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S&P Global

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Land Transfers Under Pressure: Zhejiang and Jiangsu LGFV Deep Dive

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Key Takeaways

- In our view, cities in Jiangsu and Zhejiang generally have good support capacity for LGFVs. However, differences in debt and economic and financial strength can lead to uneven support from region to region. Zhenjiang, Lianyungang, Suqian and Yancheng have heavy debt burdens, while Zhoushan's economic strength is relatively weak. For these cities, indicative support capacity lags behind the rest of the region, and is weaker than the national median level.
- We found that LGFV bond spreads in Jiangsu and Zhejiang are generally lower than the national average level. This is particularly the case in Zhejiang.
- In our view, cities with heavy debt burdens, high fiscal reliance on land transfer revenue and significant exposures to declining land transfer activity have been hit particularly hard during this stage of the cycle. Such cities are typified by Yancheng, Taizhou, Huai'an and Zhoushan. LGFVs in these cities generally have weaker credit quality, but given low bond spreads, valuation risks should be closely monitored.

Overview of LGFV Credit Quality in Jiangsu and Zhejiang

Jiangsu Province

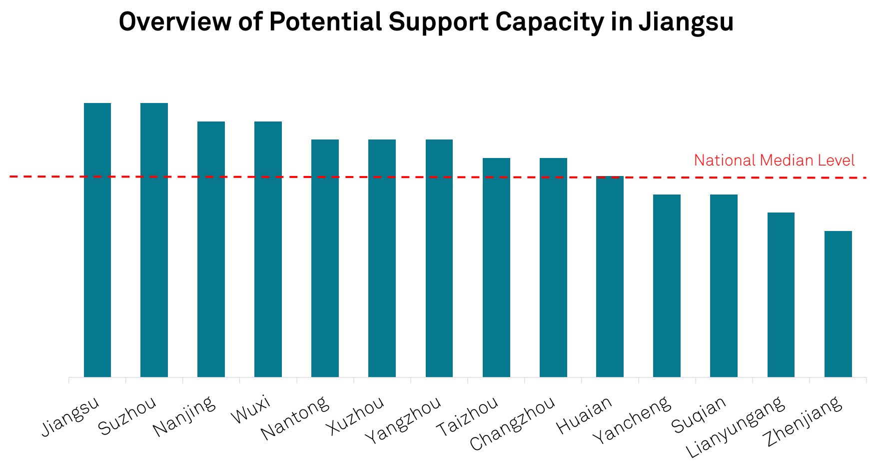
Given Jiangsu's strong fiscal position, we believe the region has strong potential support capacity. This potential support is however somewhat limited by the region's high debt level. Within the province, we believe differences exist between the support capacities of different cities, mainly due to the wide variation in cities' debt ratios.

Jiangsu has been at the forefront in terms of economic development for many years, and is one of China's most developed provinces. Its total economic volume has long ranked second among provincial-level regions, with a particularly strong fiscal position. Among prefecture-level cities, there are clear differences in terms of economic and fiscal development. In 2021, Suqian and Lianyungang achieved GDP of more than 300 billion RMB and general public budget revenue of about 27 billion RMB. While there is a clear gap between Suqian and other provincial cities, it is still at a relatively good level on a national scale.

In our view, the main factor that limits Jiangsu cities' potential support capacity is high debt ratios. The cities' large number of LGFVs and significant debt piles have pushed the debt ratios of most

Jiangsu cities to a high level. Debt in Yancheng, Lianyungang, Suqian and Zhenjiang is at a high or very high level among China's prefecture-level cities. For this reason, we believe these cities' potential support capacities are weaker than the national average.

Chart 1



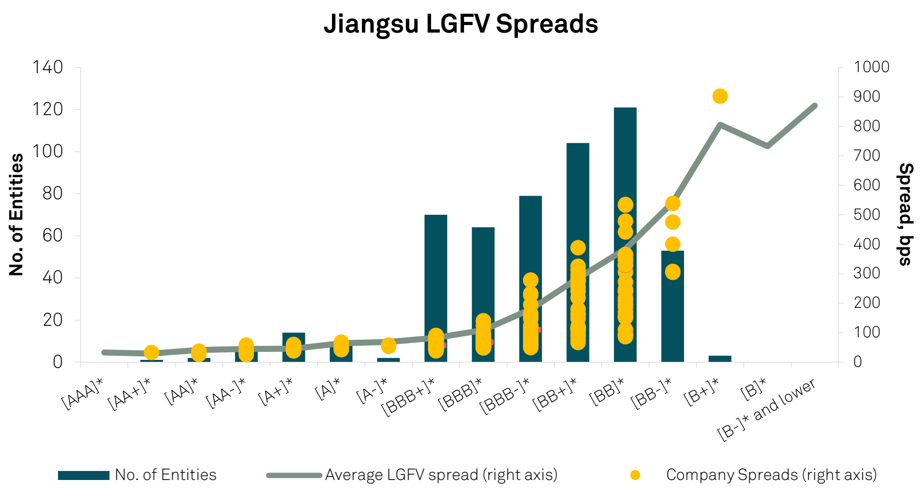
Source: S&P Global (China) Ratings.

