NUS INVESTMENT SOCIETY

Fixed Income Department
China Real Estate Industry Research

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Section 1: Introduction

a. Overview of the Real Estate Sector

The market size of the real estate industry in Asia Pacific region is estimated to be valued at USD2.1tn. Typical business models include property development, management, construction, and investment. Depending on the maturity and growth of the real estate company, the company would choose to concentrate or specialize more in development and construction or investment, which may also be reflected in the breakdown of revenue by business segments. It is also very common for real estate companies to maintain a portfolio of operations that deliver diversification of earnings by segment and region, providing a mitigant to property cycles.

The industry or business models of companies can also be classified into certain sectors such as office, logistics, retail, residential, and hotels. Real estate companies may choose to specialize in a single or few of these sectors. Another strategy bigger real estate companies may take is to diversify their business and revenue across all these sectors. This is to mitigate unique risks in the individual sectors.

Many real estate companies have also identified and integrated certain trends into their business model. Some of these trends include urbanization, global infrastructure, funds growth, the ageing population, sustainability, and technology. Certain trends like ageing population are more prevalent in the Asia Pacific region. Many real estate companies will undoubtedly adopt unique and customized business models. Moving forward, real estate business models will definitely evolve to factor in the trends and the changing world. Real estate companies will have to adapt to the changing needs of the world and embrace modern real estate business models.

Sustainability has notably started to be integrated into the business models of many real estate companies in Asia Pacific. More real estate companies are shifting their focus to creating major precincts, new communities, and important civic and social infrastructure. With sustainability being a key theme in the market in recent years, investors are on the lookout for the sustainability commitment of firms. This puts real estate firms that integrate sustainability into their business model at an advantage due to their forefront in sustainability compared to their peers. Additionally, the sector is the largest contributor to greenhouse gasses and global warming. Buildings account for upwards of 40% of global energy use and carbon emissions. The real estate sector is ideally positioned to help reduce impacts and increase resilience to environmental risks.

Some of the key companies (non-exhaustive list) in Asia Pacific include City Developments Limited, Frasers Company, Mitsubishi Estate, New World Development Company Limited, Wheelock and Company Limited, GuocoLand Limited, Lendlease Group, The Ascott Limited, and CapitaLand.

Now, with the move to treat COVID-19 as an endemic and reopening of economies, the outlook is bright for the Asia Pacific real estate market in 2022. There are significant growth opportunities across sectors.

Section 2: China Industry Overview

a. Historical Development of China's Real Estate Sector

China's property market has been a significant driver of the Chinese economy since China began opening its markets in the 1980s. As of 2021, the property market still contributes greatly to the economy, with estimates ranging from 17 to 29% of China's GDP, depending on the scope of the industries included. The boom in the market in the past 30 years was particularly evident in the 1st tier cities.

During the Global Financial Crisis in 2008, China's housing market slowed sharply. In response, the government introduced a CNY4tn (US$585bn) post-financial crisis stimulus package which made it much easier for developers to obtain loans, with lower capital requirements.

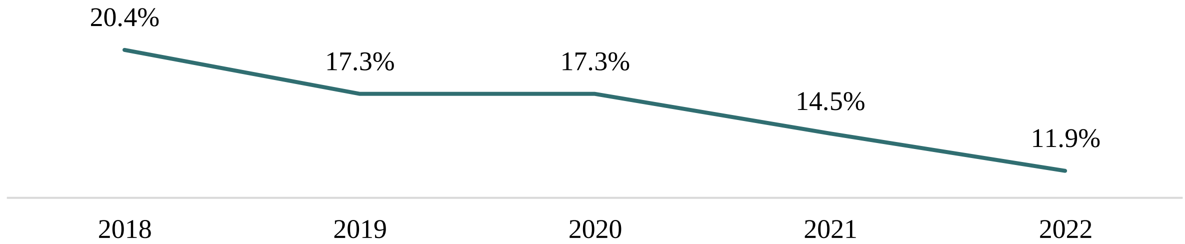
Buyers took advantage of the low interest rate environment and looser lending requirements. Home prices surged – rising by 19.7% in Beijing in and 12.85% in Shanghai in 2013. In 2017, home prices started to cool down due to tightened government measures. For example, the down-payment ratio in Beijing for a second home was raised to a record high of 60% for ordinary homes and 80% for luxury homes. Recognition of a first-home buyer also became stricter – those newly-divorced were considered second-home buyers. Consequently, yearly growth in housing loans slowed by 25.2% in 2017, controlling home prices. Despite this, home prices generally continued on an upward trend and increasingly became more and more unaffordable.

