Mid-Year Review on Chinese Property Developers: A Tale of Two Cities

Overview of Chinese Property Developers Offshore USD Bond Issuance

Total offshore USD bonds issuance amount by Chinese property developers recorded a year-on-year decrease of c. 8.2% to USD25,791 million in 1Q 2020, and continuously dropped to USD5,513 million in 2Q 2020, representing another year-on-year decrease of c. 74.8%. The number of issuances also fell by c. 60.7% year-on-year in 2Q 2020. In 1H 2020, Chinese property developers tended to issue offshore bonds with shorter tenors. Bonds with maturity of below three years accounted for c. 55.5% of the total issuance amount in 2Q 2020, representing a 24.4 percentage points increase vis-à-vis 1Q 2020 for the same tenor category.

New bonds issued carrying coupon rates of higher than 8% increased to c. 55.0% of the total issuance amount in 1Q 2020 from c. 46.6% in 4Q 2019, followed by those with coupon rates of 6-8%, which accounted for c. 20.0% of the total issuance amount in 1Q 2020. The percentage of new bonds issued with coupon rate higher than 8% fell to c. 43.0% in 2Q 2020.

Exhibit 1: Bond Issuance Amount and Number of Issuance

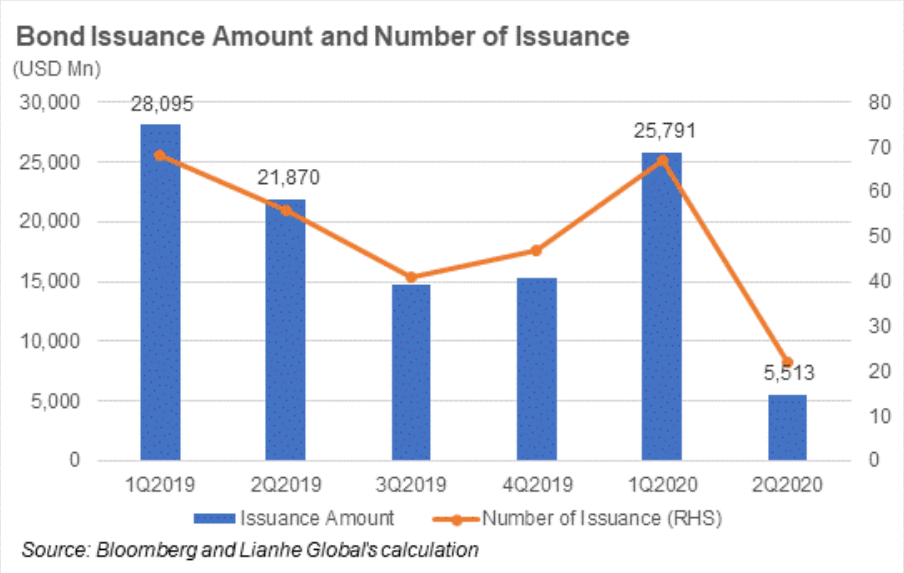


Exhibit 2: Breakdown of Bonds Issued by Maturity

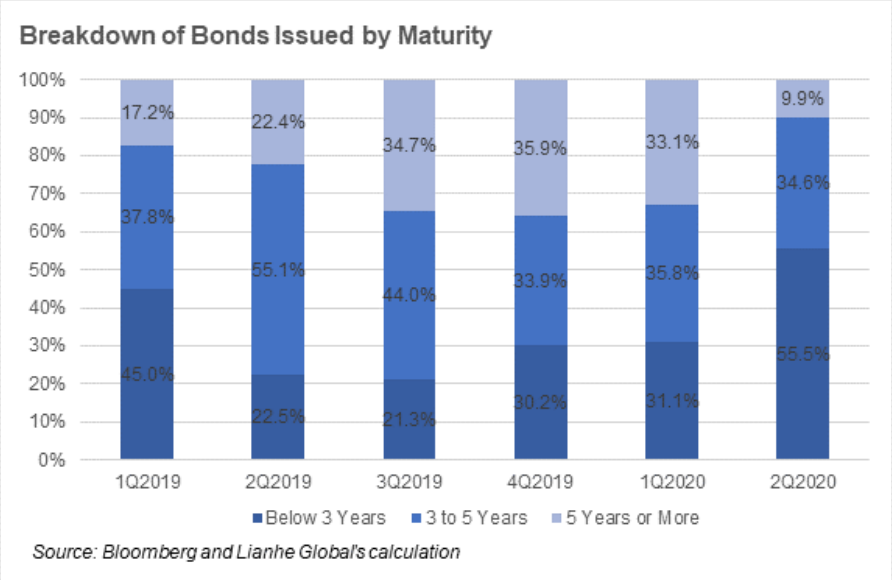
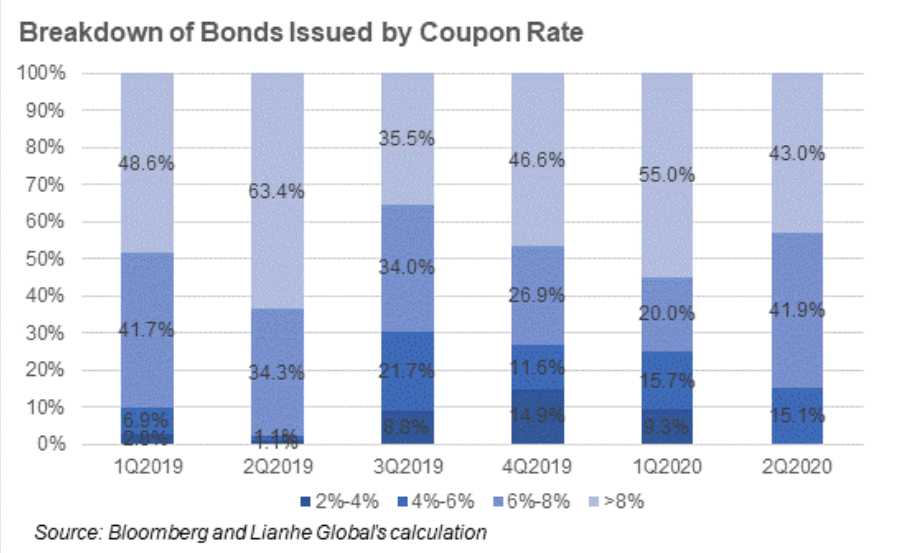


Exhibit 3: Breakdown of Bonds Issued by Coupon Rate



In 1H 2020, Chinese property developers' offshore USD bond prices on the secondary market experienced a wave of fluctuations with some dropping dramatically (as low as 50 cents on the dollar) in March. Market speculation of such drop was partly due to the chase for USD liquidity in response to deteriorating investor confidence in the overall capital markets and hence the resulting bond fund redemptions. Bond prices have gradually recovered since April with some of the bonds trading closer to par recently.

