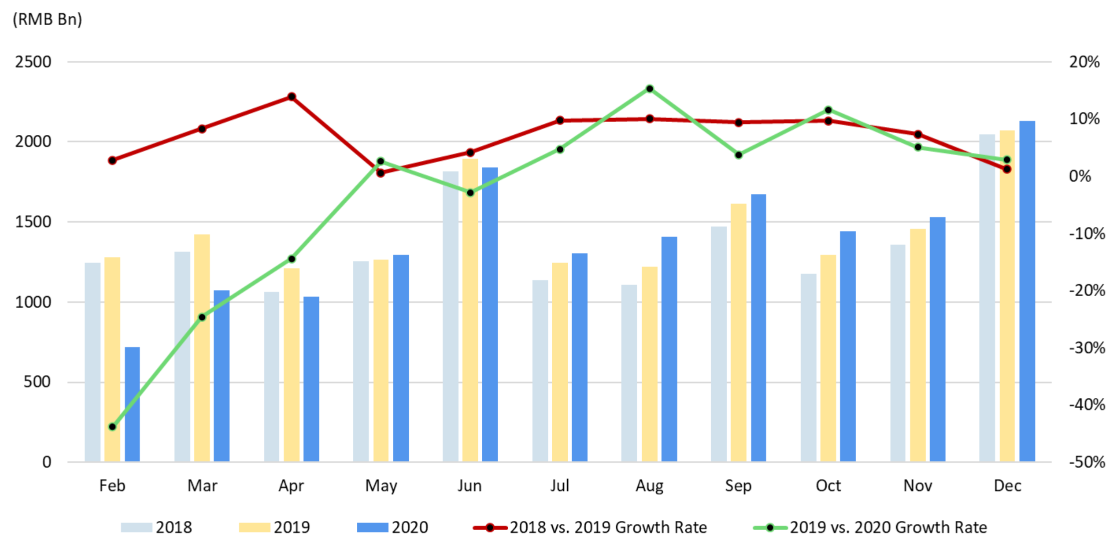
Non-Rating Commentary
29 January 2021

Chinese Property Developers 2021 Outlook: On the Recovery Path

Market Updates – Sustainable Contracted Sales Recovery

China's property market experienced a roller-coaster year in 2020. It was severely hit by the Coronavirus outbreak ("COVID-19") at the beginning of 2020, with the contracted sales hitting the trough on a 35.9% year-on-year decrease in the first two months of 2020. Thanks to the effective control of the COVID-19, loosening monetary policies and relaxation of curbs in some cities, monthly contracted sales have gone through a gradual rebound since March. As a result, the full-year total contracted sales and GFA rose 8.7% and 2.6% year-on-year in 2020, respectively. Going forward, we foresee this steady growth momentum to persist in 2021, mainly supported by Tier 1 and some leading Tier 2 cities. The contracted sales is expected to rise by c. 5% in 2021, mainly driven by the higher ASP in high-tier cities. At the same time, the contracted sales GFA will likely be flat or record a low single-digit growth. Technically, it is not surprising to see some extraordinary growth figures in 1Q2021, given the low base recorded in 1Q2020 during the COVID-19.

