China Offshore Bond Market 2021 Review and 2022 Outlook: There is Light at the End of the Natural Selection Process

Summary

The China offshore bond market was severely hit by a series of defaults and credit events caused by Chinese property developers in the second half of 2021 (2H2021). Developers were virtually facing a shutdown of bond financing channel due to the significant surge in bond yields and the widening spread in coupon rates. As such, China offshore USD bond new issuance dropped by 11.9% to USD165.5 billion for the first ten months in 2021 (10M2021). In particular, the new issuance amount decreased by 30% for the four months ended October in 2H2021, compared with the same period in 2020.

The Chinese property developers' offshore USD bond new issuance dropped by 51.4% year-on-year and contributed only 18% of the total offshore USD new issuance for the four months ended October in 2H2021. Developers' default risk was heightened when most of their cash were held in project companies instead of holding companies, and when some covenants of early repayment for some non-traditional financings were triggered. In the operation aspect, developers' contracted sales shrank in 2H2021, and most of them rapidly reduced their land purchase spending to safeguard their liquidity conditions.

The LGFVs' offshore USD bond issuance rebounded by 17.9% for the four months ended October in 2H2021, compared with the same period in 2020. Investors' risk aversion favored IG LGFVs' bond issuance. The central government urged local governments to resolve the risks arising from implicit debt and escalating debt burden. Also, the fiscal conditions of provinces vary across different regions.

Green and sustainable bond issuance continued to grow rapidly in 2021. There were 60 Chinese offshore green and sustainable issuances for 10M2021, compared with the total of 18 issuances for 2020. In November 2021, the HKSAR government sold c. USD3 billion equivalent of USD and Euro-denominated and RMB5 billion of RMB-denominated green bonds, which helped to set a yield curve for the green bond markets.

The virtual shutdown of the USD public bond financings for most Chinese property developers will probably last at least into the first half of 2022, as offshore investors suffered huge losses in their high yield bond investments. We expect investors to become more cautious on scrutinizing developers' liquidity and financial positions in evaluating their credit and liquidity profiles. Bondholders will also pay more attention to bond issuance terms stated in the offering circular. IG issuers were relatively less affected by the credit events, though their refinancing capabilities were also being undermined.

Chinese property developers will prioritize the soundness of their financial conditions over scale expansion. We expect contracted sales will drop by 10-20% in 2022, which is a major business risk for developers. It will hit developers' financial and cash positions, and heighten the risk of their interest coverage slippage. If there is no positive action from the government to ease the current situation, the risk of liquidity stress may spread to highly-rated developers.

On the LGFVs front, credit polarization among LGFVs will continue in 2022. LGFVs with lesser roles in core policy functions and lower visibility of government support are under higher risk of being consolidated. In addition, LGFVs in regions with weaker economic and fiscal conditions will face more challenges in terms of financing and cash flow sustainability. The restrictions on land premium ceiling and the centralized land sales revenue collection may weaken local governments' flexibility in their fiscal conditions.

A. Review of China Offshore Bond Market in 10M2021

New Issuance Suffered Amid Concern on Developers' Credit Crunch

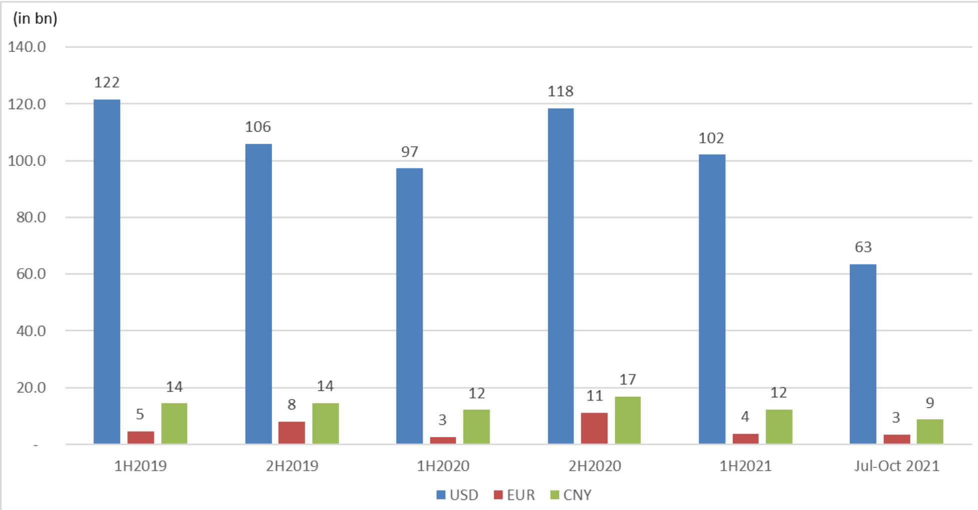
The China offshore USD bond new issuance dropped by 11.9% to USD165.5 billion for 10M2021, compared with USD187.9 billion issued during the same period in 2020. It was mainly due to the significant decrease for the four months ended October in 2H2021, in which the new issuance amount dropped by 30% compared with the same period in 2020. Having said that, there were 574 new issues for 10M2021, compared with 536 and 567 new issues during the same period in 2020 and 2019, respectively.

The offshore bond market was severely hit by the elevated concerns on the deteriorating credit crisis caused by China Evergrande Group ("Evergrande") and a series of defaults and credit events of Chinese property developers, particularly in 2H2021 (See Section E). Investors turned risk-averse as they pulled out from the offshore bond market, especially the high yield bonds issued by Chinese property developers. As a result, bond prices dropped significantly with non-investment grade and/or high-yield property developers suffering the most. Other than the credit events, the leverage used by some investors in their bond positions also triggered selloff when the prices of these bonds dropped to certain stop-loss or margin call levels. These actions in turn intensified the bond price fluctuations.

The significant decline in bond prices led to increase in bond yields and thus widening the spread with coupon rates, which narrowed developers' financing channels and weakened their refinancing capabilities. These developers would face substantial increase in their costs of funding if they issue new bonds with the coupon rates matching their relevant market bond yields. Bond financing became almost impossible for these developers, and they were forced to rely on the other options for their refinancing needs, such as their own financial resources and cash collections from contracted sales.

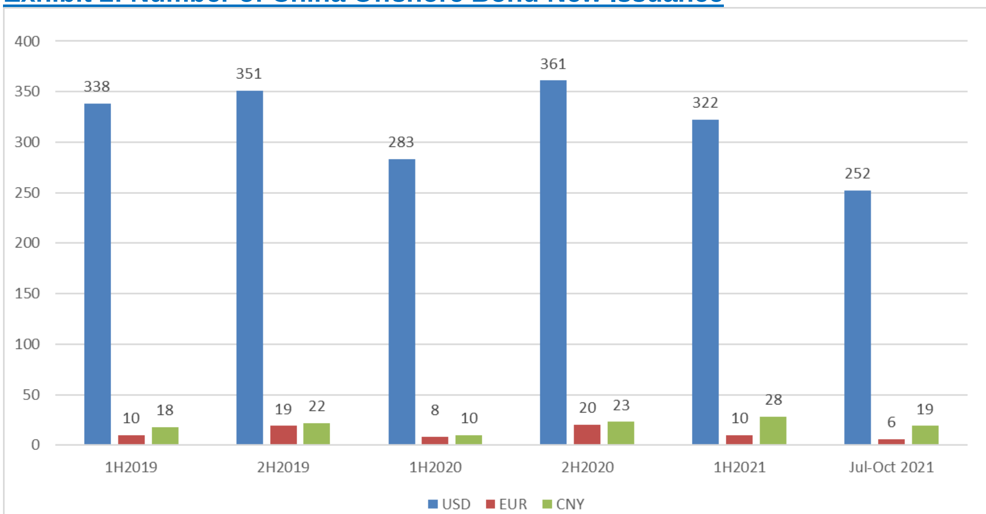
On the other hand, the panic sentiment due to weak investors' demand and their concerns over the heightened default risk also contributed to the tough environment on the demand side for offshore bond issuance. As such, we believe the offshore USD bond issuance will likely hit a trough for the remaining period in 2H2021.

