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S&P Global China Ratings

Bank Industry Credit Quality to Remain Stable Amid Calls for More Lending to Property Developers

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On November 23, the People's Bank of China ("PBOC") and the China Banking and Insurance Regulatory Commission ("CBIRC") issued a notice "Providing Financial Support for the Stable and Healthy Development of the Real Estate Market." The notice included 16 guidelines which, in our view, should help stabilize credit quality in the real estate sector. This in turn should play a positive role in maintaining stable credit quality in the banking industry.

We view the banking industry as the key driving force behind maintaining stability in the real estate market. At present, the credit quality of China's banking industry is stable. By the end of June 2022, the total assets of China's banking industry had reached 367.68 trillion RMB, accounting for 90% of China's financial industry and underlining its role as the engine that drives domestic financing.

Looking at the cooperation plans that banks currently have in place with real estate companies, China's mega banks have pledged strong support. To date, disclosed support agreements show that ICBC, Bank of China, PSBC and Bank of Communications have agreed to provide support worth about 655 billion RMB, 600 billion RMB, 280 billion RMB and 120 billion RMB respectively. As a proportion of overall exposures to real estate loans and residential mortgage loans as of the end of June 2022, these support agreements represent 9% (based on the domestic branches' exposures to real estate loans and all mortgages), 12% (based on the mainland exposures to real estate loans and mortgages), 12% and 6% respectively.

While the implementation of the PBOC and CBIRC's latest guidelines may significantly increase the mega banks' exposures to real estate loans, any additional risk exposure is controllable and, in our view, would not have a negative impact on the credit quality of the six mega banks. The mega banks have sufficient capital and strong profitability, with solid foundations in place to act on the new guidelines.

Our sensitivity analysis found that even if loans of the real estate and construction industry have a NPL ratio of 30% and a non-performing loss given default ("LGD") of 70%, the six mega banks' tier-1 capital adequacy ratio would be expected to stay basically unchanged from current levels, since the mega banks' profits are sufficient enough for them to set aside adequate reserves.

The majority of real estate companies to have signed strategic cooperation agreements with the mega banks are investment-grade issuers according to our analysis. We therefore do not expect the new guidelines to have a significant negative impact on the asset quality of the mega banks.

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Table 1

Cooperation Agreements Between Mega Banks and Property Developers

Bank	Developer	Details of Partnership	Amount involved (RMB, billions)
ICBC	Country Garden Gemdale Radiance Greentown Longfor Group Midea Real Estate Vanke and etc. with 12 in total	Bank to meet real estate companies' reasonable financing needs in terms of real estate loans, residential mortgage loans, real estate project M&A financing, rental housing financing, letters of guarantee to replace pre-sale funds in escrow accounts, bond underwriting and investment. Agreement covers planned financing of 655 billion RMB in total.	655
China Construction Bank	China Communications Construction Beijing Capital Development Yuexiu Group Dahua Hopson Longfor Group Midea Real Estate Vanke	Agreements signed with eight real estate companies cover real estate finance, housing leasing, comprehensive financial services, joint risk prevention and mitigation measures.	Undisclosed
Agricultural Bank of China	CR Land Gemdale Longfor Group Vanke China Overseas	Deepen cooperation on real estate loans, residential mortgage loans, M&A loans, bond underwriting and investment. Cooperation to focus on key areas such as residential housing, affordable housing and urban renovation.	Undisclosed
Bank of China	Country Garden Binjiang Real Estate Gemdale Greentown CR Land Longfor Group Midea Real Estate Vanke China Overseas China Merchants Shekou	Agreement covers intended credit lines of more than 600 billion RMB to be provided, cooperation to focus on real estate loans, M&A loans, bond underwriting and investment, residential mortgage loans, letters of guarantee and other business areas.	600

PSBC	Country Garden Longfor Group Greentown Midea Real Estate Vanke	Agreement focuses on real estate loans, residential mortgage loans, M&A loans, bond underwriting and investment, letters of guarantee, supply chain financing and settlement services. Agreement covers total intended financing of 280 billion RMB.	280
Bank of Communications	Midea Real Estate	Agreement covers intended credit lines of no more than 20 billion RMB, the scope of which includes but is not limited to real estate loans, bond investment, M&A loans, letters of guarantee, supply chain financing, etc.	20
	Vanke	Agreement covers intended credit lines of no more than 100 billion RMB, the scope of which includes but is not limited to real estate loans, residential mortgage loans, M&A loans, letters of guarantee, supply chain financing, bond investment, etc.	100

Source: Public information, collected and adjusted by S&P Global (China) Ratings.