Exhibit 1: Monthly Contracted Sales (Amount) and Growth Trend

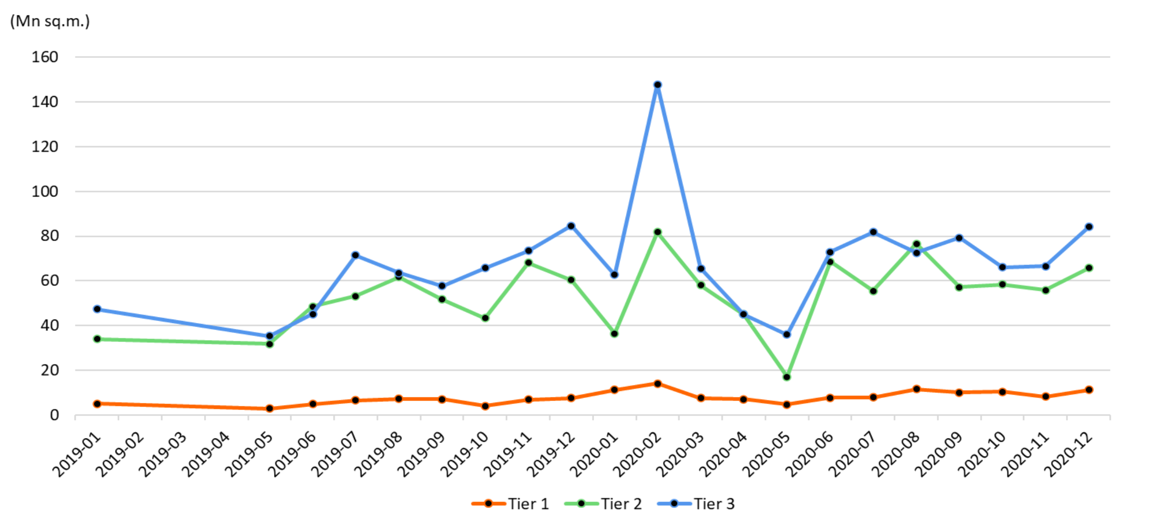


Source: National Bureau of Statistics of China and Lianhe Global's calculations

The land purchase activities were constrained by the contracted sales slowdown in 1Q2020. Riding on the contracted sales recovery since 2Q2020, Chinese property developers started to replenish their depleted land bank. However, the advocate of the "3 Red Lines" guidance in August alerted developers to the need for deleveraging. Together with the return of restrictive policies given the heated property markets in some cities, land purchases have started to cool down again since 3Q2020. According to the National Bureau of Statistics, land sales volume dropped 1.1% year-on-year in 2020, but the land sales revenue rose 17.4% during the same period. We believe it is due to the developers' favor for prime locations and high-tier cities.

Going forward, we expect the land market will stay stagnant in 1H2021, and fierce competition will be rare that happens in prime land sites only. Nevertheless, after the developers have stabilized their financial positions and sense the need for land bank replenishment, the land market may experience a recovery going to 2H2021. The recovery will likely be led by Tier 2 & 3 cities, especially in Tier 2 cities with higher demand for shantytown redevelopments.

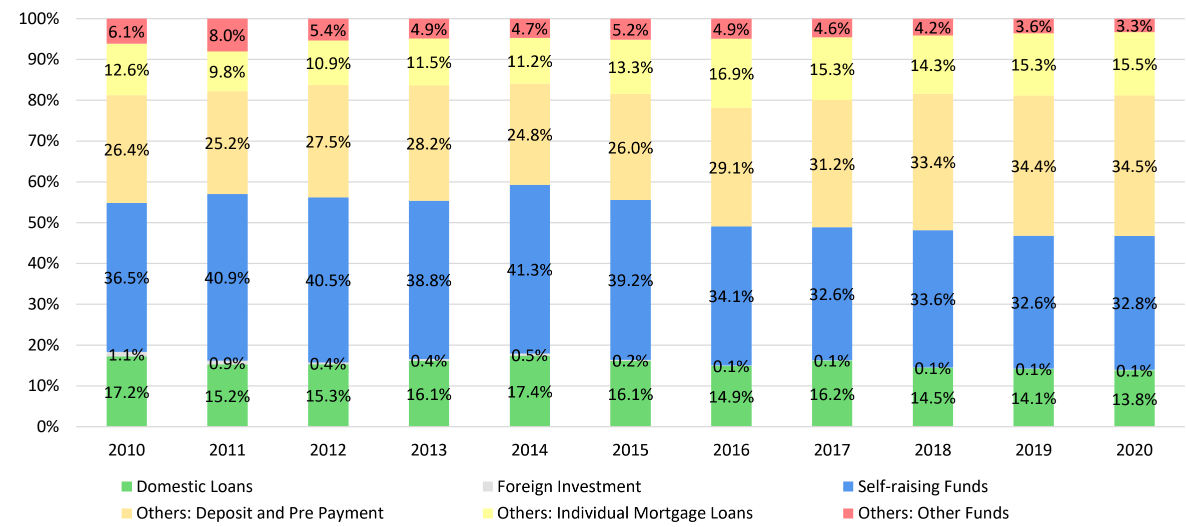
Exhibit 2: Monthly Land Supply (in terms of GFA) in 100 Large and Medium-Sized Cities



