Lianhe Ratings Global

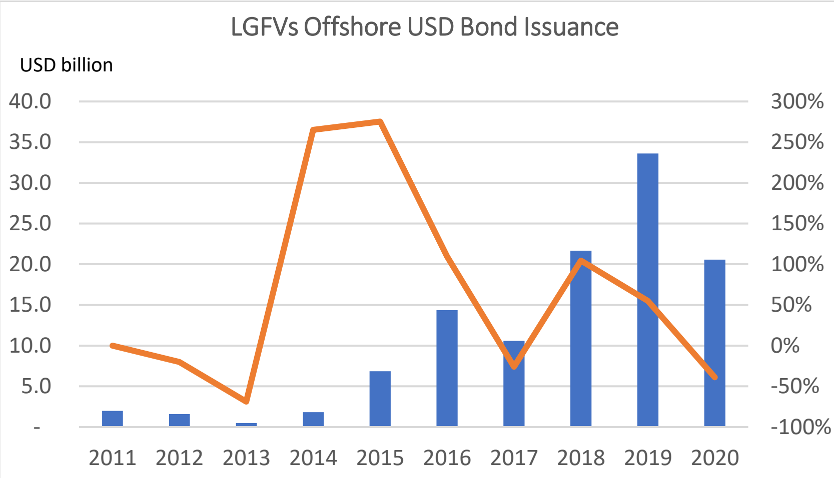
Non-Rating Commentary
29 January 2021

China LGFVs 2021 Outlook: Policy Functions Remain Intact; Credit Polarization Intensifying

China LGFVs Offshore USD Bond Issuance in 2020

Due to the impact of COVID-19 and the tightening financing policies from the No. 666 Announcement by the National Development and Reform Commission (NDRC), the issuance amount of China LGFVs' offshore USD bond experienced a year-on-year decrease of c. 39% in 2020. According to the No. 666 Announcement, compliance and regulatory requirements are strictly imposed on the issuer and issuance scope for local government entities with a responsibility for financings for local governments, and the use of proceeds are restricted to refinancing offshore indebtedness maturing within one year.

Besides the decreasing issuance amount, the cost of funding has also decreased for China LGFVs. The U.S. Federal Reserve has released a considerable amount of liquidity to the market and kept interest rates low in response to the negative economic impact in 2020, which pushed the treasury yield curves down and in turn offered lower costs of funding for offshore USD bond issuance. In 2020, the weighted average coupon rate of China LGFVs' offshore USD bond issuance was c. 2.6%, representing a c. 30 basis-point decrease compared with 2019.



Source: Bloomberg

Credit Fundamentals Drawing More Attention: Profitability, Cash Flow Generation and Debt Repayment Capabilities

With the Central Government's continuous initiatives to further reform the China LGFV industry in order to strengthen financial performance and sustainability, we noticed that revenue and profitability of China LGFVs continued to grow in 2020, despite profitability still being on the weak side with "Other Income", which mainly consists of various government subsidies, continuing to increase. Traditional LGFVs such as those responsible for urban infrastructure constructions and land redevelopments remain one of the key drivers to revive the Chinese economy from the COVID-19 impact. Local governments still have strong willingness to support larger and major LGFVs in order to support local economic development. With the development of market-oriented transformation, the profitability of LGFVs is expected to continue the improvement trend in the near term.

In 2020, the scale of net cash flow from financing activities of China LGFVs has increased year-on-year, providing support for debt repayments and capital expenditures for pipeline projects. Net cash flow from operating and investing activities remained negative, primarily as the scale of payments for infrastructure construction has expanded. The inaugural launch of infrastructure real estate investment trusts (REITs) and further refined Public-Private-Partnerships (PPPs) scheme would also open other onshore financing channels for China LGFVs.

With the increase in investments, the total indebtedness of China LGFVs continued increasing. Even though the new issuance tenor has shortened slightly for offshore USD bond issuance, maturity profile (including both onshore and offshore financings) has improved at end-2020, which partly alleviated short-term refinancing pressure. Offshore USD bond issuance will likely be driven by refinancing in 2021.

Policy Easing to Support China LGFV's Business; Tightened Policy on Debt Management

The Central Government's effort to bolster the infrastructure construction area continued to increase in 2020. In order to promote and stimulate investments, the Central Government has adopted a series of measures to strengthen the role of government special bonds (政府专项债). The quota for government special bonds significant increased in 2020, which accelerated the pace of government special bonds issuance. The cap for government special bond issuance increased to RMB3,750 billion in 2020 from RMB2,150 billion in 2019. In addition, the proportion of proceeds from special bonds issuance used as project capital can be appropriately increased from the 20% baseline, which would help alleviate pressure from capital commitment on major infrastructure projects for China LGFVs.

According to the relevant policies, local governments are to increase investment in new infrastructure constructions in 2021, to implement modern infrastructure initiatives such as urban renewal and old town reforms, and to promote urban and rural developments. Meanwhile, 120 "new-type" urbanization pilot counties, such as Huidong County (Guangdong), Ninghai County (Zhejiang) and Pei County (Jiangsu), were announced as demonstrative samples, to accelerate urban developments through leveraging strengths and tackling weak areas of counties.

On the debt management front, the revision of rules for implementation of budget law published in August 2020 further clarified the way of formation of public budgets and improved transparency on the transfer payment system, as well as enhanced the management of local government indebtedness.