Given the large number of LGFVs in the province, we believe indicative issuer credit quality varies among LGFVs in the region. For weaker LGFVs, indicative issuer credit quality is relatively weak. We conducted a desktop analysis of 389 LGFVs in Jiangsu with publicly available information. Indicative issuer credit quality generally varies from [BBB_{spc}+] to [BB_{spc}] categories. A minority of weaker LGFVs are at [BB_{spc}-] and [B_{spc}+] categories, mainly due to the large number of LGFVs in certain regions, districts and counties.

We note that for certain counties, population and area are limited. Economic development and growth opportunities are both fairly average. However financing demand is large, resulting in the region having many LGFVs, with significant business overlap. This impacts on their potential importance to the local government. There aren't many LGFVs at [A_{spc}-] category and above. Those that are at such a level are usually municipal-level LGFVs or located in stronger districts and counties in top cities, with fewer rival LGFVs in the same jurisdiction.

At the same time, given Jiangsu's economic and fiscal strengths and the province's good regional debt management system, investors have strong confidence in Jiangsu LGFVs. This is reflected in their lower bond spreads compared to the national average for LGFVs at the same level.

Chart 2



Note: The spreads in this chart are average spreads for all LGFVs tested by S&P Global (China) Ratings on October 31, 2022. Company spreads are calculated by subtracting the estimated value of the company's bonds from domestic treasury yields over the same period, resulting in the average spread of the company's bond.
*The indicative issuer credit quality distributions expressed in this report are only our indicative views of credit quality derived from a desktop analysis based on public information. We have not carried out any interactive review or other forms of interactive communication with any particular institution, nor a full credit rating process such as a rating committee for the review and handling of the indicative issuer credit quality distributions expressed in this report. The opinions expressed herein are not and should not be represented as a credit rating and should not be taken as an indication of a final credit rating on any particular institution.
Source: Wind, ChinaBond, S&P Global (China) Ratings.

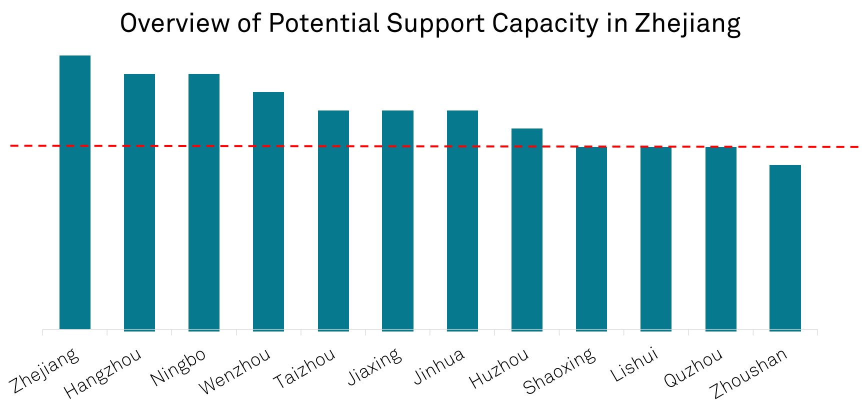
Zhejiang Province

In our view, Zhejiang's economic and fiscal strengths are at a leading level nationwide. Overall debt is moderate, and potential support capacity is very strong. While Zhejiang cities vary significantly in terms of economic and fiscal strengths, there is little differentiation in potential support capacity. Zhejiang's economic strength has ranked fourth among provincial-level regions for many consecutive years, and its fiscal strength is also in a leading position.

While Zhejiang lags slightly behind neighboring Jiangsu in terms of economic output, its debt level is significantly lower, and support capacity is very strong and higher than Jiangsu. There is clear differentiation in the economic strength of Zhejiang cities. Hangzhou's GDP (1,819.9 billion RMB in 2021) and general public budget revenue (238.7 billion RMB in 2021) are both ten times that of Lishui and Zhoushan, cities at the average level for prefecture-level cities in China (the latter's GDP and general public budget revenue were 170.4 billion RMB and 18.1 billion RMB).

While Lishui and Zhoushan lag behind other cities in the province in terms of economic and fiscal strengths, their lower debt ratios or better fiscal balances mean they still have strong potential support capacity, on a par with the national average. In contrast, Shaoxing and Huzhou, two cities in Zhejiang with stronger economic and fiscal positions have reasonable government debt burdens. But because the cities have a high number of LGFVs and significant LGFV debt burdens, their potential support capacities are weaker as a result.

