale funds paid by home buyers must be deposited into a supervised account, which is jointly supervised by the housing and urban-rural development department and the bank. These funds must be prioritized for the construction of this project, allocated in batches according to the progress of the project, and theoretically can be used for the designated purpose only.

### 2.2. Risk allocation analysis -- taking Evergrande Group as an example

The aforementioned systems appear comprehensive, yet they fail to prevent the recurring phenomenon of uncompleted residential buildings in the mainland. In the following, Evergrande Group will be taken as a typical case to analyze the reasons and impacts.

Local governments in mainland China rely on land-based fiscal revenue to boost GDP, adopting a welcoming or even indulgent attitude towards large real estate enterprises. Evergrande, leveraging local development demands and exploiting flexibility in regional regulatory enforcement, has weakened the government's constraints on land and pre-sale aspects. From the very beginning, the regulatory function of the government has been undermined [3].

Before the implementation of the long-term regulation mechanism for the real estate industry, there had long been an implicit expectation in the market that top-tier real estate enterprises would not go bankrupt and that the government would guarantee the delivery of properties. However, after the introduction of risk management policies in recent years, this expectation has been continuously weakened. Evergrande Group utilizes implicit expectations to enhance market trust, making home buyers and banks willing to invest in it for a long period of time [4].

Evergrande Group has its usual means of expansion. Although such operations are completely prohibited in cities with strict supervision, in regions where the implementation of fund supervision is lax, Evergrande has engaged in irregular operations such as misappropriating pre-sale funds from individual projects to purchase land plots in other places and expanding across projects in a rolling manner. In this operation process, Evergrande only invested the land acquisition cost and down payment for the first project, while the rest were mortgage loans. Essentially, it used future cash flow to support current expansion, forming extreme leverage and a huge foam [5].

In fact, the original intention of the land transfer system in the mainland is to allow developers to acquire land with their own funds, but Evergrande Group has replaced these self-owned funds with leveraged funds obtained through loans. Against the backdrop of the deteriorating relationship between Evergrande Group and the government mentioned earlier, some local governments have allowed the early disbursement of funds from regulatory accounts, despite the project construction progress not meeting the standards. Moreover, it tacitly allowed Evergrande Group to misappropriate funds for debt repayment and new projects, rendering the fund supervision system completely ineffective [6].

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After the introduction of the "three red lines" policy, the financing channels for real estate enterprises were tightened. Coupled with Evergrande's long-term high debt, misappropriation of presale funds across projects, diversified losses, and other multiple issues, it ultimately led to the breakdown of the overall capital chain. This has led to the suspension of ongoing projects due to insufficient funds, resulting in countless unfinished buildings, and simultaneously triggering a wave of default on mortgage payments among homebuyers, causing risks to spill over into the financial and social sectors [7].

In summary, the crisis of Evergrande Group is not a single case of business failure. Instead, through high leverage and institutional arbitrage, it systematically broke through institutional constraints such as land transfer, pre-sale financing, and fund supervision, transforming the pre-sale system from a risk diversification tool into a risk amplification mechanism. This ultimately led to the outbreak of large-scale uncompleted residential property issues, revealing serious deficiencies in the real estate laws and institutions in mainland China.

## 3. Risk prevention and control mechanism of the pre-sale system for commercial housing in Hong Kong

### 3.1. Framework of the pre-sale system

The Hong Kong government plays the role of rule-setter, pre-approval authority, and ongoing regulator in the pre-sale system. Firstly, the Hong Kong government established the "Residential Properties (First-hand Sales) Ordinance" to provide a legal basis for uncompleted residential properties and set up the "Sales of First-hand Residential Properties Authority" (SRPA) to enforce the law and ensure compliance with the regulations. Secondly, in Hong Kong, pre-sale of commercial residential properties is only permitted through the "Lands Department Consent Scheme for the Pre-sale of Flats", which means that pre-sale is a specially licensed activity by the government. Again, before issuing the permit, the Special Administrative Region government conducts a pre-access review. Developers must submit proof of sufficient self-owned funds, materials on the progress of ongoing projects, and performance guarantee documents to demonstrate their ability to complete the project before the pre-sale permit for uncompleted residential properties can be approved. In summary, the Hong Kong government does not rely on post-event relief in the presale of commercial housing, but instead adopts "entry requirements + process supervision" to prevent risks in advance.

In terms of the land transfer system, according to the Basic Law and the Crown Lands Ordinance of Hong Kong, the vast majority of land in Hong Kong is owned by the Special Administrative Region (SAR) government and leased to developers through long-term Crown land leases. The registration of land ownership is governed by the Land Registration Ordinance.