Source: Wind and Lianhe Global's calculations

On the funding aspect, in view of the stringent financing environment, the limitation of total debt growth, and the usage of proceeds from the bond issue, we anticipate developers will rely more on their internal resources, such as cash inflow from contracted sales, and refinancing channels as well.

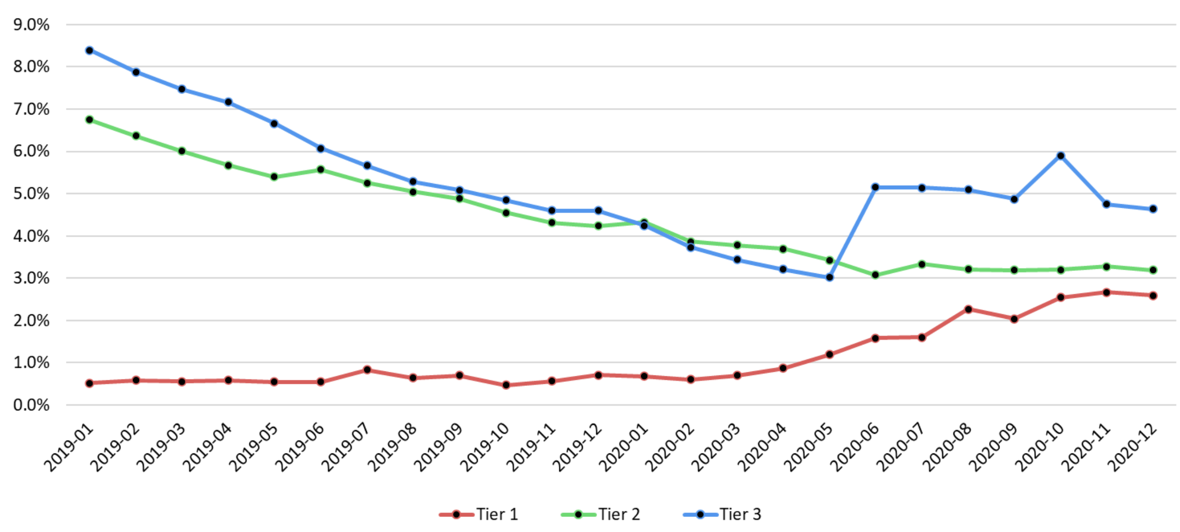
Exhibit 3: Breakdown in Sources of Funds for Property Developers



Source: Wind and Lianhe Global's calculations

On the home price aspect, we believe the domestic consumption recovery and sprawling urbanization will continue to serve as the economic growth drivers in Tier 1 & 2 cities, which help to boost the contracted sales. With stricter price restrictions in place on Tier 1 cities, we see more room for home price growth in Tier 2 cities. On the other hand, some potential Tier 3 cities will still benefit from the concept of city centre expansion and the enlargement of the major metropolitan areas. Nevertheless, we are concerned some low-tier cities that are still struggling with the oversupply, inventory clearance pressure from developers and sluggish demand. Unless more stimulus is introduced, we see downward pressure on sales volume and home price ahead in these cities.