b. Market Size

The Chinese real estate market is valued at about US$55tn (as of October 2021). Its sheer size has dubbed it by some as the most important sector in the world because of the importance it has amassed recently in Asia's growth. Globally, China is also the largest real estate market.

In terms of revenue, there has been a consistent growth in revenue across the market. However, in recent years, this growth is falling as seen from Figure 1, which may indicate that the size of the real estate market is stabilising and not growing as at fast a rate as it used to.

Figure 1: Revenue growth of Chinese Real Estate Market (2018 - 2022)



c. Regulatory Implications and Developments

The 3 red lines policy

The 3 red lines are financial regulatory guidelines introduced in China in August 2020, which restricted developers to the extent which they can take on debt. If the developers fail to meet one, two or all of the 3 red lines, its allowable annual growth in debt would be restricted.

The 3 red lines are as follows:

- Liability-to-asset ratio of less than 70%
- Net gearing ratio of less than 100%
- Cash-to-short-term debt ratio of more than 1x

This policy was introduced against a backdrop of growing debt levels, rising land prices and booming sales. One of the reasons for its introduction was to control home prices – the property market in China has been booming for the past 15 to 20 years, partly attributed to speculative behaviour, which has made property unaffordable for millions in China. Another reason is to control the credit and ensure the sustainability of the real estate market. Such a policy forced deleveraging among real estate developers and reduced their reliance on debt.

The Evergrande crisis

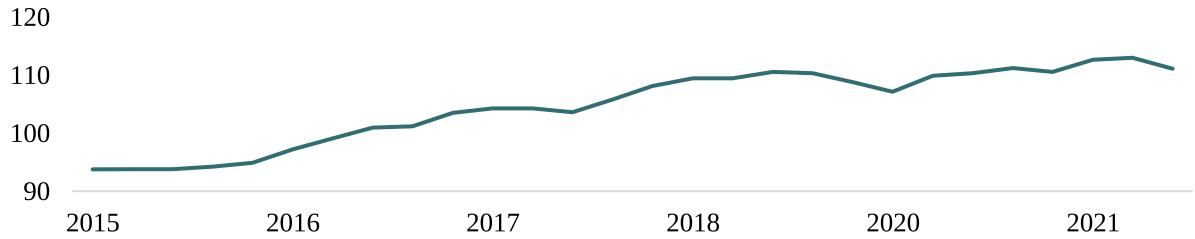
Evergrande is one of China's largest developers, but faced a major crisis as it became the world's most-indebted developer. Evergrande has been highly leveraged for many years. Naturally, the three red lines policy had a devastating impact on the company. At that time, Evergrande had accumulated over US$300bn in liabilities, which included US$19bn in overseas bonds.

In December 2021, Evergrande defaulted on US$1.2bn of its overseas bonds, heightening concerns over the company's ability to repay the rest of its liabilities. Along with Evergrande, many Chinese developers also started defaulting around the same time, signalling a weakening Chinese real estate market. Sinic Holdings Group Co., China Properties Group and Sunac China Holdings Ltd. are some examples of developers that defaulted.

Falling house prices

Home prices in China began to fall in the second half of 2021, following the start of the property market crisis in China. As major property developers failed to repay their debt obligations, confidence in the market dwindled, leading to falling prices, sales and construction. Sales among China's top 100 real estate developers dropped by an average of 3.5% in 2021 from the previous year, with over 80% not reaching their annual sales targets by the end of the year. As seen in Figure 2, although home prices have been on the rise in the past few years, there has been a recent dip in residential home prices towards the end of 2021 and an overall slowdown in growth.