The new guidelines aim to support the reasonable financing needs of homebuyers and provide financial services with the aim of ensuring housing projects are delivered. This should help maintain healthy demand for banks' mortgage business and prevent a deterioration in mortgage loan quality caused by the lack of supply of uncompleted housing projects.

While the guidelines include an extension to the grace period outlined under the real estate loan concentration management policy, in the medium and long term, oversight of real estate loan concentration should be tightened to ensure stability of the credit quality of China's banking industry.

International experience shows that real estate development is a high cyclical and high-risk industry. High concentration and high leverage have been major factors behind risk events at many global financial institutions. Only those banks that manage real estate risks well can maintain good credit quality for a long time.

While China's real estate crisis has been serious in the past year, the overall credit quality of China's banking industry is still stable. One of the main reasons is that domestic banks have limited exposure to real estate loans (about 7% of total loans).

In addition, the guidelines call for support of reasonable extensions to outstanding real estate loans while safeguarding creditors' rights. This may have an impact on the market's ability to accurately gauge actual risk among financial institutions in the short term. The guidelines stipulate that should a loan mature within the next six months, it can be extended for one year, and can remain in their original category under the loan classification system. Therefore, the five-category classification of real estate loans disclosed by banks in the next year may not fully reflect the loans' actual quality.

The guidelines call for more support for quality real estate companies. For this reason, high-risk companies that have already seen credit events may not be able to resort to these new guidelines to redress their problems.

With regard to those at-risk distressed companies, some banks (especially certain joint-stock banks and regional banks) still face credit cost pressure. Our sensitivity analysis found that should the non-performing loan ratio of the real estate and construction industry rise to 30%, assuming that the non-performing LGD is 70%, there would be four joint-stock banks facing capital adequacy pressure. That is to say, without external support, their capital adequacy ratios would not reach regulatory minimum requirements.

Of 82 major regional banks, 28 small and medium-sized lenders would have tier-1 capital adequacy ratios below 8.5%. Many small and medium-sized banks face capital pressure because their problem loans to other industries already weigh heavily on their capitalization. Should such pressure overlap with real estate risk, those banks would soon find themselves with insufficient capital adequacy ratios under our stress scenario.

Looking ahead, some small and medium-sized banks are set to continue facing pressure from the real estate industry, but strong government support has given banks added time to properly resolve risk.

In November 2022, Evergrande announced that Shengjing Bank had sent an enforcement notice for unrecoverable debts owed of 32.6 billion RMB. However, the bank disclosed in its 2022 interim report that its non-performing real estate loans were only 1.5 billion RMB. Therefore, we expect even greater pressure on the bank in terms of its loan classification and provisioning for loan credit losses in the future, with real estate exposure more likely to cause capital erosion.

Meanwhile, in 2021 Evergrande Real Estate Group (Nanchang) Co., Ltd. sold 20.26% of its equity in Shengjing Bank to Shenyang Shengjing Finance Investment Group Co., Ltd. As of the end of 2021, the single largest shareholder of the bank was Shenyang Shengjing Finance Investment Group Co., Ltd. (the actual controller is Shenyang SASAC), with a shareholding ratio of 20.79%. In September 2022, Evergrande transferred all of its remaining equity in Shengjing Bank to a consortium of seven enterprises, including Shenyang Heping District State-Owned Assets Co. Ltd. and Liaoning Guoke Industrial Co., Ltd. In our view, the capital support provided by the local government and relevant SOEs to Shengjing Bank has given the bank the time and opportunity to resolve its risk exposure to Evergrande.

In addition to the banking industry, the PBOC and CBIRC guidelines also encourage specialized credit enhancement agencies and asset management companies ("AMCs") to add their support to the industry in terms of financing and risk mitigation. However, compared with the banking industry, we believe the capital of credit enhancement agencies is limited. A significant increase in real estate exposure would heighten leverage and industry concentration risks for credit enhancement agencies. As of the end of September 2022, the equity of China Bond Insurance Corporation, one such specialized credit enhancement agency, was 10.9 billion RMB while the equity of the six mega banks was 13 trillion RMB.

China's "Big Four" AMCs have accumulated rich experience in dealing with various types of non-performing assets for many years. We expect them to play an important role in risk resolution for real estate non-performing assets. Their own expertise in efficient disposal of real estate bad debt is expected to be especially useful. However, in terms of providing financing support, we believe that AMCs already face significant asset quality pressure. This weighs on their capital adequacy, limiting their capacity to significantly increase financial support to the real estate industry.

This report does not constitute a rating action.