Exhibit 4: Year-on-Year Growth Rate of Home Price in 100 Large and Medium-Sized Cities



Source: Wind and Lianhe Global's calculations

USD Bond Key Default Events in 2020

26 issuers defaulted in the offshore USD bond market in 2020, with three incidents of default among Chinese property offshore USD issuers, including Yida China Holdings Limited ("Yida"), Tahoe Group Co. Ltd (Tahoe), and Tianjin Real Estate Group (TJ Real Estate). 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. Tahoe's debt distress was mainly due to its high leverage and heavy reliance on debts from non-bank financial institutions, including trust loans and borrowings from asset management companies. Tahoe is currently undergoing the process of debt restructuring. TJ Real Estate's financial difficulties were largely aligned to its parent company, Tewoo Group which was in default.

We expect incidents of offshore bond default will likely be limited in 2021 among rated Chinese property developers, given their access to both the onshore and offshore capital markets, and the continuous contracted sales recovery.

“3 Red Lines” – Intensifying Polarization of Developers’ Credit Profile

The idea of the widely-concerned “3 Red Lines” rule was first introduced following the meeting between the Ministry of Housing and Urban-Rural Development (MOHURD) and major Chinese property developers in August 2020. Under this policy, Chinese property developers are allowed to increase their total debts between 0% and 15% per annum, depending on how many metrics they are able to meet. While the official kick-off date for the “3 Red Lines” is yet to be announced, Chinese property developers, particularly those with weaker balance sheets, have already been forced to focus on deleveraging to accommodate the guidance.

We believe the rule does not merely affect those highly-geared Chinese property developers, but has an impact on almost all of them. Under this policy, developers’ debt growth is limited to a maximum of 15% per annum. Therefore, we expect most of the developers will pay more attention to their cash flow and liquidity, which will be reflected in accelerating asset turnover and cash collection. On the contrary, they may be less focused on scale and land bank expansion. Consequently, most of the developers are set to adopt more prudent strategies such as accelerating contracted sales pace and inventory clearance, more attention on cash collection ratios, faster project delivery, slower land bank expansion, and narrowing profit margins. In one word, the theme of “Cash is king” is going to prevail again among Chinese property developers.

As we anticipate more discounted sales on slow-moving inventories, especially in low-tier cities, together with the robust sales in high-tier cities, we believe developers will still able to record decent contracted sales growth of 10-15% in 2021. In the longer run, given the backdrop of restrained land bank expansion, we predict a more modest contracted sales growth target of c.10% on average for most of the Chinese property developers. At the same time, the profit margin squeeze will continue, due to the discounted sales and rising land costs. We reckon Chinese property developers’ gearings to go down moderately, but it is difficult for them to fulfil all of the three thresholds of the “3 Red Lines” in one step.

The advantages for cash-rich, low-geared and state-owned Chinese property developers will be more evident going forward, in our view. There will be more bargain hunting opportunities arising from project or company stake sales offered by cash-strapped developers. Also, these developers have bigger war chests and probably less land replenishment pressure. As a result, they are able to optimize their land bank portfolio by acquiring prime land at reasonable costs.

On the contrary, given the limited room for new capital from debt financing, those high-geared Chinese property developers have to consider other financing alternatives, such as bringing forward the contracted sales schedule, equity financing, spin-off listings, project stake sales, off-balance financial arrangements, etc. For instance, Agile Group (3383 HK) sold stakes of seven property projects to Ping An Insurance (2318 HK) for RMB7.05 billion in December 2020. Similarly, Guangzhou R&F Properties (2777 HK) completed the transaction of disposing 70% stake of its logistics park in Guangzhou to Blackstone Group for RMB4.06 billion in January 2021. China Evergrande (3333 HK) launched a reimbursement scheme for selling its non-core assets of retail shops in some cities. Under the scheme, 10% of the consideration will be returned each year starting from 2022, so buyers will get back all of their payments eventually. It is also not surprising to see other innovative financing methods to dodge the leverage requirements going forward.

Also, Chinese property developers are eager to refinance their debts to alleviate the repayment burden and lengthen the duration of their total debts. Through shifting the short-term debt to long-term debt, these refinancing actions will help to enhance their cash to short-term debt ratio, one of the thresholds under the “3 Red Lines” policy. Therefore, we believe this backdrop will remain conducive to the frequent offshore bond issue activities going forward.