Figure 2: Growth of Real Residential Price Index in China



Government's efforts to tackle the property crisis

Besides negatively affecting homeowners and property developers, the crisis in the property sector also affected local governments as some of their budget comes from the sale of land-use rights, of which property developers are the biggest buyer. Coupled with the pressure to increase spending to stimulate the economy, the liquidity crunch is also felt by local governments.

In response, the central government relaxed the three red lines policy. In January 2022, several developers were notified that merger and acquisition loans were excluded from the calculation of property developers' debt, and allowed them to increase their debt level by 5%. This move would have a substantial increase on developers' liquidity. However, many believe that this alone is not enough to help resolve the property crisis in China.

Another measure the government took was to increase the cap of the number of special purpose bonds (SPBs) that local governments can issue. The idea of this measure is to inject more liquidity and stimulate infrastructure spending. However, it has been noted that local governments were slow to issue SPBs in 2021 due to the shortage of commercially viable projects to fund, affecting the effectiveness of this measure.

Finally, the government imposed a new property tax to prevent speculative activity in the housing market, expanding it to cover tax on real estate for residential use. This step falls in line with the 'common prosperity' drive, as home ownership – or more so investment driven home ownership, is widely considered a source of wealth inequality in China.

d. Key Companies

Evergrande, previously China's largest real estate developer by sales, had to settle for second place, with contracted sales attributable to shareholders totalling CNY 418.5bn in 2021. This is after being knocked out by Country Garden, which saw CNY 557bn in contracted sales in 2021. Maintaining its third place from 2020 is China Vanke, which had a contracted sales of CNY 403bn. Below is the table of the top 10 developers in China by contracted sales in 2020.

Rank	Company	Contracted Sales in 2021 (CNYbn)
1	Country Garden	557.2
2	Evergrande	418.5
3	Vanke	403.2
4	Poly Real Estate	371.6
5	Sunac	361.1
6	China Overseas Land & Investment	346.7
7	Greenland Group	261.3
8	China Resources Land	217.4
9	Gmdale	204.3
10	Longfor Group Holdings	202.9

Section 3: Key Players

a. China Vanke Company Limited

China Vanke Co. (Vanke) is a China-based company principally engaged in real estate development and property management businesses. Established in 1984, Vanke focuses on developing commodity residential housings and is the largest residential real estate developer in China. It mainly operates in China, constantly looking out for investment opportunities overseas. It has already entered eight cities including New York, London, and Singapore. It owns over 400 subsidiaries, some of which are listed, such as Vanke Overseas Investment Holding Company Limited.

Vanke was first publicly listed on the Shenzhen Stock Exchange in 1991, and subsequently also listed on the Hong Kong Stock Exchange in 2014. Currently, its main shareholder is the Shenzhen Metro Group, which holds a 28% stake in the group.

As of 10 December 2020, China Vanke Co. has a market capitalization of CNY229 bn, an enterprise value of CNY523 bn and made a revenue of CNY419 bn in FY2020. This puts the group at a rank of #160 on the Fortune Global 500, only behind 3 other Chinese real estate developers.

The top 10 competitors of China Vanke Co. are Greenland Holdings Corporation Limited, Country Garden Holdings Company Limited, China Evergrande Group, Sunac China Holdings Limited, China Resources Land Limited, China Merchants Shekou Industrial Zone Holdings, Guangzhou R&F Properties Co. Ltd., Agile Group Holdings Limited, CIFI Holdings (Group) Co. Ltd. and Logan Group Company Limited. These competitors are closest in terms of revenue to Vanke in the last 12 months (LTM) – having a revenue ranging from CNY11.8bn to CNY88.3 bn, with Vanke's LTM revenue at CNY70.5bn.