Exhibit 1: Total Amount of China Offshore Bond New Issuance



Source: Bloomberg and Lianhe Global's calculation

Exhibit 2: Number of China Offshore Bond New Issuance



Source: Bloomberg and Lianhe Global's calculation

Short Tenor Dominated New Issuance, Upcoming Maturity Wall in 2022

Given investors' risk appetite remained low and the new bond issuance by both developers and LGFVs were mainly for refinancing purpose, bonds with short tenors (1-5 years) accounted for the majority (75%) of the total offshore USD bond new issuance in 10M2021 (EXHIBIT 3). Short-term bonds with maturity of less than 1 year contributed 8.8% of the new issuance in 10M2021. Bonds with maturity of 1-3 years accounted for 34.7% of the new issuance during the same period, followed by bonds with maturity of 3-5 years (31.7%).

At end-October 2021, the outstanding amount of the offshore USD bond reached USD794 billion. USD208 billion will mature before the end of 2022, accounting for 26.2% of the total outstanding amount (EXHIBIT 4). In particular, USD120 billion will mature before the end of the first half in 2022. As such, we expect the refinancing need from issuers remains intact in the next 12 months.

Exhibit 3: Tenor Distribution of China Offshore USD Bond New Issuance in 10M2021

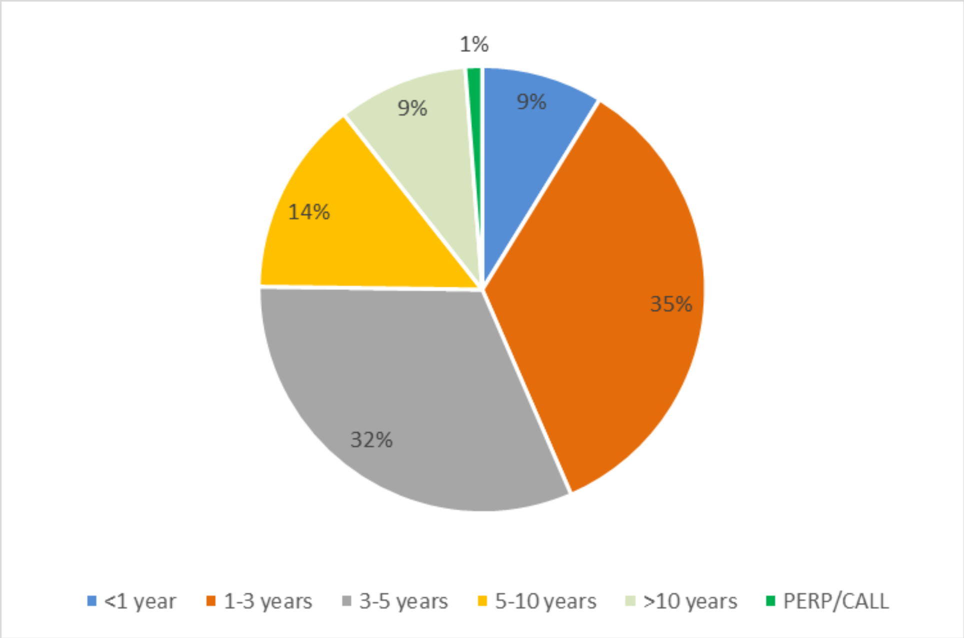
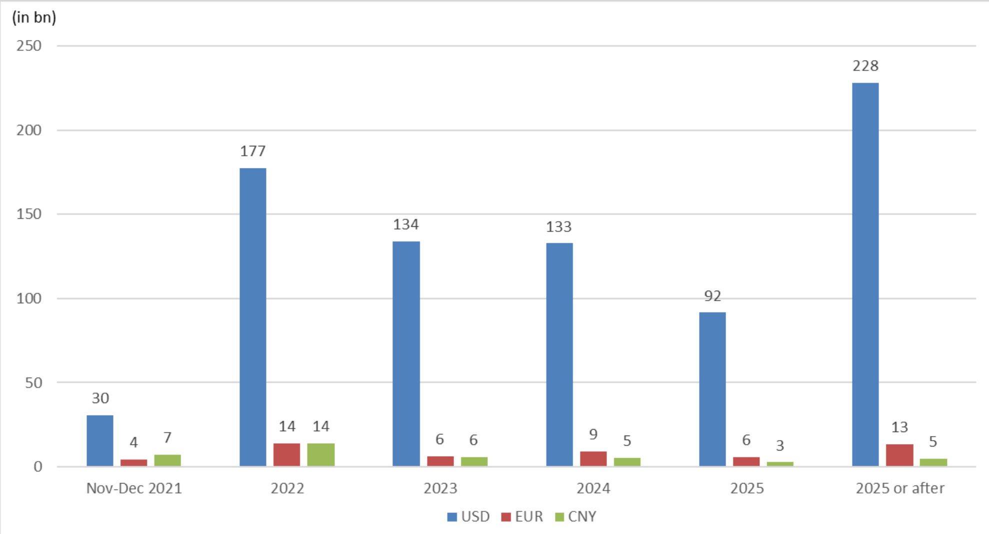


Exhibit 4: Maturity Distribution of China Offshore Bond at end-October 2021



Source: Bloomberg and Lianhe Global's calculation

B. Review of China's Property Market in 10M2021

Significant Decline in Real Estate Offshore USD New Bond Issuance

The sharp decline in bond prices since September 2021, dragged by Evergrande's distressed liquidity condition and the Chinese property developers' credit events, led to the considerable increase in spread between bond yields and coupon rates and halted new bond issuance for most of the Chinese property developers in 2H2021. As a result, the Chinese property developers' offshore USD bond new issuance dropped by 27.5% to USD41 billion for 10M2021 compared with the same period in 2020 (EXHIBIT 5). In particular, the new issuance amount dropped by 51.4% for the four months ended October in 2H2021, compared with the same period in 2020. The Chinese property developers' bond issuance contributed 25% of the total issuance in 10M2021, down from 29% and 30% in 1H2021 and 2020, respectively.

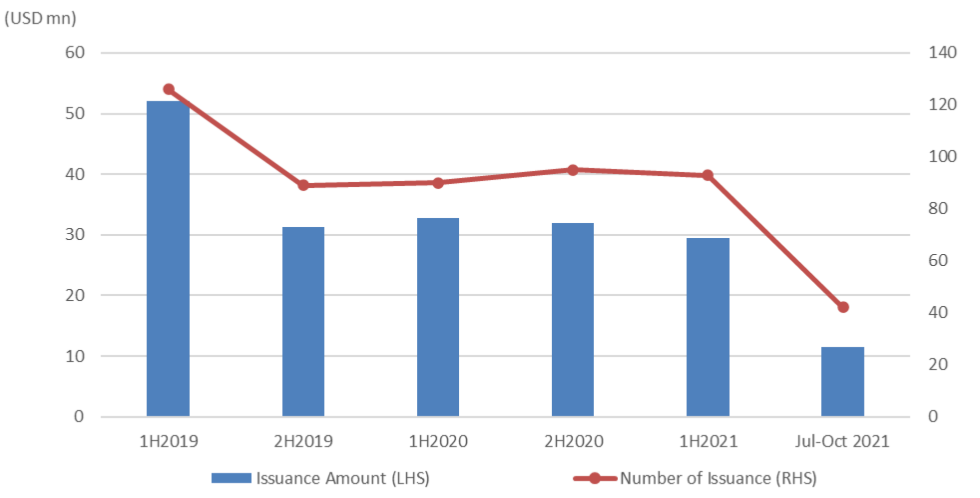
In particular, the Chinese property developers' bond issuance contributed only 18% of the total issuance for the four months ended October in 2H2021.

While most of the developers recorded ample cash balance at end-June 2021, it was a surprise to the market when some of them announced they were unable to repay the matured debt and declared default. Developers' default risk was heightened when most of their cash balance was held in project companies instead of holding companies. In this case, the holding companies' flexibility of cash flow management and their repayment capability were weakened, as they were not able to access all of their cash for debt repayments.

Moreover, the narrowed financing channels and slower capital release from banks' mortgage approvals put further pressure on developers' liquidity since 3Q2021. The downgrades of developers by credit agencies also triggered some early debt repayments, in particular some non-traditional financings including trust loans, which intensified their liquidity crunch.

Also, developers' liquidity condition was crucial to their refinancing and repayment capabilities, regardless of their market shares in some cases. For instance, Yincheng International (ranked 113th in terms of total contracted sales in 2020, according to CRIC) redeemed its USD notes in full in November 2021, DaFa Properties (ranked 90th) completed the USD senior notes issuance in October 2021. On the contrary, Yango Group (ranked 18th) proposed exchange offers to extend the maturities for three of its USD notes in November 2021, Sinic Holdings (ranked 35th) declared it failed to pay accrued interest of its onshore financing arrangements in September 2021, followed by its inability to repay its USD notes in October 2021.