In terms of fund supervision, in addition to requiring developers to prove that they have sufficient funds to complete the project before pre-sale, Hong Kong also has strict financing constraints imposed by the banking system. Banks disburse loans in installments according to the progress of the project, and it is difficult to obtain financing if the construction progress is not met [8].

### 3.2. Risk prevention and control

Through the above-mentioned institutional framework, Hong Kong has achieved risk management with prevention and control in advance as the core: the government strictly screens projects and developers through the pre-sale licensing system to ensure that only projects with the ability to

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complete can enter the market. The land lease and land grant contract sets the pre-sale right as a franchise authorization, and the system restricts the developer from the source to use the pre-sale of real estate as an unconstrained cross project financing tool and only allows the pre-sale funds to be used exclusively for the construction of the building. At the same time, people cut off the path of "relying on the rolling development of house purchase money" by requiring the proof of financial ability and the prudent lending mechanism of banks [9]. The three work together to control the risk at the source and reduce the probability of uncompleted and systemic risks.

## 4. A comparative analysis of the mainland and Hong Kong

### 4.1. Structural differences in institutional arrangements

Based on the above interpretation and analysis, it can be seen that although the basic forms of the pre-sale system of commercial housing in mainland China and Hong Kong are similar, such as the government led land supply mechanism and the regulatory arrangements for the pre-sale funds, there are significant differences in the actual effects of risk allocation between the two. This difference is mainly reflected in the following aspects.

First, there are obvious differences in the subject of risk taking. Under the pre-sale system in mainland China, property buyers are required to pay the down payment and assume the mortgage liability when the project is not completed. In fact, they have become the main bearers of project construction risks. Once the project is stopped, property buyers will become passive creditors. In Hong Kong's real estate development system, developers and financial institutions bear more risks in the early stage of the project through strict pre-sale permission, review of developers' financial ability and prudent bank lending mechanism, and the risk exposure of property buyers is relatively low.

Secondly, there are differences in the time points of risk control. The pre-sale system in the mainland has also set up three-tier mechanisms, namely, pre-approval, in-process capital supervision and post event risk disposal. However, in practice, the threshold for pre-examination is low, and risk resolution relies on in-process rectification and post event guaranteed delivery. In Hong Kong, through the pre-sale permit system, the risk control is moved forward to the project before entering the market. The pre-sale can be carried out only when the developer can prove that he has the ability to complete the project, reflecting the obvious characteristics of prior access.

Thirdly, in terms of risk constraint mechanism, the two places present different institutional combinations. The mainland mainly relies on administrative supervision and policy tools to restrict the development behavior. In practice, this constraint is vulnerable to the impact of the relationship between the local government and developers. In contrast, Hong Kong has formed a dual mechanism of "administrative supervision + market constraint": on the one hand, the government implements strict approval and continuous supervision, and on the other hand, banks form external constraints through the mechanism of linking prudent lending with project progress, so as to improve the rigidity of system implementation.

### 4.2. Root causes behind differences

Compared with the differences in superficial institutional arrangements, the divergence in the effectiveness of real estate risk control between Hong Kong and the Chinese mainland stems from the differences in the government's incentive structure and the roles it has shaped. In mainland China, at this stage, the cadre assessment increases multiple indicators such as people's livelihood

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security, debt risk and property market stability, weakening the single GDP orientation. However, in the traditional assessment system in the past, the weight of regional GDP was high, and the pressure of local development was large [10]. The real estate market and land finance are powerful means to develop GDP, and the pre-sale of commercial housing is the key path to the development of real estate, which leads to the high dependence of local governments on the pre-sale of commercial housing, making them both regulators and stakeholders in the real estate market. On the one hand, the government obtains a large amount of fiscal revenue through land transfer and bears the pressure of economic growth in the performance evaluation system; On the other hand, it is also responsible for the supervision of the real estate market [11]. This dual identity of "being both an athlete and a referee" determines that it is difficult for the government to maintain regulatory neutrality in practice.

Under this incentive structure, local governments tend to promote the development scale and market activity by relaxing constraints. In the face of the financial pressure of developers, they often provide support for enterprises by relaxing the conditions for the use of pre-sale funds and acquiescing in the flow of funds across projects, which in fact weakens the risk isolation function of the capital supervision system. This selective implementation is not simply the failure of supervision, but the inevitable result of the operation of incentive logic.

Further, the problems caused by the government's "dual identity" attribute will be amplified by market expectations. Due to the deep participation of the government in the real estate market, the market players generally form the implicit guarantee expectation that "the government will not allow the project to fail". This expectation will help maintain market confidence in the short term, but it will also weaken the risk constraints of developers, induce them to adopt non-conforming development models, and make property buyers and financial institutions more inclined to ignore potential risks and invest blindly.