Revenue by Segments
Vanke has 2 main revenue streams by segments – Real Estate Development and Property Services, which took up 95.5% and 3.7% of revenue in FY2020 respectively. This meant that revenue of Vanke from Real Estate Development reached CNY400.5bn, while revenue from Property Services reached CNY15.4bn. Its other businesses include Rental Housing, Hotel and Resort Business, Logistics and Warehousing Services, and the Education Business.

Revenue by Geography
Vanke mainly operates in China. It draws most of its revenue from the Shanghai Area as well as the South Area, which includes the Shenzhen Area and Guangzhou Area. The rest of its revenue is mainly from the Central West Region and the Northern Area (mainly Beijing).

Vanke's overseas business contributed revenue of CNY6.3bn. This amount to a mere 0.09% of its total revenue, highlighting how heavily reliant Vanke is on its domestic market.

Credit Rating
Vanke generally has a strong credit rating, especially against its competitors. As of 10 December 2021, Vanke has a credit rating of BBB+ and has a stable outlook – Fitch affirms Vanke's credit rating at BBB+, which is investment grade, unlike most of its peers. Vanke has held this credit rating since it was first rated by Fitch, further emphasizing its stable outlook.

Moreover, as of May 2020, a distribution of Chinese Developers by credit ratings show that more than 75% of developers are rated high yield.

Vanke has operational advantages from its large scale, strong execution ability and healthy financial profile, which gives it the flexibility to control business risks in China's highly competitive and cyclical homebuilding sector.

Management of Vanke

Mr. Liang Yu has been the Chairman of Vanke since July 2017. He also served as its President from 2017 to early 2018 and was the General Manager for the 17 years before that. Prior to that, he served as Vanke's General Manger from 2001.

The CEO of Vanke is Mr. Zhu Jiusheng, and has held his position since January 2018. He has also served as the executive director of the Group since June 2020. In addition, Mr. Zhu used to work at the Wuhan Jiangxia Finance Bureau of Hubei Province, as well as in the Shenzhen Branch of China Construction bank Corporation Limited.

Shareholders of Vanke

Shenzhen Metro Group Co. Ltd. (SZMC) is the majority shareholder of Vanke – holding a 28% stake. SZMC is a large-scale state-owned enterprise, which leads the construction and operation of rail transit in Shenzhen. It mainly offers rail freight services, but also provides railway track construction, operation, and property management services.

SZMC only became the majority shareholder in June 2017, when it acquired CNY29.2bn worth of shares, or 14% of its shares, surpassing financial conglomerate Baoneng Group.

This 28% is significantly larger than the next largest shareholder, which holds only about 2.2% of outstanding shares. About 27% of Vanke's shares are owned by institutions, 30% by private corporations and the remaining by the public and individual investors.

Financial Analysis

Revenue in FY2021 increased 8% to CNY452.8bn and the net operating cash flow remained positive for 13 consecutive years.

Net profit declined by 45.7% year-on-year in FY2021. There has been an attempt by Vanke Chairman Yu Liang to explain such declines to investors. He said at an online meeting that "some city branches invested rashly, resulting in a decline in gross profit margin". Net profit of Vanke is projected to be positive in the next FY.

b. China Resources Land

China Resources Land Limited ("CR Land") is a property development and investments business unit under China Resources Group ("CR"). CR is a diversified state-owned enterprise in China with five business areas, including consumer products, healthcare, energy services, urban construction and operation, technology, and finance. Established in 1994, CR Land enter the property industry through financial management and control and has evolved into a model of development property and investment property. CR Land accounts for 60% of the revenue by CR, the largest portion as compared to other business units.

CR Land is listed on Hong Kong Stock exchange and has a market capitalization of CNY200 bn at the end of 2021. It is a constituent under the Hang Seng Stock Index as well as one of the blue chips in Hong Kong.

The top 5 competitors of CR Land are China Vanke Group, Longfor Group Holdings, Poly Developments and Holdings Group, China Overseas Land & Investment Limited, Country Garden Holdings Company Limited. These competitors are closest in terms of market capitalization having a range of market capitalization of CNY220 bn to CNY135 bn.