Exhibit 5: Offshore Real Estate USD Bond New Issuance Amount and Number of Issuance



Source: Bloomberg and Lianhe Global's calculation

Profit Margin Compression with Lower Net Gearings in 1H2021

Developers generally recorded gross margin compression in their 1H2021 interim results. It was mainly due to: i) rising land and construction costs, ii) limited average selling price growth under the price restriction policies in some higher-tier cities, and iii) developers' strategies to accelerate asset turnover and contracted sales to safeguard their financial positions at the expense of profit margins. Lianhe Global's rated Chinese property developers recorded an average GPM of 23.7% in 1H2021, compared with 29.1% and 23.3% in 2019 and 2020, respectively (EXHIBIT 6). If Yuzhou was excluded, which recorded an extraordinary GPM of 4.6% in 2020, the average GPM would have dropped to 24.0% in 1H2021 from 24.5% in 2020.

On the other hand, developers continued to focus on deleveraging in order to comply with the “3 Red Lines” thresholds, as demonstrated by the decrease of their net gearing ratios. Having said that, some developers posted fast growth of their non-controlling interest amounts on their balance sheets, along with higher proportion of non-controlling interests in their total equities. This practice helped to enlarge their total equity bases, and thus lowered the net gearing ratios. Also, some developers recorded rapid increase in their trade and account payables, which were not included in their total debts. Therefore, these developers’ total debt change may not fully reflect the increase of their liabilities.

Lianhe Global’s rated Chinese property developers recorded a net gearing ratio of 74.4% on average in 1H2021, compared with 109.8% and 75.5% in 2019 and 2020, respectively. Most of these developers were able to pass 2 out of the 3 thresholds, namely net gearing ratio and cash/short-term debt ratio, at end-June 2021. These developers target fulfilling the remaining requirement, namely liability-to-asset ratio, either at end-2021 or end-2022.

Exhibit 6: Lianhe Global’s Rated Chinese Property Developers’ Gross Margins and Net Gearings

Issuers’ name	Reported Gross Margin (%)			Net Gearing Ratios (%)		
	2019	2020	1H2021	2019	2020	1H2021
Agile Group Holdings Limited ("Agile")	30.5%	30.0%	28.1%	82.8%	61.0%	45.3%
CIFI Holdings (Group) Co. Ltd. ("CIFI")	25.0%	21.7%	20.7%	65.6%	64.0%	60.4%
Dexin China Holdings Company Limited ("Dexin")	32.2%	24.9%	21.8%	68.7%	75.0%	72.4%
Huijing Holdings Company Limited ("Huijing")	45.6%	34.6%	30.3%	82.0%	17.9%	13.9%
Jiangsu Zhongnan Construction Group Co., Ltd. ("Zhongnan")	16.7%	17.3%	16.3%	167.9%	97.2%	94.9%
Jingrui Holdings Limited ("Jingrui")	20.2%	19.6%	24.1%	57.7%	69.0%	81.1%
Jinke Property Group Co., Ltd. ("Jinke")	28.8%	23.2%	20.1%	117.8%	73.1%	73.7%
Logan Group Company Limited ("Logan")	31.5%	30.0%	26.9%	67.4%	61.4%	60.7%
LVGEM (China) Real Estate Investment Company Limited ("LVGEM")	64.2%	49.1%	47.5%	135.2%	76.2%	77.6%
Radiance Holdings (Group) Company Limited ("Radiance") (1)	21.8%	22.1%	21.1%	166.9%	75.3%	75.9%
Redco Properties Group Limited ("Redco")	34.3%	22.6%	24.8%	17.9%	48.7%	51.1%
Redsun Properties Group Limited ("Redsun")	25.1%	22.4%	21.1%	70.4%	50.3%	53.9%
Shinsun Holdings (Group) Co., Ltd. ("Shinsun")	23.9%	18.1%	18.0%	360.9%	136.4%	96.6%
Yincheng International Holding Co., Ltd. ("Yincheng")	16.3%	10.8%	18.2%	160.6%	151.0%	196.3%

Yuzhou Group Holdings Company Limited ("Yuzhou")	26.2%	4.6%	20.1%	70.2%	85.8%	80.4%
Zhongliang Holdings Group Company Limited ("Zhongliang")	23.3%	21.0%	20.8%	65.6%	65.8%	56.1%
Average (2):	**29.1%**	**23.3%**	**23.7%**	**109.8%**	**75.5%**	**74.4%**

Note:
(1) Radiance Group Company Limited, Lianhe Global's rated entity, is the operating subsidiary of Radiance Holdings (Group) Company Limited.
(2) Simple average is applied for all average figures.
Source: Issuers' annual and interim reports, Lianhe Global's calculations

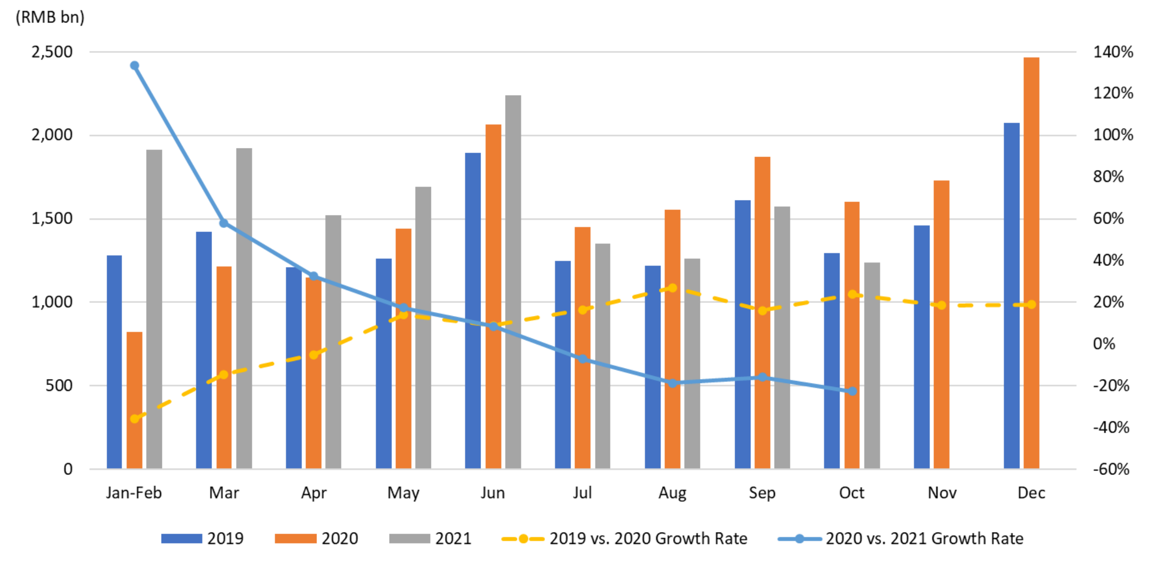
Contracted Sales Slowdown in 2H2021

The tightening on banks' mortgage approval and release played an important role for the contracted sales slowdown in the third quarter of 2021 (3Q2021), reversing the strong contracted sales momentum in the first half of 2021 (1H2021). A longer period of time was required to obtain mortgage approvals and releases of capital. Also, buyers' growing concern over the bankruptcy risk of distressed developers hindered their property purchase's decisions. According to the National Bureau of Statistics, total contracted sales and GFA increased by 11.8% and 7.3% for 10M2021, respectively (EXHIBIT 7). Nevertheless, the growth rates slowed down significantly from 38.9% and 27.7% recorded in 1H2021, respectively. Also, the monthly contracted sales dropped by 15.8% and 22.6% year-on-year in September and October, respectively.

According to Bloomberg, following a meeting held by the People's Bank of China (PBoC) and the China Banking and Insurance Regulatory Commission (CBIRC) in late September 2021, large-scale commercial banks were allowed to accelerate mortgage approvals starting from the fourth quarter of 2021 (4Q2021). Also, the CBIRC urged banks to ensure sufficient support to first-time homebuyers in terms of downpayment ratio and mortgage rates in mid-October.

Lianhe Global's rated Chinese property developers recorded contracted sales growth of 17.3% year-on-year on average for 10M2021 (EXHIBIT 8). However, their contracted sales slowed down with a 24.2% decline on average for the four months ended October in 2H2021. Also, their contracted sales were slightly behind schedule as they achieved 76.7% of their full-year targets on average for 10M2021.