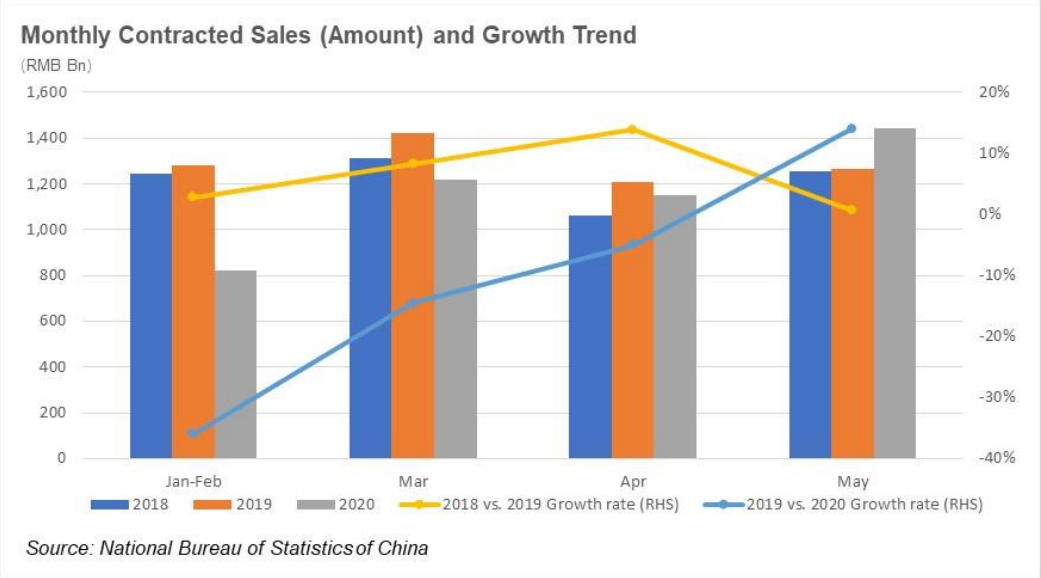
USD Bond Key Default Events in 1H 2020

10 issuers defaulted in the offshore USD bond market in 1H 2020, with only one incident of default among Chinese property offshore USD issuers. Yida China Holdings Limited ("Yida") defaulted on its offshore USD notes on 19 April 2020. Yida's predicament was largely attributed to its close association with the troubled China Minsheng Investment Group. We expect incidents of default will likely be limited in 2H 2020 among rated Chinese property developers with access to both the onshore and offshore capital markets.

Market Updates – COVID-19 to Fuel Pace of Polarization

The coronavirus outbreak ("COVID-19") at the beginning of 2020 has driven down the pace of contracted sales of Chinese property developers in China, which experienced a significant drop in the first two months of 2020 with year-on-year decrease of c. 35.9%. Given the effective first phase control of the COVID-19 in China, monthly contracted sales performance has gradually recovered since late March 2020, showing a c. 14.0% increase in May 2020 when compared with the same period in 2019. Some of the Chinese property developers' contracted sales started to recover remarkably from the February slumped figures, while others are still trailing behind. A divergence in sales performance is developing. In some cases, the March contracted sales accounted for about 50% to 60% of 1Q 2020 contracted sales. Meanwhile, the April and May contracted sales figures continued painting a picture of recovery. We expect total contracted sales of China property developers to slightly decline in 2020 due to the repeating COVID-19 cases and still unstable operating environment.

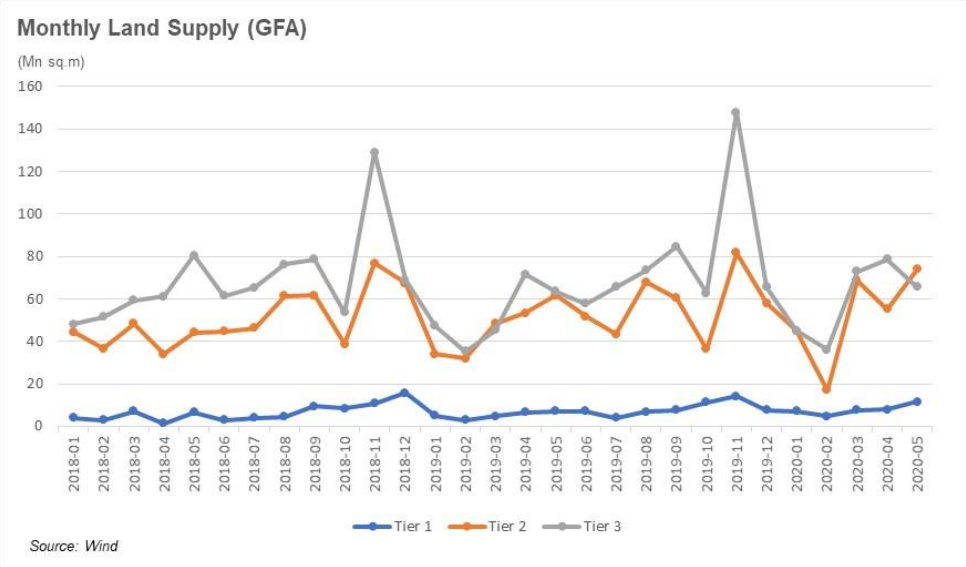
Exhibit 4: Monthly Contracted Sales (Amount) and Growth Trend



Source: National Bureau of Statistics of China

Constrained by the slow-down in contracted sales, land purchases as measured by GFA continued declining to 48 million sq.m. in the first five months of 2020. Given the recovering contracted sales performance, a number of Chinese property developers have started replenishing their depleting land bank. Land supply in Tier 1 cities remained stable (instead of an imminent increase) due to stricter regulatory restrictions. As many Chinese local economies are hard hit by COVID-19, some cash-strapped local governments are turning to land sales to fund its fiscal revenue budgets. Land supply in Tier 2 & 3 cities started to improve in March 2020 and we expect it will maintain the growth momentum, especially in Tier 2 cities with higher demand for old town developments and shantytown redevelopments.