Revenue by Segment
CR land has 4 main business segments, namely, Development Property business, Investment Property business, Asset Light Business Service and Eco-System Elementary Business.

Revenue by Geography
CR Land mainly operates in China. Revenue from property development is drawn mostly from the North China Region which accounted for 22.3%. East China and West China region accounted for 18.0% and 18.8% respectively to property development revenue while the last 4 regions made up about 60% of revenue in property development.

Credit Quality
CR Land has investment grade issuer credit ratings of BBB+/stable, Baa1/stable and BBB+/stable respectively from S&P, Moody's and Fitch. They have remained their investment grade credit rating since April of 2013 after a credit rating upgrade from Baa2 to Baa1 by Moody's. Moody's assigned first time Baa2 rating to CR Land in 2011 due to volatilities inherent in the Chinese property market before the upgrade in 2013. The upgrade in 2013 was then a result of the establishment of a sustainable business model under which the stable income from its investments properties partly offsets its development risk. CR Land's investment grade issuer credit rating has remained since and was recently affirmed by Moody's.

Management of CR Land
Mr Wang Xiangming is currently the chairman of China Resources Group, he was appointed as Chairman of the Board, a non-executive Director of the company and chairman of Nomination Committee of the Company in December 2019. Prior to that, Mr Wang served as the Director and General Manager of China State Construction Engineering Corporation, and the President and Director of China State Construction Engineering Corporation Limited.

Financial Analysis

CR Land has consistently enjoyed positive profits in the last 5 years. Gross profit grew at an average of 8% year on year while net income grew at an average of 14% year on year. CR Land performed well in FY20 as well amidst the various regulatory policies implemented by the Chinese government which has negatively impacted the performance of many Chinese real estate companies including Evergrande. There was indeed a slowdown in growth in FY20 and FY21 with net income growth of 3% and 8% respectively, it was a much better performance than their peers like Vanke which experienced a decline in profits as aforementioned.

Profit margin remained consistently above 15% in the last 5 years with a slight decline in FY20 and FY21. CR land also has healthy Return on Equity (ROE) figures of around 13% to 17%. However, CR land Return on Asset (ROA) figures dropped below 5% in FY18 which is unhealthy especially for a real estate company which should have a greater number of assets on the balance sheet.

Current ratio has remained consistently above 1 at 1.3x which is a positive sign indicating that CR Land has the ability to pay back their short term liabilities with assets on hand. However, quick ratios have been very low over the last 5 years and is below the healthy level of 1. This may indicate that CR Land has high amount of inventory on hand which can be concerning if these are ready inventory.

Debt to equity figures remained around 80% in the last 5 years which shows that CR Land is not over leveraging which gives investors the confidence that they are in a good position to handle their debt obligations. Debt over assets figures remained around 70% which also shows that CR Land have a very good balance between their debt and assets and is not overly reliant on debt for financing.

c. Longfor Group Holdings

Longfor Group Holdings is a Chinese investment holding company that engages in property development, investment, and management business. Founded in Chongqing, China in 1993, Longfor mainly operates in mainland China and Hong Kong SAR. The firm was formerly known as Longfor Properties Co. Ltd., but subsequently changed its name to Longfor Group Holdings in June 2018.

Longfor's has 6 core business arms which include real estate development, property investment, rental housing, space service, housing agency service, and housing decoration. Apart from its main line of business, Longfor has ventured into other fields such as health and elderly care services and city-industry integration.

Longfor was first listed on the main board of the Hong Kong Stock Exchange in 2009. Its largest shareholder is Wu Yajun, who holds a 42.6% stake in the group. She is the co-founder, chairwoman and former CEO of Longfor from 2005 up until 2011.

As of 20 May 2022, Longfor has a market capitalization of HKD242.2 bn, an enterprise value HKD 517bn and a revenue of HKD 261bn in FY2021. It is one of the largest real estate developers in China, and part of the Forbes Global 2000 companies, at number 345 in the 2019 list. The group has also been awarded "Best 10 of Comprehensive Strength of China Real Estate Developers" for 9 consecutive years and has won the "China Charity Awards", the highest-level government award in the field of public welfare and charity in China.