Exhibit 7: Monthly Contracted Sales Amount and Year-on-year Change



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

Exhibit 8: Lianhe Global's Rated Chinese Property Developers' 10M2021 Contracted Sales

Issuers' name [1]	Contracted Sales [2] (RMB bn)					
	10M 2021	10M 2020	Change (%)	Jul-Oct 2021	Jul-Oct 2020	Change (%)
Agile	113.1	104.8	**8.0%**	37.8	49.7	**-23.9%**
CIFI	209.3	174.4	**20.0%**	73.1	93.6	**-21.9%**
Dexin	62.3	47.4	**31.3%**	19.2	21.7	**-11.5%**
Zhongnan	170.2	168.3	**1.1%**	61.2	86.9	**-29.6%**
Jingrui	25.2	18.9	**33.3%**	6.4	11.2	**-42.7%**
Jinke	161.6	172.9	**-6.5%**	59.5	86.1	**-30.9%**
Logan	116.1	97.0	**19.7%**	42.5	50.7	**-16.2%**
Radiance [3]	80.4	70.3	**14.3%**	24.6	32.9	**-25.3%**
Redsun	74.0	64.5	**14.8%**	24.9	32.9	**-24.4%**
Yincheng	22.8	14.2	**60.8%**	6.3	8.1	**-22.1%**
Yuzhou	90.1	88.6	**1.7%**	37.4	45.7	**-18.3%**
Zhongliang	143.3	130.7	**9.6%**	48.3	63.0	**-23.3%**
Average [4]:			**16.8%**			**-23.4%**

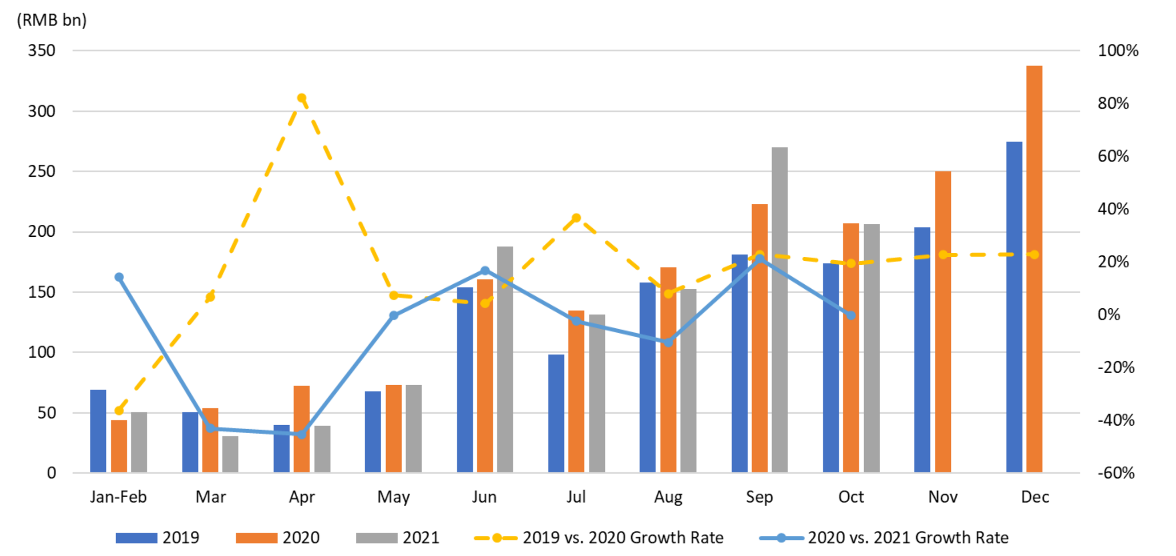
Note:
(1) Developers with public announcement of comparable contracted sales data are included in this exhibit.
(2) Developers' Jul-Oct 2021 figures are derived by subtracting their 1H2021 sales from their 10M2021 sales. The same principle is applied for deriving Jul-Oct 2020 figures.
(3) Radiance's 10M2020 and 1H2020 figures are derived from its stated growth rates of 10M2021 and 1H2021 sales, respectively.
(4) Simple average is applied for all average figures.
Source: Issuers' announcements, Lianhe Global's calculations

Land Purchase Remained Stagnant

The centralized land supply policy has been implemented in 22 cities which limits the number of residential land sales to thrice a year. On the other hand, developers' land acquisition strategies remained cautious given their stretched financial positions. A majority of developers rapidly slowed down their land purchase paces following the tightened credit environment and mortgage approvals in 10M2021.

As a result, state-owned ("SOE") and government-related developers dominated the land sales in the second and third land auctions in these 22 cities, as the land plots won by them increased. At the same time, unsold land plots due to withdrawal or no bidder increased compared with the first land auction. According to the National Bureau of Statistics, China's land purchase amount increased marginally by 0.2% for 10M2021, but land purchase volume dropped by 11% during the same period (EXHIBIT 9).

Exhibit 9: Monthly Land Purchase Amount and Year-on-year Change



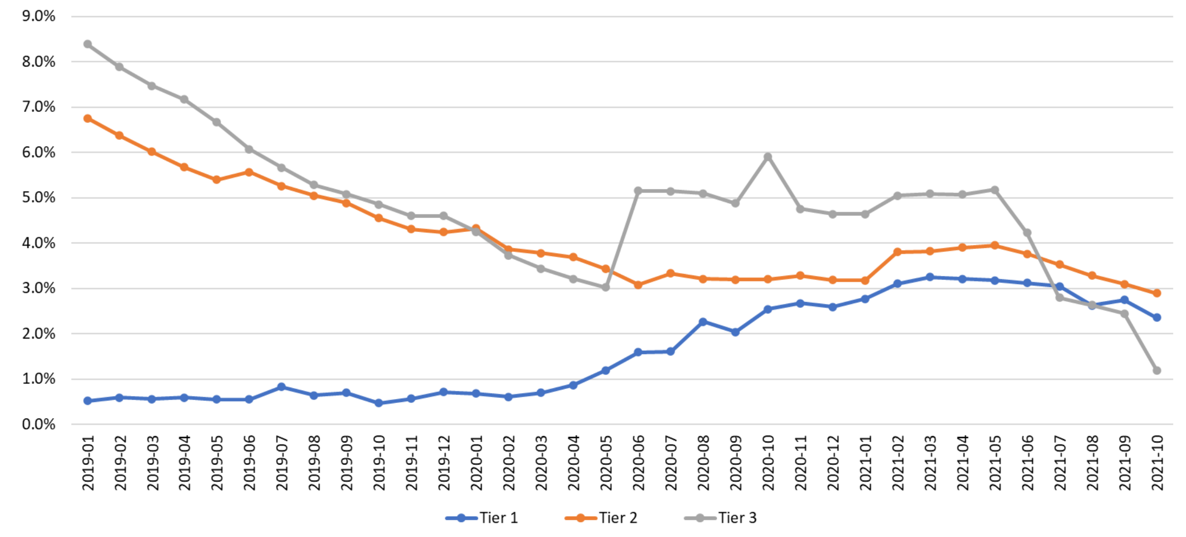
Source: National Bureau of Statistics of China, Lianhe Global's calculations

Policy Headwinds to Restrain Robust Home Price Growth

China's home price maintained a modest uptrend in 1H2021, but demonstrated a slowdown during 10M2021. In addition to home price caps, the tightened mortgage approvals weakened the purchasing power of buyers. Also, developers accelerated project launches given their needs for cash collection from contracted sales. We believe all these factors contributed to the slowdown of home price growth in 10M2021.

The downward pressure of home price was more evident in some low-tier cities, due to ample land and property supply, coupled with more price cut from developers and weak demand. Some individual tier 3 or 4 cities imposed a 'two-way policies' by providing stimulus in addition to the existing restrictions, with the purpose of stabilizing their property markets. These cities offered tax subsidies to property buyers and additional support to first-time buyers. Also, they set 'price guidance' and price floors against the price cut provided by developers.

Exhibit 10: Year-on-year Growth Rate of Home Price in 100 Major Cities



Source: WIND, Lianhe Global's calculations

Pilot Property Tax Scheme to Rein in Home Price in Hot Cities

In October 2021, the Chinese regulator announced to roll out a five-year pilot property tax scheme in some regions. According to the announcement by the Standing Committee of the National People's Congress, the scheme will cover residential and non-residential properties. The State Council determines the participating regions, implementation date and other details of this pilot scheme. Shanghai and Chongqing, which have implemented a similar pilot program since 2011, are under the spotlight to be included in this scheme. Also, regions in eastern and southern China are the possible candidates to join this scheme.