Chart 3



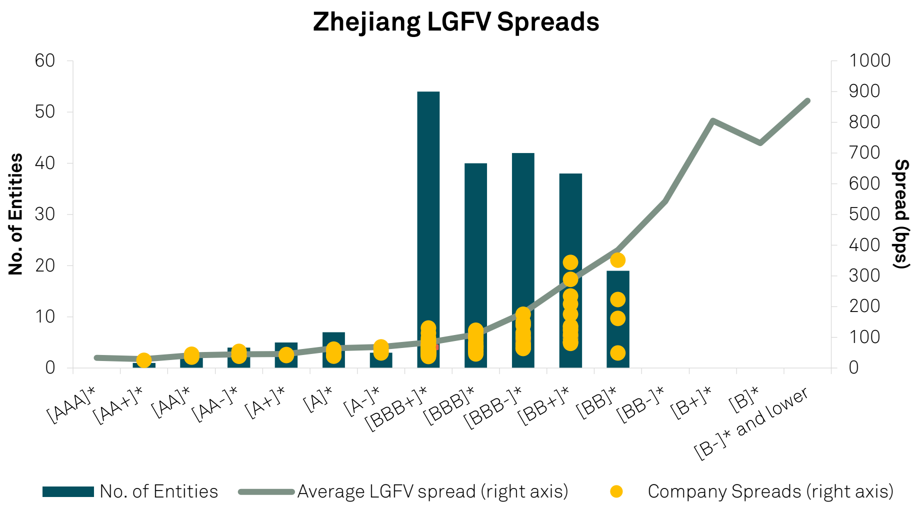
Source: S&P Global (China) Ratings.

While there is some differentiation in LGFVs' indicative issuer credit quality in Zhejiang, weaker LGFVs still have healthy indicative issuer credit quality, with good market recognition, access to refinancing, continuous net financing cash inflows and low financing costs. We conducted a desktop analysis of 215 LGFVs in Zhejiang, using publicly available information. Most range from [BBB_{spc}+] to [BB_{spc}]. The majority are district and county-level LGFVs, and a minority are at or below [BB_{spc}-] category.

Although cities like Zhoushan and Lishui have smaller economic and fiscal positions, their debt burdens are moderate and support capacity is still at a good level, and they don't have a large number of LGFVs. Lower-level LGFVs may still receive some government support, and the weakest LGFVs in the province still have fairly high indicative issuer credit quality.

There aren't many LGFVs in Zhejiang with indicative issuer credit quality of [A_{spc}-] and above. Such LGFVs are generally higher-tier entities in developed districts and counties in top cities, with few rival LGFVs in their jurisdiction.

Chart 4



Note: The spreads in this chart are average spreads for all LGFVs tested by S&P Global (China) Ratings on October 31, 2022. Company spreads are calculated by subtracting the estimated value of the company's bonds from domestic treasury yields over the same period, resulting in the average spread of the company's bond.

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Source: Wind, ChinaBond, S&P Global (China) Ratings.

We found that due to the strong economic and fiscal strength and low debt ratio of Zhejiang Province, LGFVs in the province have very high market standing. Bond spreads for Zhejiang LGFVs are generally lower than the national average for LGFVs of the same level.

Which Areas are More Exposed to Declining Land Transfer Activity?

Given the ongoing downturn in the real estate industry, we note that land transfer revenue in all provinces has generally declined since 2022. For Jiangsu and Zhejiang, revenue from government funds has also declined significantly. From January to June 2022, nationwide revenue from government funds was 2,796.8 billion RMB, down 28% YoY. For Jiangsu and Zhejiang, government fund revenue was 320.9 billion RMB and 399.5 billion RMB, down 34% and 22% YoY respectively.

In our view, the sharp decline in land transfer revenue may impact on government support for LGFVs. On the one hand, land transfer revenue is an important revenue source for local governments. Declining land transfer revenue puts greater pressure on local governments' fiscal revenues, and pushes up the regional debt burden. On the other hand, land transfer revenue is, alongside government subsidies, an important source of funds collected by LGFVs. Declining land transfer revenue may force governments to reduce their corresponding expenditures, impacting on the cash inflow that LGFVs can obtain.

In our view, the pressure on land transfer revenue impacts on potential support for LGFVs in different ways. At a regional level, the impact during this current phase of the cycle would be felt hardest in cities with heavy debt burdens and high fiscal dependence on land transfers. This is especially the case in those cities that saw significant declines in land transfer revenue over 2022. Pressure on LGFVs' credit quality would be even greater in such regions.

