ShoreVest
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China Debt Dynamics

China's Property Support Measures: Rescue, not Reflation

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Over the past few months, China's authorities have rolled out a wave of support measures for the property sector. Their efforts have accelerated since Thanksgiving.

The measures represent a major shift in Beijing's handling of the property sector. Since launching the three-red-lines – a policy designed to curtail borrowing by heavily indebted developers – in mid-2020, China's authorities have remained fairly hands-off in their management of the property development industry's decline. However, the sector's problems have clearly gone far beyond what Beijing is willing to tolerate, and the authorities are now intervening on a massive scale.

However, despite the scale of the resources being mobilized by both the central bank and commercial banks, the support measures aren't stimulus. Nor are they an effort to reflate housing demand. The measures are primarily an exercise in triage – that is, allocating resources to save some parts of the property sector, while leaving others to fend for themselves. Specifically, the measures are designed to:

1. Help keep alive well-run private sector developers that currently don't have adequate access to credit.
2. Help smooth the dismantling of distressed developers by making it easier for well-run developers to buy their assets.
3. Ensure that homebuyers get what they paid for by ensuring that unfinished housing projects can access the funding they need to finish construction.

To truly stimulate the economy, Beijing needs to revive housing demand. Only then will developers have a reason to buy new land and launch new construction projects. However, despite repeatedly cutting mortgage lending rates and reducing minimum down payments for home loans, China's authorities have been unable to convince would-be homebuyers to purchase new housing in volumes necessary to revive the market.

Consequently, this round of property support measures is vital to halting defaults among developers. However, the impact on economic activity will be muted.

The measures

The following is a briefing accounting of the additional financial resources that have been made available to the property sector. Some were officially announced by regulators. Others have been disclosed by the press only.

1. China's six large state-owned commercial banks were asked by authorities to increase lending to the property sector by RMB 600 billion in the last quarter of 2022, and the 12 joint stock banks were asked to increase their lending by RMB 400 billion.
2. Starting August, well managed private sector developers have been able to issue domestic bonds backed by state guarantees. Previously, domestic investors were increasingly unwilling to purchase new bonds issued by private sector developers.
3. In late November, the Big Four banks were told to make offshore loans to help developers repay their dollar-denominated bonds.
4. Also in late November, well-managed developers were granted greater access to funds raised from pre-sales; that is funds held in escrow accounts from the sale of unfinished housing.
5. On November 21, the People's Bank of China (PBoC) said it will lend up to RMB 200 billion at zero interest to commercial banks under a new relending facility designed to fund the completion of stalled housing projects. Separately, Reuters reported that the PBoC will create a new RMB 100 billion relending facility to fund the purchase of bonds issued by developers.
6. In the past few weeks, banks around the country have extended new credit lines to well managed developers.
7. Listed developers are allowed to issue new shares – something they've been barred from doing for years – and the door is open to new IPOs by developers.

The fallout from Beijing's deleveraging efforts has far exceeded anything China's regulators envisioned or planned for. Those efforts, embodied by the three-red-line policy, were supposed to surgically reduce the amount of debt propping up the property sector by going after the most over-leveraged developers.

However, contagion has spread well beyond a handful of firms. Credit conditions are tighter for all developers, but private sector developers – even well-managed firms – have found it increasingly difficult to get adequate funding. Funds from presales, traditionally a major source of cash, have plunged in the face of massively reduced demand for new housing, no doubt partly as a result of the COVID-zero lockdowns which have loosened in recent weeks as we wrote about here. Dozens of defaults have resulted in developers being effectively shut out of the offshore dollar bond market. And mainland bond investors have grown increasingly wary of buying debt issued by private-sector developers.

Even banks have been reluctant to lend. Starting December last year, regulators repeatedly called on banks to increase their support for the property sector. However, 40% of publicly traded banks reduced their outstanding loans to developers in the first half of 2022, with many saying they had pared back exposure to those deemed overly risky.

To preserve China's best private sector developers – those that haven't already defaulted – it's become clear that state support is necessary. The new support measures will not distribute funds equally to all developers. They will mainly go to state-owned developers, those that aren't considered state-owned but nonetheless have significant state ownership (like Vanke), and private sector developers that haven't as yet defaulted on their public debt.

Those developers that have already defaulted on their bonds are unlikely to enjoy much of the new credit being unleashed. To the extent that they do, it will because state-owned developers are being encouraged to borrow in order to buy assets from distressed developers. However, state developers have so far proved reluctant to buy distressed developers' assets, and it's unclear whether more readily available credit will change that.

The package of measures rolled out over the past few weeks are unequivocally good for the property sector, and by extension the economy. However, it doesn't signal the imminent reflation China's housing market or a meaningful boost to economic growth. Nor does it represent a broad-based loosening of credit conditions. It's merely an attempt to keep good developers alive and lessen the disruptive impact of distressed developers as they unravel.

ShoreVest welcomes the news that Beijing is attempting to mitigate the severity of further stresses. Similar to China's move in recent weeks to reverse the prior COVID-zero policies, the government's effort to provide targeted support in the property developer market should boost sentiment after a very difficult 2022 in China.

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