We believe the main purpose of the property tax is to rein in the property price in tier 1 and 2 cities. This scheme will also likely diversify and stabilize the sources of revenue for local governments by supplementing and lowering their reliance on the volatile income from land sales. The actual impact on the property market will depend on the tax rate, scope of properties being taxed and other provisions such as exemptions, standard or progressive tax rate model, etc.

C. Review of LGFVs in 10M2021

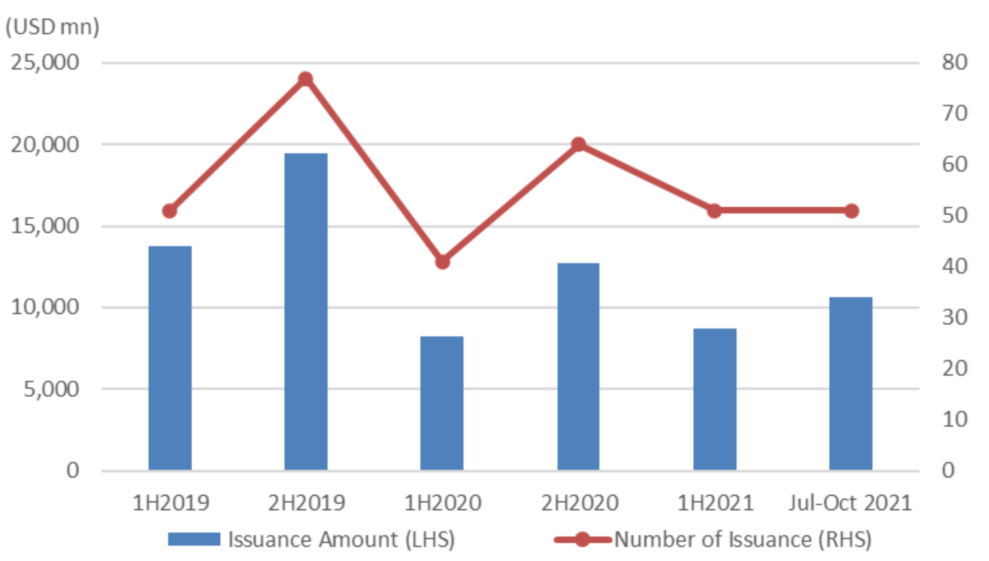
LGFVs' Offshore USD Bond Issuance Has Rebounded since 3Q2021

China LGFVs' offshore bond issuance remained subdue in 1H2021, followed by a recovery since 3Q2021. Investors' sentiment was dampened by a spate of SOE defaults in 1H2021, while LGFVs' bond issuance was hampered by the tightened regulations on local governments' debt managements. Having said that, the credit events in the Chinese property sector lowered investors' risk appetites, which in turn has favored LGFVs' bond issuance since 3Q2021, especially the highly-rated LGFVs. Also, LGFVs' pent-up refinancing demand and the favorable financing cost offshore also led to the rebound in LGFVs' bond issuance in 10M2021.

As a whole, China LGFVs' offshore USD new bond issuance reached USD19.4 billion in 10M2021, increased by 12.1% compared with the same period in 2020 (EXHIBIT 11).

Specifically, the issuance amount reached USD10.6 billion for the four months ended October in 2H2021, which increased by 17.9% and surpassed the amount achieved in 1H2021.

Exhibit 11: Offshore LGFV USD Bond New Issuance Amount and Number of Issuance



Source: Bloomberg and Lianhe Global's calculation

Tightening Regulations to Accelerate Crackdown on Implicit Debts

The central government has taken measures aiming to control and eliminate implicit debts of local governments, which is known as hidden debts. In April 2021, the State Council issued the circular known as "No.5 Document" (国发〔2021〕5 号文), which urged local governments to reinforce their debt managements and resolve the risk of implicit debts. LGFVs were prohibited from raising new debt for repaying implicit debts. Moreover, the central government would allow weak LGFVs to default, liquidate or undergo restructuring. In July 2021, the China Banking and Insurance Regulatory Commission (CBIRC) issued the circular known as "No. 15 Document" (银保监发〔2021〕15 号文). The document prohibited banks and financial institutions from increasing the implicit debts of local governments, as they were not allowed to provide working capital loans to LGFVs with implicit debts and LGFVs' projects that rely on fiscal subsidies as the sole source of cash inflow.

These regulations put pressure on LGFVs' liquidity as their financing channels were narrowed. They encountered tougher restraints for issuing bonds and obtaining loans from banks and financial institutions. Local governments with heavy implicit debt were under more intense pressure.

Divergence of Fiscal Conditions among Different Regions

According to the Ministry of Finance, total new bond issuances by local governments reached RMB5.6 trillion for the first nine months in 2021 (9M2021), decreased by 1.1% compared with the same period in 2020. However, the decrease was narrowed from 4.2% recorded in 1H2021. Similarly, LGFVs recorded a net financing amount of RMB1.73 trillion in 9M2021, representing a decline of 2.6% year-on-year, but the decline was narrowed from 12.9% recorded in 1H2021. At end-September 2021, local governments' total outstanding debt reached RMB28.96 trillion, increased by 13.2% year-on-year. The growth rate was narrowed from 14.2% recorded at end-June 2021.

The fiscal conditions of provinces vary across different regions. At end-June 2021, most of the provinces with large outstanding local governments' debt were located in eastern China, such as Shandong, Jiangsu, Guangdong and Zhejiang. These provinces were also able to record a moderate growth of 5-10% for their debts compared with end-2020. Shandong surpassed Jiangsu to become the province with the highest local governments' debt balance of RMB1.83 trillion. In terms of broad-based outstanding debt, which included both local governments' debt and LGFVs' debt, Jiangsu was ranked first with the outstanding balance of RMB8.7 trillion, driven by its extensive scale of LGFVs and the sizable debt balances of these LGFVs in the province. Zhejiang and Shandong provinces were ranked second and third nationwide, respectively, with the broad-based debt balance of over RMB4 trillion at end-June 2021.

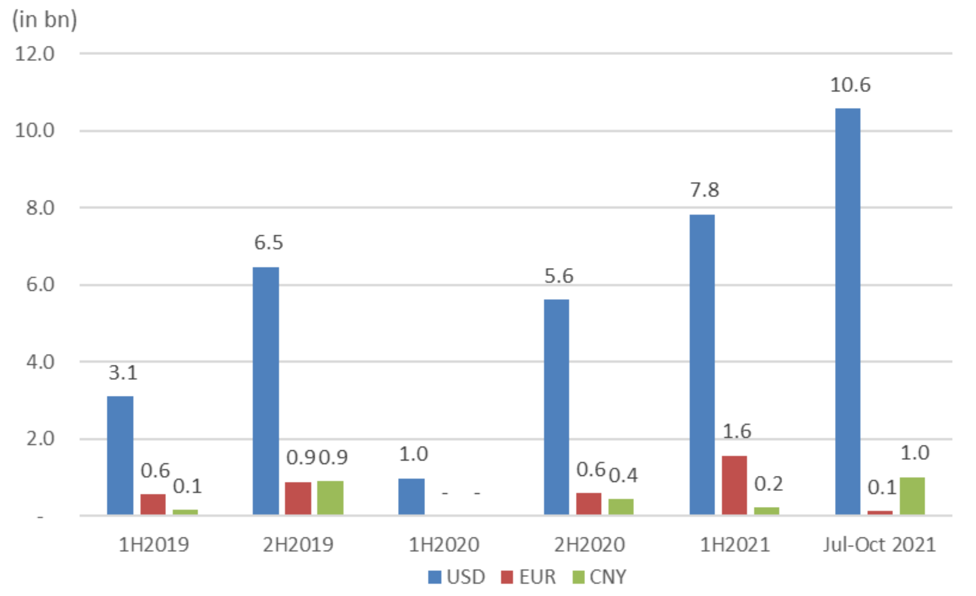
On the contrary, provinces in the northwestern and the northeastern regions generally had low broad-based outstanding debts at end-June 2021, with the regional average balance of less than RMB1 trillion. Some provinces, such as Ningxia and Guizhou, also recorded low growth rate of less than 2% for both their local governments' debts and broad-based debts. Also, some provinces in the northwestern and the southwestern regions, such as Guizhou, Gansu and Qinghai, recorded high broad-based debt ratio, which was defined by the total outstanding debt over the sum of rolling 4-quarters GDP. The high debt ratio reflected tight fiscal conditions and lower debt raising ability for these provinces.

