Firmer foundations for China's property market in 2023

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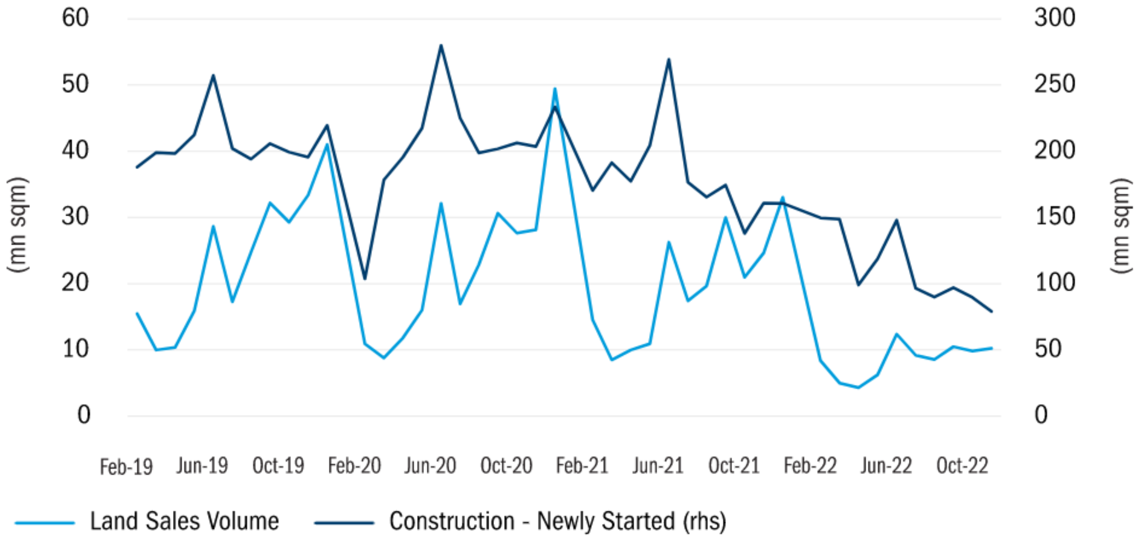
- The Chinese property sector has been in the headlines over the past year, and not for the right reasons
- However, updated comprehensive support measures mark a turning point for the high-quality property developers
- Although the investable segment of the China property sector has shrunk sharply, the direction of travel is generally positive and there is an opportunity space with those developers who are benefiting directly from the expanded credit lines

In 2020 real estate developers in China came under huge pressure following a tightening of control on debt by the government. Large developers were no exception and among the first to default was Evergrande, sparking a crisis across the industry. The country's strict implementation of a zero-Covid policy didn't help as homebuyers were physically unable to view properties, projects stalled, and buyers protested by withholding mortgage payments until their homes were completed.

Almost three-quarters of high yield-rated property developers defaulted in 2021-22, including issuers involved in distressed bond exchanges. The scope for a solid recovery in contracted sales in 2023 is weak given the decline in saleable resources. This is an outcome of the drop in both land investments and the volume of newly started construction in 2022. According to the China National Bureau of Statistics, the total land purchased in 10M22 by property developers plunged around 53% year-on-year to 74.3 million square metres, while new construction fell 38% year-on-year to 1,037 million square metres during the same period (Figure 1 shows the monthly variation).

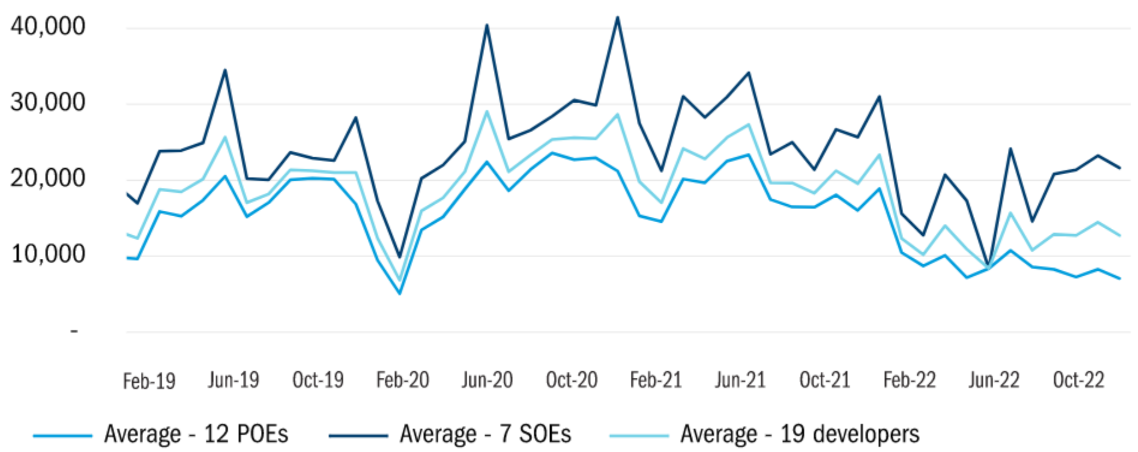
Figure 1: land investment and newly started construction



Source: China National Bureau of Statistics, November 2022

Prior to the latest round of policy initiatives in November 2022, even the fundamentally solid POEs (privately owned enterprises in real estate) were shaken by concerns of liquidity stress. This is reflected by the staggering proportion of China property bonds trading at depressed levels. In fact, around 70% of the bonds were trading under 20pt at the end of October 2022 . In the physical property market there was a divergence in homebuyers' confidence too. The year-to-date contracted sales performances (Figure 2) of SOEs (state-owned enterprises) or state-linked property developers have been more resilient than the POEs (privately-owned enterprises) given the former's higher certainty of project completion and delivery.