Revenue by Segments
Longfor has 3 main revenue streams by segment – Property Development, Property Investment and Property Management and related services. Property Development is its largest segment and amounted to a revenue of CNY 204bn in FY 2021, constituting 91% of revenue. Property investment and Property Management takes up about 4% and 5% of revenue in FY 2021 respectively.

Revenue by Geography
Longfor obtains all of its revenue from China, drawing an income from a variety of cities. Chongqing, Chengdu and Hangzhou were the 3 cities with the highest revenue streams, with revenues of CNY 22.4bn, CNY 16.8bn and CNY 16.5bn respectively, making up 10%, 7.5% and 7.4% of total revenue accordingly.

Credit Rating
Longfor has a credit rating of BBB, which is investment grade, indicating that expectations of default risk are currently low. The group was first rated In September 2019 by S&P, and this rating has been last reviewed in April 2022, where a stable outlook the company was given.

Fitch's most recent rating of Longfor was also BBB, which was given in December 2021. This rating was a downgrade from Fitch's previous rating of BBB+ in December 2020. Although Longfor generally has a strong financial profile, the impact of the China property crisis may have affected its credit rating as rating firms announced downgrades of the credit ratings of many Chinese developers in 2021.

Management of Longfor

Madam Wu Yajun is the chairwoman and executive director of Longfor. She previously served as the CEO of the group from September 2005 to August 2011 and was a co-founder of the group. Madam Wu also serves as a member of the National Peoples' Congress, Vice-Chairperson of the Federation of Industry & Commerce of Chongqing Municipality and Vice-Chairperson of the Real Estate Branch Chamber of the Chongqing General Chamber of Commerce.

Mr. Chen Xuping serves as the CEO of Longfor since March 2022, and serves as an executive director since August 2021. He joined the group in 2008 and has held various positions including construction manager, project manager and the general manager of property development core business. He also serves as the vice president of the group.

Shareholders of Longfor

Madam Wu Yajun is the largest shareholder of Longfor, holding a 42.6% stake in the group. The next highest shareholder is Junson Development International Limited, which holds a 23.0% stake in the group. Junson Development International Limited is a private company headquarter in British Virgin Islands. Previously, Junson Development held about a 26.0% stake in Longfor, but in January 2019, Junson agreed to sell a total of 150 million shares for aggregate consideration of approximately HKD 3.41 bn through a share placement, reducing its stake in Longfor to around 23.5%.

Overall, 52.3% of Longfor’s share are owned by individuals or insiders, 23% is owned by private corporations while 13.95% is owned by institutions. The rest is owned by public investors. Additionally, Bank of China Group Investment Limited and Talent (China) Investment Management Co. Ltd. also have private ownership in the group.

Financial Analysis

Revenue in FY 2021 increased by 21.0% from FY 2020, from HKD 215.8bn to HKD 262.2bn. This is similar to the increase in revenue from FY 2019 to FY 2020 which was 22.2%. However, this is lower than the revenue growth pre-COVID, which averaged at around 30%. Although revenue levels fell in the years of the pandemic, Longfor did not appear to be severely affected by the Chinese real estate crisis, signifying financial strength. Similarly, net income margins at FY 2021 was 10.7%, which remained close to FY 2020’s 10.8%.

In terms of its liquidity and solvency ratios, Longfor generally has healthy current ratios of about 1.4x addition and a debt-equity ratio of 1.03 as of FY 2021. Compared to its peers, Longfor generally has healthier liquidity and solvency ratios, which puts it in a better position to repay its debt.

Section 4: Key Industry Trends

Policy easing to support recovery of China Real Estate Industry

In 2021, China's government reined real estate developers with stricter financial rules for property development, resulting in a cooling property market. The most prominent policy implemented by China's government is the Three Red Lines policy. It targets debt reduction for property developers by tightening banks' lending limits to those parties, thus forcing developers to deleverage.