The Central Economic Work Conference held in December 2020 reiterated that resolving implicit local government indebtedness is one of the important tasks for local governments in

2021. Special development zones, such as economic development and technological zones and Hi-tech zones, who used to have independent fiscal power, can no longer enjoy previous ability and flexibility in mobilizing financial resources within their own zones.

Credit Polarization Intensifying; Special Events Affecting Market Sentiment

At end-2020, the top three provinces with the highest outstanding indebtedness amounts were Jiangsu, Zhejiang and Shandong. Economic fundamentals and fiscal performance should be observed to gauge the underlying re-financing risks. More attention should be paid to the willingness of and ability to (i.e., financial resources, healthiness of banking system) support from various local governments in assessing the credit profile of China LGFVs, on top of the standalone fundamental analysis. We believe local governments' support would favor larger LGFVs with strong policy functions. On the other hand, LGFVs at lower administrative level or of smaller asset sizes will face more difficulty in financings. The LGFVs consolidation will likely continue in 2021.

In addition, regions such as Guizhou, Qinghai or Yunnan with relatively high level of debt burden at end-2020, coupled with less-than-desired economic performance and default incidents of non-traditional financing products, would possibly expose LGFVs in these regions to further credit and liquidity risks. With the increased expenditures to boost local economies and counter the impact of COVID-19, regions with weaker economic performance, lagging-behind industry structures and lack of financial resources will face more economic and fiscal pressure. The increasing pressure would inevitably hinder these local governments' ability as well as willingness to support LGFVs. As aforementioned, special development zones will also likely be impacted by the reform of budget law.

List of Lianhe Global's Rated China LGFV Entities

Issuer Name	Province/City	Issuer Rating/Outlook
Liangshan Development (Holdings) Group Co., Ltd	Liangshan	BBB-/Stable
Qingdao City Construction Investment (Group) Limited	Qingdao	A-/Stable
Wuxi Construction and Development Investment Corporation Limited	Wuxi	A/Stable
Yancheng Oriental Investment & Development Group Co., Ltd.	Yancheng	BB+/Stable
Zhengzhou Urban Construction Investment Group Co., Ltd.	Zhengzhou	A-/Stable

Source: Lianhe Global

Analysts

Stan Ho
Chief Executive Officer
(852) 3462 9568
stan.ho@lhratingsglobal.com

Alex Kung
Senior Director
(852) 3462 9577
alex.kung@lhratingsglobal.com

Ben Yau
Director
(852) 3462 9586
ben.yau@lhratingsglobal.com

Business Development Contact

Joyce Chi
Managing Director
(852) 3462 9569
joyce.chi@lhratingsglobal.com

Disclaimer

Credit rating and research reports published by Lianhe Ratings Global Limited ("Lianhe Global" or "the Company" or "us") are subject to certain terms and conditions. Please read these terms and conditions at the Company's website: www.lhratingsglobal.com

A credit rating is an opinion which addresses the creditworthiness of an entity or security. Credit ratings are not a recommendation to buy, sell, or hold any security. Credit ratings do not address market price, marketability, and/or suitability of any security nor its tax implications or consequences. Credit ratings may be subject to upgrades or downgrades or withdrawal at any time for any reason at the sole discretion of Lianhe Global.

All credit ratings are the products of a collective effort by accredited analysts through rigorous rating processes. No individual is solely responsible for a credit rating. All credit ratings are derived by a credit committee vesting process. The individuals identified in the reports are solely for contact purpose only.

Lianhe Global conducts its credit rating services based on third-party information which we reasonably believe to be true. Lianhe Global relies on information including, but not limited to, audited financial statements, interviews, management discussion and analysis, relevant third-party reports, and publicly available data sources to conduct our analysis. Lianhe Global has not conducted any audit, investigation, verification or due diligence. Lianhe Global does not guarantee the accuracy, correctness, timeliness, and/or completeness of the information. Credit ratings may contain forward-looking opinions of Lianhe Global which may include forecasts about future events which by definition are subject to change and cannot be considered as facts.

Under no circumstances shall Lianhe Global, its directors, shareholders, employees, officers and/or representatives or any member of the group of which Lianhe Global forms part be held liable to any party for any damage, loss, liability, cost, expense or fees in connection with any use of the information published by the Company.

Lianhe Global receives compensation from issuers, underwriters, obligors, or investors for conducting credit rating services. None of the aforementioned entities nor its related parties participate in the credit rating process aside from providing information requested by Lianhe Global.

Credit ratings included in any rating report are solicited and disclosed to the rated entity (and its agents) prior to publishing. Credit rating and research reports published by Lianhe Global are not intended for distribution to, or use by, any person in any jurisdiction where such use would infringe local laws and regulations. Any user relying on information available through credit rating and research reports is responsible for consulting the relevant agencies or professionals accordingly to comply with the applicable local laws and regulations.

All published credit rating and research reports are the intellectual property of Lianhe Global. Any reproduction, redistribution, or modification, in whole or part, in any form by any means is prohibited unless such user has obtained prior written consent from us.

Lianhe Global is a subsidiary of Lianhe Credit Information Service Co., Ltd. The credit committee of Lianhe Global has the ultimate power of interpretation of any methodology or process used in the Company's independent credit ratings and research.