Figure 2: contracted sales (CNY million) – POE vs SOE



Source: China National Bureau of Statistics, November 2022

What has the government done?

Following the People's Congress in October 2022, a slew of coordinated policy initiatives was announced to support the property sector. This is a meaningful shift from the previous piecemeal policy approach which has had limited impact in mitigating the liquidity distress across the sector

Firstly, high-quality property developers – notably POEs such as Longfor Group and Country Garden – which had been impacted by the spill-over liquidity risk could regain better funding access. Secondly, the defaulted and distressed (not yet defaulted) developers can obtain more special policy loans to fund the completion and delivery of stalled construction projects. Importantly, we are seeing a higher level of resolve by the Chinese authorities to stabilise the property sector and reduce the contagion of liquidity stress:

- **The 16-point plan – broad strategic intent and direction, slowly stirring into action** We view this as an inflection point for the high-quality property developers with regards to funding access. In November 2022, the People's Bank of China (PBOC) and China Banking and Insurance Regulatory Commission (CBIRC) jointly issued a notice that laid out a 16-point plan to ensure the stable and healthy development of the property sector. It encompasses a number of new measures as well as reinforces previous policies, calling for the equal treatment of funding access for SOEs and POEs, providing some breathing room through a one-year extension of short-term loans, and includes special loans from policy banks (the China Development Bank and Agricultural Development Bank of China) for project completions. The compliance requirement for financial institutions to adhere to the caps on real estate exposure has also been temporarily lifted.
- **Re-lending program to support bond issuances** The benefit of this, in our view, will largely be limited to the high-quality developers or those with relatively high levels of unpledged investment properties. The PBOC relending program for private enterprises, including property developers, known as the "Second Arrow" will provide up to CNY250 billion (around $36 billion) in financing support via bond issuances with credit enhancements.
- **Potential funding from second-tier banks** PBOC and CBIRC instructed second-tier banks to extend CNY400 billion (around $56 billion) of financing in the form of loans, mortgages and bond investment, to the property sector in November and December 2022. This is in addition to the CNY600 billion ($85 billion) of net financing announced in September 2022 that the regulators told the six largest banks in China to extend to the property sector in Q4 2022.
- **Policy easing on escrow accounts** We expect that only fundamentally stronger developers can tap into their escrow accounts for eligible uses. Distressed developers would be largely restricted from using their escrow funds, other than for the completion and delivery of pre-sold units.
- **Access to equity financing ("Third Arrow")** The CSRC (China Securities Regulatory Commission) announced five measures to facilitate the access of listed real estate companies to equity financing in the A-share market. We expect the transmission effect of this equity-centric policy to be somewhat slower than the more immediate boost to

short-term liquidity from the provision of credit lines from banks and financial institutions. That said, the potential revival of the equity funding channel is helpful. In November, Country Garden and Agile Group raised around HK$3.78 billion ($485 million) and around HK$780 million ($100 million) through share placements.

- **Mobilising the policy package** Later in November 22 the largest six state-owned banks announced the provision of at least CNY1.3 trillion (around $179 billion) in new credit to 17 property developers. The drawdown of the credit lines is subject to certain conditions and restrictions. Despite this, the availability of financing from the banks will ensure that the high-quality POEs (Country Garden, Longfor, Midea) have sufficient short-term liquidity to wait out the current period of weak property sales..

What is the outlook?

We expect defaulted developers to remain stuck on the painful path of debt restructuring. So far, bond exchanges and extensions have only provided short-term respite. Distressed developers that avoided outright defaults may require more maturity extensions in the absence of a robust recovery in property sales. Some will inevitably default and would be compelled to restructure their capital structure. Hence, we expect default rates to remain elevated, albeit lower year-on-year, in this sector through 2023 and expect to see more debt restructuring initiatives.

The investable segment of the China property sector has shrunk sharply. Fundamentals continue to matter. The opportunity space is largely with the property developers who are benefiting directly from the expanded credit lines. Volatility, however, remains high with sharp moves in either direction given that bouts of bond weakness could still materialise with any delay to policy implementation. Nonetheless, the direction of travel is generally positive for this segment of high-quality property developers.

For the distressed/defaulted bonds, companies with a higher proportion of unpledged investment properties could offer better risk-reward in recovery value. Furthermore, the unpledged investment properties can provide these companies with the collateral to obtain secured borrowing, alleviating their liquidity pressure. This would be an interesting space to watch.

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