Three Red Lines

Metrics of the Guidelines

1. A 70% ceiling on liabilities to assets, excluding advance proceeds from projects sold on contract
2. A 100% cap on net debt to equity
3. A cash to short-term borrowing ratio of at least one

Number of lines violated	Debt growth permitted
0	15%
1	10%
2	5%
3	0%

Chinese Developers and the Red Lines Crossed

0 lines crossed	1 line crossed
Agile Group Holdings	Country Garden
Vanke	CIFI Holdings
2 lines crossed	**3 lines crossed**
Sunshine City	Greenland Holdings
	China Evergrande

China's property market chilled last year as the government's deleveraging campaign triggered a liquidity crisis at some major property developers, resulting in bond defaults and projects being shelved or left unfinished. Investment in China's property sector only logged a 4.4% annual growth in 2021, down from the 7% growth rate recorded in 2020. The number of new construction projects was relatively robust in the first half of 2021, but eventually decreased 11.4% (YoY) at the end of the year, after the strain of regulatory measures started affecting property developers. Due to the outsized importance of China's real estate in the global economy, the change shook multiple domestic and international investors. Property investment is predicted to drop by 3% in the first six months of 2022, compared to a 15% increase during the same period 2021.

At the start of 2022, the sector showed a higher chance of recovery thanks to the policy shift towards China's battered real estate industry. Several policy restraints were removed or reduced in China's Central Bank's quarterly report, signalling an ease on monetary policy. The sector will likely see a partial recovery in the last half of 2022 when more supportive policies will arrive. With the easing of policies, a gradual recovery of the battered real estate sector is likely. However, with the government's emphasis that houses are for living in and not speculation, red-hot growth in the property market may be a thing of the past.

The following are some examples of the policy easing or policy shift. China will postpone trials of a property tax amid fears of further dragging down a slumping real estate market that had been an engine of economic growth. Additionally, there has been growing pressure on the world's second-largest economy from a renewed virus outbreak and geopolitical turmoil. On April 29, Xi Jinping led a meeting of China's top leadership body, the Politburo, encouraging local governments to "optimize real estate policies based on local realities." Local governments may begin to offer more support for property developers. However, it is not clear if regulatory easing will be truly solve the property sector's deep rooted issues, which include years of unsustainable growth strategies based on speculative funding and debt.

Despite many controversies and uncertainties, there are bright spots in China's real estate sector. Transactions in the property market are predicted to pick up after the first quarter of 2022, while investment in the property sector is expected to be recovered after six months. Looking into 2022, reforms in the industry will be continued with more policy adjustments, adding that the government could roll out a new housing policy to support the three-child policy. Regulators have taken steps to provide greater access to funds and stabilize property sales. Commercial banks have begun to process mortgage loans faster and relax their lending policies in the last month of 2021. On a broader scale, the government encourages mergers and acquisitions in the housing sector, in which larger and often state-owned developers will likely take over the less financially stable players. These real estate development groups such as Vanke or China Resources Land are perceived to leverage their connections to access financing from local governments. In the first weeks of 2022, the sector witnessed a spurt in deals from Chinese state-owned firms, in an attempt to rescue cash-strapped private developers. Overseas investors that continue to purchase the high-yield bonds of China's prominent real estate developers in the upcoming future are paying attention to these regulatory trends too.

Policy easing may improve the industry's credit quality. This is more likely in the short term. With the China government's support for Chinese real estate developers, the tight liquidity and tight credit environment will no longer be present. Since it was the liquidity crisis that forced many major property developers into defaults, the policy easing will significantly reduce the frequency and likelihood of major Chinese real estate developers defaulting. This would help gradually gain investors' confidence in China's real estate industry as they are likely to see significantly fewer developers defaulting, especially large or major ones. Additionally, when investors observe that Chinese real estate developers have the support of the Chinese government, they may be reassured. Policy easing will also likely lead to the stabilisation of China's real estate industry, gaining the confidence of investors. In the short run, credit quality of the industry may also improve as companies are less likely to be insolvent. However, in the long run, it is unsustainable to expect policy easing to singlehandedly improve the credit quality of China's real estate industry. Whether the industry can maintain high credit quality is highly dependent on real estate companies not being overleveraged and having high liquidity. There needs to be other solutions at play to maintain high liquidity, prevent real estate companies from becoming overleveraged (China real estate companies being overleveraged historically has a high tendency to happen) and solve this deep rooted issue.