In contrast, although the Hong Kong government also relies on land transfer revenue, its financial structure and governance logic make it unnecessary to bear similar growth pressure: the Hong Kong civil service system implements a stable rank promotion system, there is no assessment model of cross regional transfer in the mainland and ranking competition of local development indicators, and GDP is not used as the standard for official performance assessment, which makes the Hong Kong government have no motivation to intervene in project development and operation [12]. In this context, the government is closer to a single role of "rule executor", which can implement relatively rigid constraints on the pre-sale funds, and there is no clear government expectation in the market, thus strengthening the self-discipline mechanism of developers.

Therefore, it can be considered that the difference in real estate risk performance between Hong Kong and Mainland China is not essentially derived from the system text, but from the behavior mode and market expectation shaped by the government incentive structure. It is this difference, which starts from the incentive structure, is transmitted through government behavior and finally reflected in the market, that constitutes the core reason for the differentiation of the results of the two systems.

## 5. Enlightenment from the path of legal perfection

Improve the legal system. First of all, people should promote the connection between the regulations on the administration of pre-sale of urban commercial housing and the superior law, clarify the conditions and procedures for the allocation of pre-sale funds, and reduce the discretionary space of local housing and construction departments. Secondly, people should establish a regulatory accountability mechanism at the legal level and set clear accountability rules for illegal approval and deregulation. Thirdly, the mandatory system of developer completion guarantee can be introduced to provide external credit guarantee for project delivery through bank guarantee or performance insurance.

The introduction of the ex-ante constraint mechanism can learn from the ex-ante constraint idea in Hong Kong and move forward the risk control through strict project approval, capital arrangement review and development conditions. In terms of specific implementation, stricter capital review requirements will be introduced in the pre-sale licensing stage before the commencement of the project. For example, increase the proportion of self-owned funds to ensure that developers' self owned funds have the ability to build and resist risks; According to the hierarchical management and control of high turnover expansion of real estate enterprises' liabilities, the number of new construction projects for high leverage entities is limited synchronously, and the number of compliant low debt enterprises is not restricted. By screening high-risk projects at the source, people can reduce the pressure of follow-up supervision, and shift from post correction to pre prevention.

Strengthening the rigid constraint of pre-sale funds. The current pre-sale fund supervision system in the mainland has been relatively complete in text, but the problem is that there is too much flexibility in implementation, and the focus of future reform is to reduce the space for administrative discretion. For example, build a national unified information supervision platform for pre-sale funds, rely on the automatic verification node of the project allocation system, reduce the flexible adjustment space brought by manual approval, and the government retains the post supervision and verification authority. Only when the fund supervision has the rigidity that cannot be relaxed at will, can the system really play the function of risk isolation.

Improving the judicial system. At the relief level after the occurrence of risks, the judicial system still has room for improvement. First of all, people should unify the judgment scale of disputes over the pre-sale of commercial housing through judicial interpretation or guiding cases and clarify the contract effectiveness and responsibility allocation rules. Secondly, people should improve the collective representative litigation mechanism to reduce the cost of protecting the rights of large-scale property buyers and improve the relief efficiency. Thirdly, priority protection can be given to the pre-sale funds and corresponding engineering assets in the bankruptcy proceedings to ensure the continued construction and delivery of the project.

## 6. Conclusion

Through comparative analysis, this paper concludes that the difference in the effect of the pre-sale risk allocation of commercial housing between Mainland China and Hong Kong is superficially reflected in the difference in technical systems such as capital supervision and access review, but in fact is rooted in the deep difference in the incentive structure and market role of the two governments. In the pre-sale system in the mainland, property buyers bear the responsibility of down payment and mortgage when the project is not completed, which essentially becomes the main undertaker of construction risks; In Hong Kong, through strict pre-sale permit, financial proof of developers and bank lending mechanism on schedule, the risk is pre locked in the developers and financial system, and the risk exposure of property buyers is significantly low. This differentiation is not accidental. The fundamental reason is that local governments in the mainland have been driven by GDP assessment and land finance for a long time. They are both regulators and stakeholders in the market, leading to the selective implementation of pre-sale fund supervision and other systems, and giving birth to the market expectation of "government telling the bottom", weakening the self-discipline of developers; The Hong Kong government has no similar growth pressure and is closer

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to a single rule executor, with strong regulatory rigidity. Therefore, to optimize the pre-sale system in the mainland, people should not only repair the provisions but also focus on adjusting the incentive structure of local governments. At the same time, people should introduce judicial remedies such as the review of ex ante completion ability, establish a national unified fund supervision platform, and improve the priority protection of bankruptcy, so as to promote the transformation of risk management from post recovery to ex ante prevention, and use the experience of Hong Kong for reference to lock risks in the developers and financial system. Only with the improvement of the system and the reform of incentives, can people realize the substantial fairness of risk distribution and the long-term stability of the real estate market.

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