In terms of debt structure, some provinces in the northwestern and the northeastern regions, such as Heilongjiang, Qinghai and Inner Mongolia recorded low and declining proportions of LGFVs' debts to their broad-based debts. Under the backdrop of curbing implicit debts, provinces were relying more on local governments' debts for their financing needs. Therefore, we expect local governments' debt will replace some of the LGFVs' debt and its contribution to the broad-based debt will become more pronounced.

D. Green and Sustainable Bonds

The issuance of green and sustainable bonds, which is developed to address the global climate change, continued to grow rapidly in 2021. For 10M2021, there were 60 Chinese offshore green and sustainable issuances, compared with 18 issuances for the full year in 2020. There were 52 offshore USD green and sustainable bond issuance with the total amount of USD18.4 billion for 10M2021, compared with 16 issuances and USD6.6 billion, respectively, in 2020 (EXHIBIT 12).

Exhibit 12: Offshore Green and Sustainable Bond New Issuance Amount



Source: Bloomberg and Lianhe Global's calculation

The HKSAR government encourages the development of green and sustainable bond markets in Hong Kong. The government spearheaded the effort by issuing USD22.5 billion of green bonds in different currencies and tenors for the next five years, which would help to set a yield curve for the green bond markets in Hong Kong. Following the issuance of USD2.5 billion of green bonds in January 2021, the government sold green bonds of USD1 billion, EUR1.75 billion and RMB5 billion in November 2021. Also, the Hong Kong Government Green and Sustainable Finance Grant Scheme was launched in May 2021 to provide subsidy for eligible bond issuers and loan borrowers to cover their expenses on bond issuances (for eligible first time green and sustainable bond issuers) and external transaction-related review costs.

Hong Kong Quality Assurance Agency (HKQAA), a local government-supported company in Hong Kong, launched the Green Finance Certification Scheme in 2018 to provide third-party conformity assessments for green bond and green loan issuers, so as to enhance credibility and stakeholder confidence in green finance. HKQAA further rolled out the Green and Sustainable Finance Certification Scheme in May 2021, which aimed to promote capital flows towards green and sustainable investments.

In view of the growing momentum and capital flow towards ESG investments, ESG ratings become increasingly important to corporates involving in green and sustainable bond issues. ESG ratings are designed to evaluate corporates' performance and exposure to ESG-related issues. It helps to provide an insight to investors on how corporates are performing on ESG-related issues, which would be crucial to their investment decisions. There is no uniform standard on the rating criteria, so rating providers have its own specific approach and set of criteria in the evaluation process. Some of the ESG rating systems are performance-based, while some of them are risk-based and/or focus on comparability across different industries. Corporates involving in ESG rating scheme are recommended to establish solid ESG policies, governance and management system. These corporates are also recommended to conduct internal review to ensure they achieve their own ESG targets and comply with the rating criteria set by rating agencies.

On the other hand, the risk of greenwashing to tap the growing demand of ESG investments should also be considered. Generally speaking, the greenwashing risk refers to corporates providing misleading or inaccurate information, intentionally or unintentionally, that exaggerate or rebrand their neutral or unsustainable products, practices or investments as “green”. Also, some corporates fail to set appropriate and meaningful ESG targets regarding the proceed raised from their green and sustainable bonds issuance, while some other corporates do not credibly meet those ESG and sustainability targets. Corporates’ greenwashing practice may hurt their corporate images, reputations, creditworthiness and corporate governance. To minimize the greenwashing risk, corporates are recommended to set clear and measurable ESG targets, together with effective executions and transparent disclosure. A growing number of corporates incorporate their ESG strategies into their business strategies, and conduct sustainability reporting in additional to financial reporting.

E. Major Credit Events in 2021

China Fortune Land Development Co., Ltd. (“CFLD”), once a top 20 property developer by contracted sales in China, announced its first missed onshore bank and trust loan principal and interest payments in early February 2021, followed by its second missed principal and interest payments including offshore bonds in late February 2021. CFLD first experienced distress as early as 2018 when it reported a dramatic drop in its cash collection rate to 45%-50% from its contracted sales as a result of an untimely expansion outside the pan-Beijing area when it was hit by a series of draconian policy measures in the region. CFLD also experienced working capital constraints as a result of long government reimbursement periods for its completed industrial park infrastructure projects including primary land development. In 2020, CFLD received another blow with an over 50% drop in its total contracted sales. CFLD’s total contracted sales ranking dropped to 47th place in 2020 from 20th in 2019, according to CRIC. CFLD’s total contracted sales dropped by 65.5% to RMB20.7 billion for the first nine months of 2021. Based on Bloomberg’s information, Ping An Life Insurance Company of China, Ltd. had a 25% equity stake in CFLD at end-June 2021. In early October 2021, CFLD proposed a debt restructuring plan for its c. RMB219 billion debts mainly through asset disposal, debt-to-equity swap and business divesture.

China Huarong Asset Management Company (“Huarong”), one of China’s big four state-owned asset management companies, announced on 1 April 2021 that it would delay in releasing its 2020 results because its auditor was not able to finalize a transaction. On the same day, its stock was suspended from trading in Hong Kong. In August 2021, Huarong reported its 2020 results with a net loss of RMB102.9 billion for 2020, mainly due to the impairment loss of RMB107.8 billion. The shareholders’ equity decreased by 85% year-on-year to RMB18 billion at end-2020. Having said that, Huarong also announced a proposed bailout involving CITIC Group and other strategic investors to replenish its capital. In October 2021, Huarong’s proposed bond issue, asset disposals and other resolutions were approved by its shareholders in the annual general meeting. As a state-owned enterprise (“SOE”), Huarong is perceived to have government support in time of need. Huarong has made good on all of its onshore and offshore bonds so far, but some investors started to have doubts about these so-called strategically or systemically important SOEs. The implication of a perceived weaker link between the sovereign and the SOE runs deep and wide.

Evergrande was one of the top 3 property developers in terms of contracted sales in China and once a prolific issuer in the offshore USD bond market with reported total borrowings amounting to RMB571.8 billion at end-June 2021. At end-June 2021, Evergrande passed one of the three thresholds, but net gearing ratio remained high at 99.8%. Evergrande had RMB161.6 billion of total cash (or RMB86.8 billion of unrestricted cash) against short-term borrowings of RMB240 billion (42% of the total borrowings) at end-June 2021. Evergrande faces a tall order to reduce its debt via debt reduction, asset disposals, as well as spinoff or listing of noncore subsidiaries to shore up its balance sheet. Evergrande disposed its 19.9% stake in Shengjing Bank Co., Ltd at the consideration of RMB9.99 billion in September 2021. However, the disposals of Evergrande's 50.1% stake in Evergrande Property Services Group Limited, its stake in China Evergrande New Energy Vehicle Group Limited and its office building in Hong Kong have not been completed by the end of October 2021. Furthermore, Evergrande's monthly contracted sales dropped to RMB3.65 billion in September 2021, compared with RMB71.6 billion in June 2021. Reuters reported that Evergrande missed two coupon payments for its USD bonds in September 2021, but it made one of them a few days before the end of the 30-day grace period in October 2021, avoiding a default of its USD bond. Nevertheless, according to Bloomberg, Evergrande's interest burden remained high with over USD500 million due before the end of 2021. Evergrande's unsettling news rattled the bond markets, and the notion of "Too Big To Fail" is being re-examined.

Sichuan Languang Development Co. Ltd. ("Languang") once a leading property developer focusing on tier 2 and 3 cities and the Chengdu region now faces a downward spiral since early 2021 due to its reliance on nonbank financing. The developer has started to expand into higher-tier cities since 2015 and it has relied on short-term and nonbank financing such as trust loans to fund its expansion. In May 2021, Languang first experienced stress as a result of cash proceeds from its contracted sales being held at the project company level for construction. Languang defaulted on its onshore debts in mid-July which likely trigger cross-default provisions on the offshore USD bonds. According to Bloomberg, Languang's overdue debts reached RMB21.5 billion at end-September 2021. Languang had unrestricted cash of RMB330 million, or a total cash of RMB10 billion at end-June 2021.