Regulatory easing will not resolve the structural roots of the Chinese real estate sector's problems. The issues that are now plaguing the sector have been long in the making, and include property developers' complacency towards high leverage, as well as their failure to deliver promised housing and thus, a loss of investor confidence.

The government may even exacerbate the problem as the sector is in need of wholesale reform with incentives to deleverage. Policy easing is a temporary and short term solution to the property development industry woes.

Chinese real estate market is expected to stabilise, but recovery may be delayed

Leading developers such as Vanke and Longfor have reported enough liquidity and stable leverage in their latest full-year financials. Moreover, companies should start to see benefits from the ongoing policy relaxation.

Cash flow is also expected to improve from projects once their projects cycles reach a new equilibrium – a release of cash from project's escrow accounts. Leading companies that are surviving have also shown to have conservative liquidity management and an extended maturity profile.

However, prolonged regional lockdowns may continue to take a toll on housing market activities, delaying recovery. Prices of newly built homes in China's biggest cities fell for the sixth straight month in February 2022. Housing activity has continued to remain weak – the sale of new homes dropped 14% on the year by floor space in the January-February period of 2022. This value has been declining since July 2021 as many struggle with the impact of COVID-19 on employment, putting off expenditure on big-ticket items.

In particular, small and midsized cities have faced the brunt of the effects of the pandemic, having been slow to recover economically. Many are also losing residents to larger metropolises, facing dwindling demand for housing.

In terms of its effect on the credit space, it is likely that a slowdown in recovery will dampen the demand for credit in the Chinese real estate market as investors may still have concerns regarding the ability of the firms to pay back. However, in the long run when the market starts to recover, it is likely that the demand will recover as well.

Increased interest in REITS from China's market.

China launched a public REITS market in Shanghai and Shenzhen in June 2021, allowing infrastructure projects from ranging from tollways to sewage plants to be listed as part of an effort to ease debt burden on local governments. The National Development & Reform Commission (NDRC) urged its local bureaus to improve its services and cut red tape so that more infrastructure projects can be listed in the form of REITs. This strongly shows China's push for REITs which can help struggling real estate companies in China. REITs can help infrastructure owners to reduce leverage and mitigate debt risks. Real estate companies can also engage in REITs through the listing projects as a way to diversify their business and create additional revenue flow.

However, the development in this space has been slow with only 11 REITs launched since June 2021. A shortage of quality and profitable projects were reported to be the reason behind the slow development. The Chinese development has vowed to step up infrastructure investment to support the economy which will aid the development in this area and benefit the real estate industry.

These 11 pioneer infrastructure-backed REITs traded in Shenzhen and Shanghai has risen by 30% on average since their debut. That included a 5.2% advance this year itself as of April 2022, while benchmark stock indices in Shanghai and Hong Kong fell by 9.8% and 5.6%

respectively. Performance of these pioneer REITS are encouraging and positive even amidst a sluggish and volatile market in 2022. Hence, REITs is now an avenue for Chinese real estate firms to leverage on for their growth as well as recovery from the regulatory crackdown implemented and the growth in this space is something to keep an eye on.

Section 5: Conclusion

The Chinese real estate industry are showing signs of recovery after the regulatory crackdown implemented in 2021. The recovery is also aided by the Chinese government through the easing of policies in the real estate space. Something we can take away for the outlook of the Chinese real estate industry would be that the high growth property market in China would be a thing of the past. Chinese real estate firms method of employing high leverage to finance and churn projects will not be possible anymore after this correction.