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China: State-Backed Property Bailout Fund

26 Jul 2022, 10:06 AM

Executive Summary

- **China plans to set up a bailout fund to address the distress faced by property developers, according to press reports yesterday.** The bailout fund is said to have an initial target size of RMB 80 bn and will extend liquidity support to 12 property developers.
- **This is not the first time that China has pledged top-down support for developers since the start of the property downturn in 2H21.** In April this year, the People's Bank of China (PBOC) urged banks and asset management companies to extend credit to 12 property developers, including M&A loans. Despite this, property M&A activity remained muted.
- **Nor is this the first government action to address the recent mortgage boycott crisis.** However, this latest central government-backed bailout fund is much larger in scale than the previous local-level bailout funds and could mobilize more resources. If the reported details of the fund are correct, we would see this as a major positive step towards resolving the mortgage boycott crisis and addressing the distress faced by the developers.
- **That said, we continue to believe that a full bailout of the unfinished home projects is unlikely due to moral hazard concerns.** The bailout funds are also unlikely to boost the recovery rates or expedite the restructuring process for holders of the defaulted property bonds.
- **The media has also reported that China's State Council is considering allowing local governments to issue special purpose bonds to acquire housing units from developers and convert them into social rental houses.** In our view, this should provide much-needed liquidity to developers that are experiencing difficulties in contracted sales, and would support local housing markets by lowering housing inventories. However, we do not expect this program to significantly boost housing prices or property demand due to the absence of cash handouts to homebuyers.

Relative Value

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According to press reports yesterday, China plans to set up a bailout fund to address the distress faced by property developers. The bailout fund is said to have an initial target size of RMB 80 bn, comprising RMB 50 bn of funding from China Construction Bank and a RMB 30 bn re-lending facility from the PBOC. The bailout fund aims to extend liquidity support to 12 property developers, namely **Evergrande**, Greenland, Sunac, Shimao, Zhongliang, Risesun, Aoyuan, Yango, Ronshine, Kaisa, Guangzhou R&F, and Jiangsu Zhongnan Construction Group. The fund can be upsized to RMB 200-300 bn.

This is not the first time that China has pledged top-down support for developers since the start of the property downturnin 2H21. In April this year, the PBOC was reported to have held a meeting with the above-mentioned 12 developers, the big 6 banks, 12 joint stock banks and 5 AMCs (asset management companies) to address the liquidity crunch faced by the property sector. The PBOC urged the banks and the AMCs to relax the approval process for M&A loans, support the refinancing of existing debt, approve property development loans (provided the funds are strictly monitored in the developers' escrow accounts), and accelerate the disbursement of mortgages. Following the PBOC's guidance, we have seen a **softening tone** from Chinese **financial institutions** towards the property sector. China Great Wall, one of the big four AMCs, also mentioned in July that it was in discussions with 12 property developers to provide RMB 8 bn of funding to their projects. Local media reported that the list of property developers to receive such liquidity support could be further expanded. However, the pace of such M&A activity has been slow in recent months, as distressed developers were reluctant to sell their better quality assets at a discount. SOEs (state-owned enterprises) and the higher quality developers have also been selective in their acquisitions. For example, China Resources Land stated during its FY21 earnings call that projects acquired through the M&A route must yield a minimum 12% net profit margin.

Nor is this the first government action to address the recent mortgage boycott crisis. A few local governments have set up bailout funds for the problematic residential projects in their respective provinces and cities. However, the reported central government-backed bailout fund is much larger in scale and mobilizes more resources; if true, we would see this as a major positive step towards resolving the mortgage boycott crisis and addressing the distress faced by the developers. We expect the central government-backed bailout fund to be used to provide bridge financing to restart housing construction and to acquire projects from distressed property developers. We also expect the central SOEs, AMCs, banks, and LGFVs to play a major role in asset purchases and debt restructurings of the distressed developers.

That said, we continue to believe that a full bailout of the unfinished home projects is unlikely due to moral hazard concerns; and the bailout funds are unlikely to boost the recovery rates or expedite the restructuring process for holders of defaulted property bonds. Post the news of the bailout fund, China property stocks rallied by 3-10% and China high-yield property bonds were 1-4 points higher, according to market sources. However, in our view, the bailout fund will likely be prioritized to deliver the unfinished housing projects instead of being used to repay property bonds. The bailout funds may help prevent the mortgage boycott from spreading further and contain systemic financial risk, but it is unlikely to immediately reinvigorate housing demand, especially in the lower-tier cities. **We maintain our view that it will take time for any property support measures to trickle down to the physical property market, and the property developers are still deep in the woods.**

The media also reported that the State Council is considering allowing local governments to issue special purpose bonds to acquire housing units from developers and convert them into social rental houses. If true, the special purpose bond proceeds will likely be granted to an LGFV or a government-backed social housing platform to acquire unsold residential properties from troubled developers. The housing units will then be moved to the LGFV/housing platform's balance sheet, generating rental income to service the special purpose bonds and other related project loans. In our view, this should provide much-needed liquidity to developers that are experiencing difficulties in contracted sales, and support local housing markets by lowering housing inventories. However, unlike the last round of shanty town reconstruction in 2015-2018, when local residents were granted cash compensations to purchase new homes, we do not expect this program to significantly boost housing prices or property demand due to the absence of cash handouts to homebuyers.

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