Fantasia Holdings Group Co., Limited ("Fantasia"), a property developer based in Shenzhen and was rated as top 100 property developer in terms of contracted sales, declared that it did not make a payment for the outstanding principal of USD205.7 million due on 4 October 2021. The action represented a shock to the market, as Fantasia has made a number of announcements regarding both repurchase of its senior notes and the purchase of its senior notes by companies owned by Ms. Zeng Jie, its controlling shareholder, between August and September. Fantasia also made a clarification announcement stressing it had sufficient working capital and liquidity with no delay on senior notes repayment in September. Moreover, Fantasia's interim report showed it had an unrestricted cash balance of RMB27.2 billion at end-June 2021. Fantasia's failed USD bond repayment triggered a cross default to its other outstanding USD bond obligations, which aroused investors' concern on Fantasia's repayment capability as well as willingness to repay, and if any asset disposal or restructure plan would take place in future.

Modern Land (China) Co., Limited ("Modern Land"), a property developer headquartered in Beijing and was also rated as top 100 property developer in terms of contracted sales, sought to extend the maturity date by three months on its USD250 million of USD bond due on late October 2021, with the purpose of improving its liquidity and cash flow management to avoid potential default of its bonds. However, Modern Land terminated the solicitation and declared it did not repay either the principal or interest later. At end-June 2021, Modern Land passed 2 out of the 3 redline thresholds, but its net gearing ratio remained high at 93%. It has an unrestricted cash balance of RMB13.6bn to cover its short-term debt of RMB9.3 billion at end-June 2021. Having said that, the solicitation and missed payment aroused investors' concern on whether Modern Land's liquidity has deteriorated during 10M2021. The concern is piled up as another USD bond of USD200 million will mature in February 2022.

Kaisa Group Holdings Ltd. ("Kaisa"), a property developer which experienced default on its USD bond in 2015 and went through debt restructuring, suspended its stock trading in Hong Kong on 5 November 2021. Kaisa declared it was in negotiation for the repayment of the wealth management products guaranteed by its onshore subsidiary. Furthermore, Kaisa estimated its internal resources might be insufficient to repay its USD400 million bond due in December 2021, and thus proposed an exchange offer. However, Kaisa announced the exchange offer would lapse on 3 December 2021, as the minimum acceptance amount was not met. Kaisa will run the risk of a material adverse effect on its financial condition if it fails to meet the repayment obligations of this USD bond.

Lianhe Global does not have any ratings on the aforementioned companies.

Sinic Holdings (Group) Company Limited ("Sinic"), a property developer headquartered in Shanghai and has strong presence in Jiangxi province, made an announcement on 30 September 2021 stating that its subsidiaries failed to pay accrued interest of c. RMB38 million on two onshore financing arrangements on 18 September 2021, and a creditor demanded repayment of the outstanding principal and accrued interests of c. US$75 million on 20 September 2021. Sinic's stock price and bond prices slumped substantially before trading of its stock and debt securities have been suspended since 20 September 2021, which significantly narrowed the possibility of refinancing through any capital market fundraisings. On 11 October 2021, Sinic stated that it would not have sufficient financial resources to repay its USD bond of USD250 million due on 18 October 2021. The probable default of this USD bond would have triggered cross defaults of Sinic's other outstanding USD bonds. Sinic had RMB14 billion of unrestricted cash on a consolidated basis at end-June 2021. However, 79% of Sinic's total debts were repayable within two years, and 31% of its total debts (including 5% of bank loans granted through trust channels) were trust loans and asset managements at end-June 2021.

On 20 September 2021, Lianhe Global placed the 'BB-' global scale Long-term Issuer and Issuance Credit Rating of Sinic on Rating Watch Negative (RWN), reflecting the deterioration in Sinic's access to financing channels and heightened refinancing risk. On 23 September 2021, Lianhe Global downgraded Sinic's issuer and issuance credit rating to 'CCC+' from 'BB-', and continued to place its rating on RWN, reflecting Sinic's imminent refinancing risk, increasing constraints on its liquidity and financial flexibility, and the lack of corporate governance and transparency. On 4 October 2021, Lianhe Global downgraded Sinic's issuer and issuance credit rating to 'D' from 'CCC+', reflecting the overdue payments and/or enforcement action by the creditor led to and/or may lead to technical defaults under certain other existing material financing arrangement of Sinic. On 5 October 2021, Lianhe Global withdrew Sinic's issuer and issuance credit rating for commercial reasons.

Yango Group Co., Ltd ("Yango"), which was ranked 18th in terms of contracted sales in 2020 according to CRIC, reported a decline of both revenue and cash in its quarter result for the third quarter in 2021 (3Q2021). Yango's total cash dropped to RMB27.2 billion at end-September 2021 from RMB40.4 billion at end-June 2021, and it was lower than Yango's current debt as of the same date. 2 out of 12 directors voted against the 3Q2021 quarter result, requiring an explanation for the deteriorating performance. On 1 November 2021, Yango announced it may not be able to repay three of its existing USD bonds, and thus proposed an exchange offer for these bonds. On 18 November 2021, Yango obtained the consent from the majority of bondholders to extend the maturities for all of the three USD bonds, which helped Yango to avoid imminent payment defaults.

On 29 October 2021, Lianhe Global downgraded Yango's issuer and issuance credit rating to 'B+' from 'BB', and revised outlook to Negative, reflecting Yango's deteriorating liquidity position as it faced a tall maturity wall in both onshore and offshore capital markets in the next 6 months, its deteriorating access to financing channels and increasing refinancing risk. On 1 November 2021, Lianhe Global withdrew Yango's issuer and issuance credit rating for commercial reasons.

China Aoyuan Group Limited ("Aoyuan"), a property developer focusing on the Greater Bay Area, had high reliance on JVs and associates for its development projects, as non-controlling interests accounted for c. 65% of Aoyuan's total equity at both end-2020 and end-June 2021. Despite slashing its land purchase spending to c. 12% of cash collection from contracted sales in 1H2021, Aoyuan's liquidity condition remained stretched. Aoyuan's contracted sales dropped by 33% in October 2021, and it had two USD bonds with the aggregate principial of USD688 million maturing in January 2022. In November, Aoyuan announced it planned to dispose interests in certain subsidiaries. Also, Aoyuan disposed properties in Hong Kong for HKD900 million, and obtained extension of redemption date for its ABS in November.

On 12 November 2021, Lianhe Global downgraded Aoyuan's issuer and issuance credit rating to 'BB-' from 'BB+', and revised outlook to Negative, reflecting Aoyuan's increasing liquidity pressure as it faced a maturity wall in both onshore and offshore capital markets in the next 12 months (with a sizable amount in the next 3 months), and its deteriorating access to financing channels and increasing refinancing risk. On 17 November 2021, Lianhe Global withdrew Aoyuan's issuer and issuance credit rating for commercial reasons.

F. Outlook on 2022

Shutdown of USD Public Bond Financings for most of the Chinese Property Developers

Given the substantially wider spread between bond yield and coupon rate, most of the Chinese property developers have been virtually shut out of both the onshore and the offshore bond issuance financings since 3Q2021. Offshore investors, such as fixed income funds and high-net-worth individuals, suffered huge losses in their high yield bond investments, and so it may take time for them to restore their risk appetites and return to the offshore bond markets. Save for any significant change in the bond market sentiment, such as any sign of policy easing from the central government, we believe the prevailing risk-averse stance towards Chinese property developers, especially high-yield issuers, will last at least into the first half of 2022.

Following a number of credit events occurred in 2021, in particular the China property sector, we expect investors to perform more in-depth scrutiny on developers' financial positions in evaluating their credit and liquidity profiles going forward, including but not limited to the following criteria:

- Updated, unrestricted and unconsolidated cash balance (i.e. the free cash balance held in holding company level),
- Offshore cash balance against the offshore debt obligations, especially if the 'green channel' is withdrawn in the future,
- Proportion of trust loan, private debt and other non-standard financing instruments in developers' debt structure,
- Any implicit or private debt not stated in developers' financial statements,
- Mismatch between proportions of minority interest in balance sheet and income statement,
- Maturity profile, especially if there is any bond maturing in near term, and
- Management's response and action, such as repurchase and assurance on fulfilling its debt obligations when the spread between bond yield and coupon rate widens

A number of alternatives are usually offered to bondholders by distressed issuers to avoid a default, such as exchange offer, maturity extension, partial redemption etc. To protect bondholders' interest when issuers are in financial distress, we believe bondholders will pay more attention to bond issuance terms stated in the offering circular, such as the minimum acceptance amount, which is usually represented as a percentage of the outstanding principal amount, for any modification, amendment and wavier of the terms, the events defined under 'Events of Default', the cross-default clauses, etc.