Exhibit 5: Monthly Land Supply (GFA)



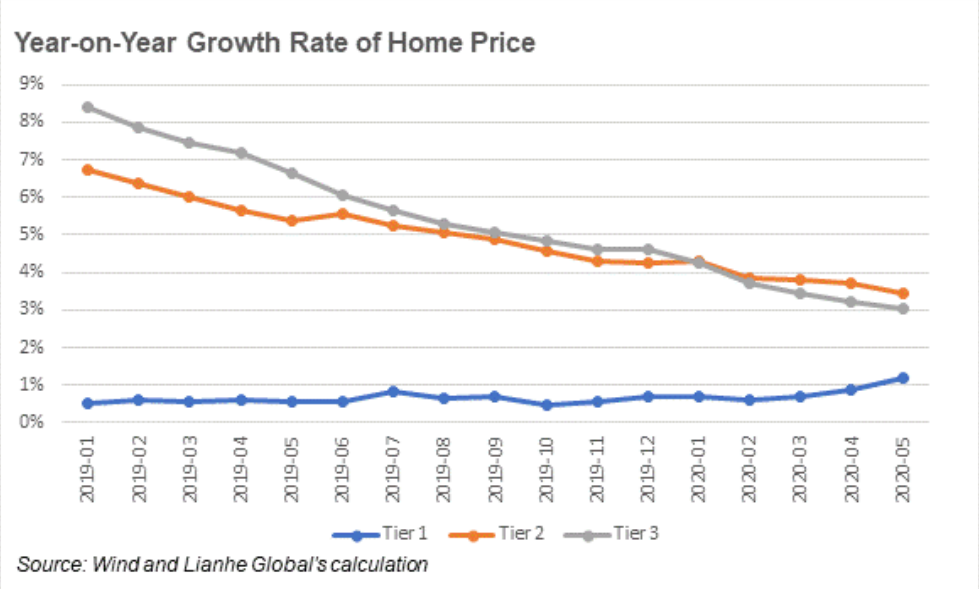
Meanwhile, Chinese property developers are facing higher financing risk and tighter liquidity position given the deteriorating cash collection from contracted sales. Cash collected from pre-sales proceeds accounted for c. 31.1% of total source of funding in the first five months of 2020, representing a decrease of 3.3 percentage points when compared to 2019. On the other hand, cash generated from domestic loans increased to c. 17.1% of total source of funding in the first five months of 2020 from c. 14.1% in 2019. We expect that large-to-medium property developers with good access to onshore funding will continue maintaining their moderate liquidity position as the onshore funding cost was lower than that of the offshore, but smaller developers may be exposed to refinancing pressure due to their weaker credit profile.

Exhibit 6: Breakdown in Source of Funding for Property Developers

With respect to home prices, we observed a higher growth rate in home prices among Tier 2 & 3 cities than Tier 1 cities, albeit at slower rate of increase in growth rates. Some of the Tier 2 cities rake benefit from the partial relaxation of purchase restrictions by lowering the thresholds on social insurance payments while some of the Tier 3 cities benefit from their close

proximities of within one-hour high-speed railways connections to major Tier-1 and -2 cities. The concept of cluster of cities or major metropolitan area continues developing.

Exhibit 7: Year-on-Year Growth Rate of Home Price



While the offshore USD bond market hit a rough patch from late February through early April 2020 with issuance almost grounded to a halt, the onshore bond market provided ample funding and liquidity to Chinese issuers. At the same time, we have been witnessing a gradual thawing of the offshore USD bond market on the heel of recovering contracted sales figures since late March 2020. We also observed a divergence in the cost of funding ("CoF") between the onshore and the offshore capital markets, with onshore funding cost lower than that of the offshore.

