Spring cleaning offers hope for an end to the crisis

Key Highlights

- The China property crisis is far from over with more defaults expected
- However, the cleanup of the sector may be drawing to an end
- There is potential for sector sentiment to improve gradually after the Lunar New Year

The crisis continues

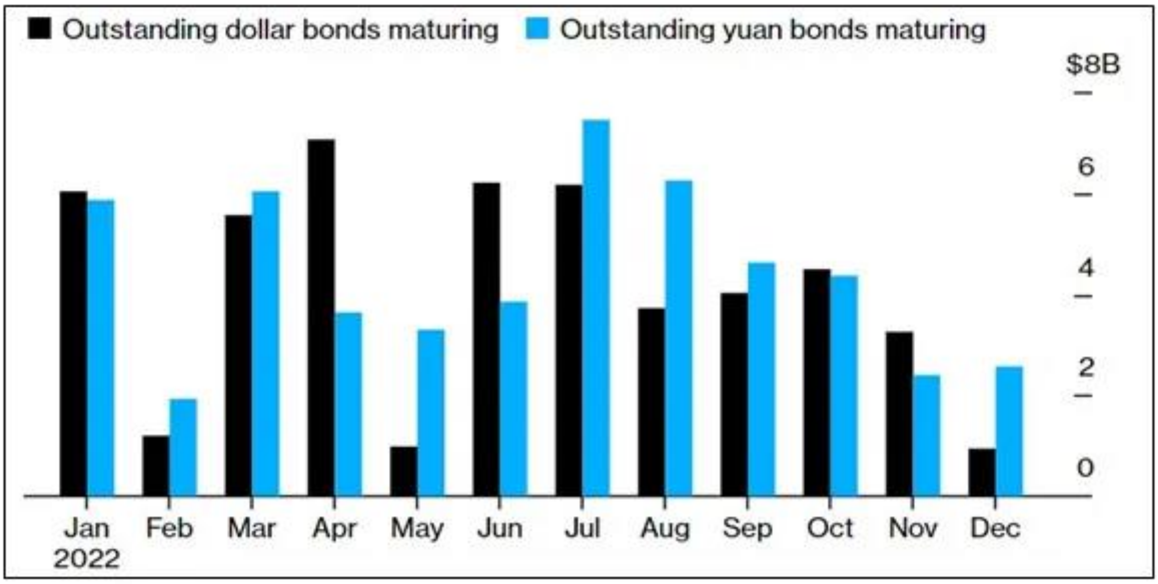
As we move into the second week of 2022, it appears that the China property crisis has still not turned the corner. In fact, despite some recent speculative stock buying, many analysts bleakly note that there remains a mountain of bad news to overcome.

Of immediate concern is, as usual, China Evergrande. Again on the verge of defaulting, this time on its first onshore yuan bond, the company is hoping that bondholders will accept a six-month payment deferral.

Sharing a similar fate is Shimao Group, having unexpectedly defaulted on a trust loan last week and more leveraged than it may have at first seemed. The group had looked to be in reasonable shape given its moderate gearing, thought to be just half of Evergrande's levels. But when contract liabilities are taken into account, its gearing rises to 70 percent, and many worry that there may be more surprises in store. This may help explain this week's reports that Shimao is seeking a buyer for some or all of its real estate projects.

Several more cash-strapped Chinese property developers are waiting in the wings and may yet be forced to take drastic action in the near future. There is, after all, still US$ 90 billion of trust loans to be repaid over the next 12 months. At the same time property sales are falling across the board. In some cases, December 2021 sales have fallen by over 80 percent. Not surprisingly, this has impacted property prices, with averages in large cities on the decline since mid-2021.

Figure 1: Chinese Developer Bond Maturities: 2022



Source: UOBAM/Bloomberg

Piling on to these many uncertainties are plans to introduce a property tax and to dismantle some environmentally damaging projects, including Evergrande's Ocean Flower Island development. Added together, it wouldn't surprise us if there were a further four or five defaults, including by a number of Top-20 property developers.

Pain and gain

And yet, it is possible to be over-pessimistic about this sector. We see some light at the end of the China property tunnel once policy makers have completed their cleanup of current irregularities. The authorities had been prepared to purge its weakest and highest risk players in order to curb speculative accesses. Now, after months of pain, the worst effects of this process may soon be reaching its climax. Some final "spring cleaning" before the Lunar New Year plus the introduction of supportive policy measures could lay the ground for a gradual sector turnaround.