Considering the three criteria of land transfer revenue dependence, debt ratio and land transaction amount, we selected the most seriously impacted cities among 24 prefecture-level cities in Jiangsu and Zhejiang. These included Yancheng, Taizhou, Huai'an and Zhoushan.

Table 1

Prefecture-level City	Province	YoY Change in Land Transaction Price	2021 Reliance on Land Transfer Revenue	Regional Debt Ratio 2021	2022 Estimated Fiscal Resources (RMB 100 million)	Bonds Maturing Within 1 Year (RMB, 100 million)	Coverage Ratio of Fiscal Resources to Bonds Maturing Within 1 Year (2022)
Time of Data		Jan-Sep 2022	2021	2021	2022	End of October 2022	End of October 2022
Yancheng	Jiangsu	-76%	64%	524%	646	514	1.26
Nantong	Jiangsu	-72%	67%	396%	1,110	621	1.79
Huai'an	Jiangsu	-68%	57%	726%	424	388	1.09
Xuzhou	Jiangsu	-66%	66%	333%	893	385	2.32
Taizhou	Jiangsu	-64%	62%	557%	665	529	1.26
Jinhua	Zhejiang	-63%	76%	184%	1,072	320	3.35
Changzhou	Jiangsu	-63%	68%	357%	1,230	657	1.87
Zhoushan	Zhejiang	-56%	44%	595%	244	110	2.21
Lishui	Zhejiang	-56%	59%	332%	440	124	3.53
Suqian	Jiangsu	-56%	69%	262%	326	46	7.05
Quzhou	Zhejiang	-55%	66%	407%	642	328	1.96
Yangzhou	Jiangsu	-55%	66%	530%	1,127	518	2.17
Shaoxing	Zhejiang	-52%	69%	227%	1,374	169	8.12
Wenzhou	Zhejiang	-49%	75%	218%	410	92	4.46
Nanjing	Jiangsu	-46%	59%	350%	3,072	1356	2.27
Jiaxing	Zhejiang	-43%	60%	334%	1,253	293	4.28
Wuxi	Jiangsu	-36%	51%	277%	1,980	625	3.17
Suzhou	Jiangsu	-31%	48%	219%	4,103	1032	3.98
Huzhou	Zhejiang	-25%	61%	618%	897	346	2.59
Zhenjiang	Jiangsu	-21%	55%	739%	640	449	1.42
Taizhou	Zhejiang	-8%	51%	277%	4,656	675	6.89
Hangzhou	Zhejiang	-8%	60%	335%	1,075	150	7.15
Ningbo	Zhejiang	-1%	48%	239%	3,302	487	6.79
Lianyungang	Jiangsu	13%	49%	579%	572	216	2.65
Median		-53%	60%	343%	985	386	2.62
Average		-44%	60%	401%	1,340	435	3.48

Note: 1. Our interpretation of change and range of land transfer revenue based on change in total price of land sold in each prefecture-level city; 2. Dependence on land transfer revenue = government fund revenue / (general public budget revenue + government fund revenue); 3. Regional debt ratio = (interest-bearing LGFV debt + local government debt) / (general public budget revenue + projected government fund revenue); 4. Estimated fiscal resources for 2022 assumes general public budget revenue is unchanged from 2021, estimated annual government fund revenue based on decline in land transaction prices from January to September 2022.

Source: Wind, local government budgets, S&P Global (China) Ratings.

Table 2

Prefecture-level City	Economic Position	Fiscal Position	Debt Level	LGFV Overview
Yancheng	Very strong	Good	Very high	Many LGFVs in county-level and national-level (and below) industrial parks. Relatively scattered strategic roles among LGFVs in some regions.
Taizhou	Very strong	Excellent	High	Rapid industrial park debt growth, with mutual guarantees commonplace among LGFVs.
Huai'an	Very strong	Excellent	Very high	Regional debt is very high, and weak economic and fiscal positions at the district and county level. High number of LGFVs with significant business overlap.
Zhoushan	Strong	Excellent	High	Potential support capacity is weak compared to the rest of the province. Fewer LGFVs, but debt scale is large.

Where lower-tier LGFVs with low bond spreads face ongoing regional financial pressure, spread differentiation may widen further

As mentioned above, there are many cases in Jiangsu and Zhejiang of low-tier LGFVs having bond spreads lower than the average value found by our testing. Among them, Yancheng, Taizhou, Huai'an and Zhoushan have high debt levels and leverage, high reliance on land transfer revenue, and have seen obvious declines in land transfer revenue. There is a mismatch between these cities' LGFV bond spreads and regional risks. If local financial pressure does not ease off, local governments' support capacity may be affected. This would see risks rise for weaker LGFVs in those cities, leading to widening debt spreads.

This report does not constitute a rating action.