Government Policy – Tight Stance Remains, Higher Emphasis on Deleveraging

The central government has reaffirmed its policy stance towards the property market by reiterating the major themes of “properties are for living not for speculation” (房住不炒) and “one city, one policy” (因城施策) in the 14th Five-Year Plan Formulation announced in November 2020. Han Zheng, the vice-premier of the State Council and Politburo Standing Committee member, urged for promoting the steady and healthy development of the property market in December 2020. Given the need for the balance between maintaining property market recovery and reining in the overheated property prices in some cities, we believe stabilizing property prices and buyers’ expectation remain the key missions going forward. The central government will continue to let local governments formulate their own policies in view of the differentiated property markets across China.

Also, the “3 Red Lines” rule was introduced as aforementioned, with no official implementation date up to this moment. Compared with the regulations mainly target financing channels in the past, such as the clampdown of trust financing and limiting the usage of proceeds from debt issuance, we view it as a more comprehensive supervision on the entire financial position of Chinese property developers. Going forward, we believe the control on financial leverage will remain tight, in order to prevent any major default event from Chinese property developers that will endanger China’s financial system and bond market.

In another dimension, People’s Bank of China (PBoC) and China Banking and Insurance Regulatory Commission (CBIRC) jointly established the collective management system, which set a cap at 40% for the ratio of outstanding property loans to the total loans, and 32.5% for the ratio of outstanding mortgage loans to the total loans. These caps are applied to the seven major large-scale national banks, while different caps are applied to smaller banks depending on the category of banking financial institutions. This rule has taken effect from 1 Jan 2021, and all banks are given a transitional period of 2-4 years to fully comply with the policy. Though most of the banks should be available to conform to these guidelines, we foresee the property loans growth will probably be shrunk in the long run, which implies a tighter bank loan supply environment to all Chinese property developers in the future.

Some local governments have introduced supportive policies or relaxation of curbs in 1H2020, in order to fight against the contraction brought by COVID-19. However, given the gradual contracted sales rebound, many cities have retreated those stimuli or even imposed new cooling measures to rein in the surging property prices since 2H2020. For example, Shenzhen, Ningbo, Wuxi, Shenyang, and Dongguan have introduced various upgraded restrictions on property purchase, property price, mortgage loans and increasing taxes for property transactions, etc. Going forward, we anticipate the divergence of policies across local governments will continue in 2021. As we are more optimistic on Tier 1 and dominant Tier 2 cities in 2021, we are not surprised to see more policies to be imposed in these cities if any rapid property price surge shall materialize. On the contrary, some low-tier cities, such as Jinan, Qingdao, may continue to rely on attracting talents to boost their property markets.

List of Lianhe Global's Rated Chinese Property Entities

Issuer Name	Long-term Issuer Credit Rating	Outlook
Yuzhou Group Holdings Company Limited	BB	Stable
CIFI Holdings (Group) Co. Ltd.	BBB-	Stable
Logan Group Company Limited	BBB-	Stable
Jingrui Holdings Limited	B+	Stable
Redsun Properties Group Limited	BB-	Stable
Yango Group Co., Ltd.	BB	Stable
Radiance Holdings (Group) Company Limited	BB	Stable
E-House (China) Enterprise Holdings Limited	BB+	Negative
China Aoyuan Group Limited	BB+	Stable
Golden Wheel Tiandi Holdings Company Limited	B+	Stable
LVGEM (China) Real Estate Investment Company Limited	BB-	Stable
Zhongliang Holdings Group Company Limited	BB	Stable
Yincheng International Holding Co., Ltd.	B+	Stable
Sinic Holdings (Group) Company Limited	BB-	Positive
Dexin China Holdings Company Limited	BB-	Stable
Redco Properties Group Limited	BB-	Stable
Source: Lianhe Global		

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