Late last year, top officials including Vice-Premier, Liu He, and People's Bank of China Governor, Yi Gang, started to echo their support for a healthy and stable development of the property sector. This has since been followed up by government calls for banks to offer low interest mortgages, a lifting of restrictions on developer pre-sales activities, and importantly, the launch of housing subsidies. There are reports that 20 third and fourth tier cities will offer a programme of subsidies in an attempt to stem population outflows, and address labour shortages. In some cases, both real estate developers and buyers will receive vouchers to encourage targeted property sales.

SOEs to the rescue

The Chinese government also appears to be taking steps to rescue struggling projects. This month it was announced that borrowings used to fund property mergers and acquisitions (M&As) will no longer be subject to the "three red lines" debt ratio restrictions. This opens the door for state-owned developers, commonly referred to as SOEs, to acquire the assets of embattled private developers. In fact, local governments such as the one in Guangdong are playing an active role in bringing together state-owned and private developers.

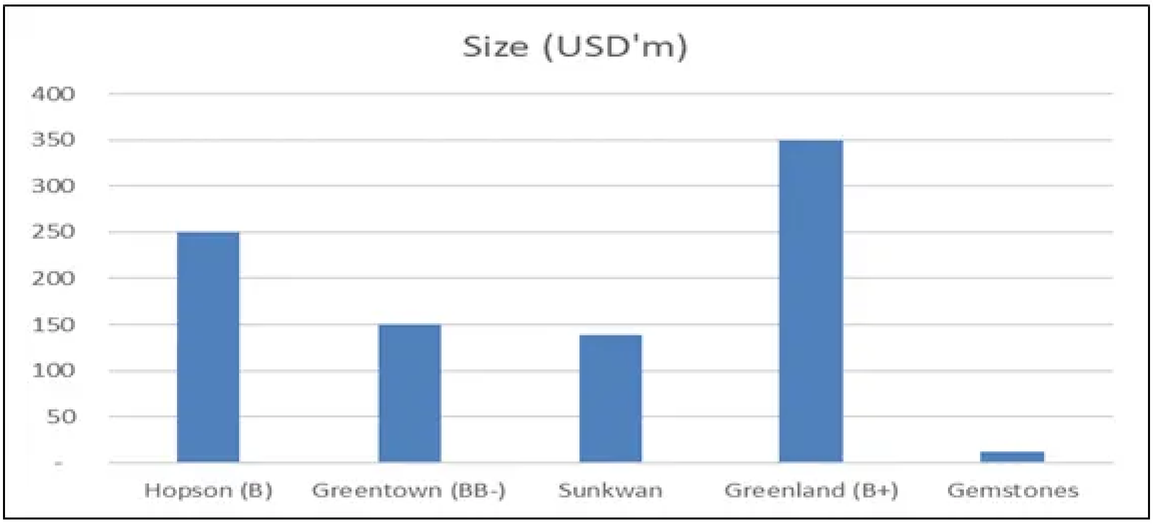
Meanwhile banks are being encouraged to step up their lending to property developers and increase their support of M&A activity in the property sector. When asked about this, Wang Jiang, President of China Construction Bank, expressed his support for this new policy orientation, saying that this was an obvious way to prevent individual developer risks from escalating into systemic risks.

A few green shoots

Within the flailing private real estate sector, there are some increasing signs of life. A number of private developers are starting once again to raise funds by issuing onshore and offshore bonds. In November, Chinese property companies more than tripled their onshore bonds issuances compared with the previous month, in an attempt to raise over 18 billion yuan (US$ 2.83 billion).

Meanwhile, despite a record month for Chinese offshore corporate defaults of over US$ 3.8 billion in December, some property companies proceeded with their offshore bond issuances. A relaxation of financing restrictions suggests that new issues will start to pick up steam, albeit at a restrained pace.

Figure 2: Chinese Developer Offshore Bond Issuances, Dec 2021 – Jan 2022



Source: UOBAM/Bloomberg

While we continue to be very cautious about the Chinese property sector in the near term, we believe that there are selective opportunities going forward, both in the bond and equity markets. Patience is warranted as we expect the clean-up of the property sector to start to pay off later this year.

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