In terms of product and business diversification, we have also noticed a trend of spin-off and public listing of property management services companies by major Chinese property developers, to unlock the value of underlying business and achieve potential synergies with property development businesses, in response to the growing consumer demand for quality services. The first spin-off and listing of property management services companies was Colour Life Services Group Co., Limited (1778.HK), a subsidiary of Fantasia Holdings Group Co., Limited. (1777.HK) in 2014, followed by other major names such as Greentown, Future Land, Agile, Country Garden, etc in 2018 and 2019. Currently there are more than 10 listed Chinese property management companies on the Stock Exchange of Hong Kong, with a number submitted listing applications. Property management companies are primarily recurring cash flow businesses with very low to nil debt.

Government Policy Updates – Tightened Policies and Regulations to Remain

The China property market was negatively impacted by COVID-19 with substantial sales and construction activities being halted in the 1Q 2020. On the other hand, in 1H 2020, Chinese property developers continued operating under the general theme of "properties are for living not for speculation" (房住不炒) as well as the "one city, one policy" (因城施策) stance guided by the Central Government. The Central Government also re-emphasized these two themes during the Two Sessions Conference held in May 2020.

On the demand side, we have seen some Tier-2 cities partially lifted their Hukou restrictions, such as Nanchang and Nanjing, in order to attract talents to provide fundamental demands to the property market. But the Central Government still aims to maintain balanced policies such that the property market will be not overheated. For example, the relaxation of down-payment requirement policy in Zhumadian, a prefecture-level city in Henan Province, and the relaxation of purchase restrictions in Qingdao city, were subsequently retreated. Tier-1 cities such as Beijing and Shenzhen also have policies to curb potential property price increase based on the concept of "school district housing" or "shantytown redevelopments". Home price cap policies, especially in higher tier cities, will likely continue through the rest of 2020.

On the supply side, local governments aim to continue to increase land supply, propel the initiative of old town developments (deepen the urbanization process) and streamline the land approval process. Major cities and provinces such as Shenzhen, Shanghai, Anhui, Zhejiang have already announced relevant policies or work plans in response to the guidance of increasing land supply and enhancing quality of living standards.

On the financing front, the No. 778 announcement, which prohibits the use of net proceeds from offshore debt issuance to finance Chinese property developers' capital expenditure and further restricts debt issuance to refinance maturating debt within one year, could remain intact in the near term, which will continue putting pressure on offshore funding channels for Chinese property developers. Onshore markets, on the other hand, are more welcoming as illustrated by the various policies and guidance by government authorities such as the Central Bank, Ministry of Finance and the China Banking and Insurance Regulatory Commission to lower the Loan Prime Rate (LPR) and Medium-term Lending Facility (MLF) rate. We also noticed a number of large property developers issuing onshore bonds with more favourable CoF as mentioned in the "Market Updates – COVID-19 to Fuel Pace of Polarization" section above.

However, the clampdown on trust loans onshore is expected to remain the focal point. The recent news on missed payments by Sichuan Trust Co., Ltd. (四川信托) triggered a new wave of speculation on further efforts to tighten the controls and compress the size of the trust loan market. Potential initiatives on this movement will inevitably affect the liquidity and funding channels of medium-to-small Chinese property developers, who traditionally have been more reliant on non-traditional financing products than the larger developers.

Lianhe Global's Rating Actions in 1H 2020

Issuer Name	Rating Action	Long-term Issuer Credit Rating	Outlook
Golden Wheel Tiandi Holdings Company Limited	Initial	B+	Stable
LVGEM (China) Real Estate Investment Company Limited	Initial	BB-	Stable
Zhongliang Holdings Group Company Limited	Initial	BB	Stable
Yincheng International Holding Co., Ltd.	Initial	B+	Stable
Logan Group Company Limited	Upgrade	BBB- (from BB+)	Stable
Yango Group Company Limited	Upgrade	BB (from BB-)	Stable

Source: Lianhe Global

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