For IG issuers, they are relatively less affected by the credit events. Having said that, the fluctuation of their bond prices and yields would possibly undermine their refinancing capabilities and push up their costs of funding. Therefore, they will also seek diversifying their funding sources apart from debt financings.

We expect any possible turnaround in the offshore USD bond market will hinge on any signal of policy support from the central government. The potential policy loosening would possibly include marginally relaxing developers' sources of financing which eases developers' liquidity pressure, and/or loosening on banks' mortgage approval which facilitates buyers' property purchase. If this scenario happens, we believe IG issuers with solid financial position will be favored by investors. On the contrary, issuers with weak financial positions may need to wait for a significant rebound of their bond prices (i.e. investors' negative sentiment improving), which narrows the spread between bond yield and coupon rates and/or their cost of funding, before they are able to tap bond financing.

Conservative Financial and Operational Strategies Ahead for Property Developers

In view of the tightened regulatory environment and narrowed refinancing channels, we believe the soundness of financial conditions will take priority over scale expansion for most of the developers. In other words, the theme of "fighting for survival" will be more prevailing among developers in 2022. While developers will continue their deleveraging effort to meet the “3 Red Lines” thresholds, some of them will likely seek other alternatives for their financing needs, such as asset disposals, debt restructuring consolidation, private deal for bond issuance, etc. Some developers with financial distress and/or facing maturity walls may carry out more advanced actions, such as corporate streamlining through layoff, pay cut and other cost-saving measures.

In the operation aspect, we identify the declining contracted sales as the major business risk. We expect contracted sales will be stagnant by dropping 10-20% in 2022. As SOE developers and some LGFVs won more land plots in 2H2021, their market shares in term of contracted sales will increase starting from 2022. But generally, developers adopted cautious land acquisition strategies in 2021, so they would face the challenges on maintaining sufficient land bank scale and saleable resource in 2022. The sluggish contracted sales outlook will undermine developers’ profit margin and earnings, and thus heighten the risk of their interest coverage slippage in the medium to long term.

Also, revenue recognition and cash collection lag behind the contracted sales performance. The deteriorating nationwide contracted sales since September 2021 will hit developers’ financial and cash positions in 1H2022. If there is no positive action from the government to gradually remove property purchase restrictions, ease developers’ liquidity stress and restore bond investors’ confidence, the highly-rated developers may gradually run into the same liquidity stress as what the high-yield developers have encountered.

On the positive side, the current industry environment represents opportunities for developers equipped with healthy financial positions. There are more acquisition and consolidation opportunities for these developers to strengthen or improve their market positions, as they enjoy less competition in land auctions and have strong warchest for acquiring projects from developers with financial distress.

LGFVs’ Issuance Influenced by Divergence of Local Governments’ Fiscal Conditions

The central government is determined to settle the risks arising from implicit debt and escalating debt burden of local governments. Given the divergence in fiscal conditions and economic profiles across provinces and regions, we believe the credit polarization among LGFVs will continue in 2022. We are cautious on cities and regions with weak economic profiles, heavy local governments’ debts and negative net financing amounts, particularly some individual provinces in the northwestern and southwestern regions. We are also concerned about the credit risk of LGFVs with heightened short-term liquidity crunch and high proportions of non-standard and/or bond financings.

Under the backdrop of the central government’s initiative to differentiate state support given to LGFVs, we believe the industry consolidation will continue and accelerate. LGFVs with lesser roles in core policy functions, lower visibility of government support and under sponsor governments at lower administrative levels face higher refinancing hurdles and are under higher risk of being consolidated.

The pilot property tax scheme will likely expand the source of revenue for local governments and help supplementing the volatile income from their land sales. Nevertheless, the actual benefits from the property tax scheme remain uncertain, as it will depend on the tax rates, scope of tax, split of tax income between the central and local governments and other details. Also, the income from property tax may be too remote for the relief of imminent financial burden for some local governments.

On the other hand, land sales revenue will likely be affected by certain policy restrictions. The centralized land supply policy implemented in 22 key cities and the restrictions on land premium ceiling will probably limit local governments' income from land sales. Moreover, the nationwide implementation of centralized land sales revenue collection starting from 2022 may weaken local governments' flexibility in their fiscal conditions. Under this situation, investment in infrastructure projects may act as a counter-cyclical measure to the dwindling property market.

Appendix

List of Lianhe Global's Rated Chinese Property Developers

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
Radiance Holdings (Group) Company Limited	BB	Stable
LVGEM (China) Real Estate Investment Company Limited	BB-	Stable
Zhongliang Holdings Group Company Limited	BB	Stable
Yincheng International Holding Co., Ltd.	B+	Stable
Dexin China Holdings Company Limited	BB-	Stable
Redco Properties Group Limited	BB-	Stable
Shinsun Holdings (Group) Co., Ltd.	BB-	Negative
Jinke Property Group Co., Ltd.	BB+	Stable
Agile Group Holdings Limited	BBB-	Stable
Huijing Holdings Company Limited	B+	Positive
Jiangsu Zhongnan Construction Group Co., Ltd.	BB	Stable
Source: Lianhe Global		

List of Lianhe Global's Rated Corporates and Non-Banking Financial Institution (NBFI)

Issuer Name	Long-term Issuer Credit Rating	Outlook
China Hongqiao Group Limited	BB+	Stable
E-House (China) Enterprise Holdings Limited	BB-	Negative
Jiangsu Shagang Group	BBB+	Positive
Lionbridge Capital Co., Ltd.	BB+	Stable
Pujiang International Group Limited	BB-	Stable
Source: Lianhe Global		

List of Lianhe Global's Rated LGFVs

Issuer Name	Province/City	Issuer Rating / Outlook
Liangshan Development (Holdings) Group Co., Ltd	Liangshan	BBB-/Stable
Qingdao City Construction Investment (Group) Limited	Qingdao	A-/Positive
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
Shaoxing City Investment Group Limited	Shaoxing	A-/Stable
Taizhou Huaxin Pharmaceutical Investment Co., Ltd.	Taizhou	BBB-/Stable
Source: Lianhe Global		

List of Lianhe Global's Issuance Rating Actions Year-to-date in 2021

Issuer/Obligor Name	Date	Issuance / Long-term Issuance Credit Rating
Dexin China Holdings Company Limited	2021-01-04	BB-
Zhongliang Holdings Group Company Limited	2021-01-05	BB
CIFI Holdings (Group) Co. Ltd	2021-01-05	BBB-
Redsun Properties Group Limited	2021-01-06	BB-
Logan Group Company Limited	2021-01-06	BBB-
Dexin China Holdings Company Limited	2021-01-06	BB-
Golden Wheel Tiandi Holdings Company Limited	2021-01-06	B+
Sinic Holdings (Group) Company Limited	2021-01-18	BB-
Fujian Yango Group Co., Ltd.	2021-03-08	BB-
Jingrui Holdings Limited	2021-03-16	B+
Logan Group Company Limited	2021-03-31	BBB-
Redco Properties Group Limited	2021-04-07	BB-
Jingrui Holdings Limited	2021-04-21	B+
Yango Group Co., Ltd.	2021-04-26	BB
Redco Properties Group Limited	2021-05-07	BB-
CIFI Holdings (Group) Co. Ltd.	2021-05-10	BBB-
Jingrui Holdings Limited	2021-05-12	B+
Redsun Properties Group Limited	2021-05-17	BB
Jinke Property Group Co., Ltd.	2021-05-20	BB+
Jiangsu Shagang Group Company Limited	2021-05-21	BBB+
China Hongqiao Group Limited	2021-06-01	BB+
E-house (China) Enterprise Holdings Limited	2021-06-02	BB+
Shinsun Holdings (Group) Co., Ltd.	2021-06-03	BB-
China Aoyuan Group Limited	2021-06-15	BB+
Redco Properties Group Limited	2021-06-28	BB-
Agile Group Holdings Limited	2021-07-15	BBB-
Huijing Holdings Company Limited	2021-07-19	B+
Shaoxing City Investment Group Limited	2021-08-11	A-
Yuzhou Group Holdings Company Limited	2021-08-27	BB-
Redsun Properties Group Limited	2021-09-13	BB
Yincheng International Holding Co., Ltd.	2021-09-16	B+
Source: Lianhe Global		

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