

Real Estate Developers with High Leverage to See Inventory Quality Tested Under Broader “Three Red Lines” Policy

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In our view, the widening of regulations aimed at controlling real estate developers' interest-bearing debt would further reduce the industry's overall credit risk in the long term. However, the nearer term may see less headroom for highly leveraged developers to finance in the capital market, pushing them to sell off inventory to ease liquidity pressure.

The People's Bank of China said in September that measures aimed at monitoring the funding and financial management of key real estate developers will steadily be expanded. Media reports suggest that the new regulations would see a cap of 15% on annual growth of interest-bearing debt for all property developers. Developers will be assessed against three indicators, which are called “red lines”: whether asset liability ratios (excluding advance) exceeded 70%; whether net gearing ratio exceeded 100%; whether cash to short-term debt ratios went below 1.0. Developers which breached all three red lines won't be allowed to increase their debt. If only one or two of the red lines are breached, such developers would have their interest-bearing debt growth capped at 5% and 10% respectively.

The first half of the year saw debt grow rapidly among developers. In a sample of 87 real estate developers that we are monitoring, more than 40% saw their interest-bearing debt grow at a faster rate than 15% year over year as of the end of June (see the chart below). If the proposed financing regulations are implemented on a larger scale, developers may no longer be able to develop their business through aggressive debt expansion, no matter their current leverage level.

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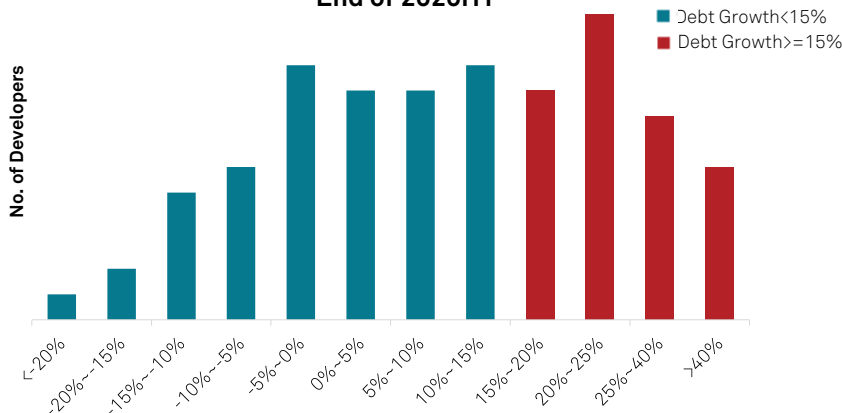
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Chart 1

Distribution of Sampled Developers' Debt Growth YoY by End of 2020H1



Note: YoY--Year on Year.

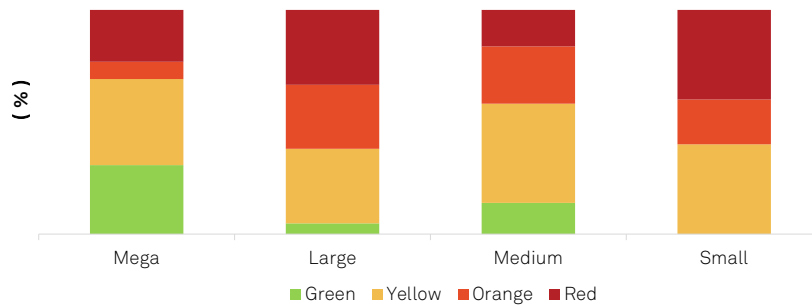
Source: Wind, S&P Global (China) Ratings.

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Developers with high leverage that are touching the "red line" will have less room for debt expansion and may have to resort to their existing resources to grow their business. In other words, a rapid sell-off of inventory leading to an uptick in sales or accelerating the cash collection from sales. 24.1% of our sample developers touched all three red lines, and only 12.6% of the sample developers steered clear of the lines at all (see the chart below).

Chart 2

"Green" Mega Developers Account for the Highest Proportion



Note: Using data as of June 30, 2020, we assign sampled developers four colors -- Red, Orange and Yellow developers breach three, two and one of the regulatory lines respectively. "Green" developers pass all three. "Mega" developers had consolidated sales over 100 billion RMB in 2019, "large" developers 50-100 billion RMB, "medium" developers 10-50 billion RMB and the rest are "small" developers.

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

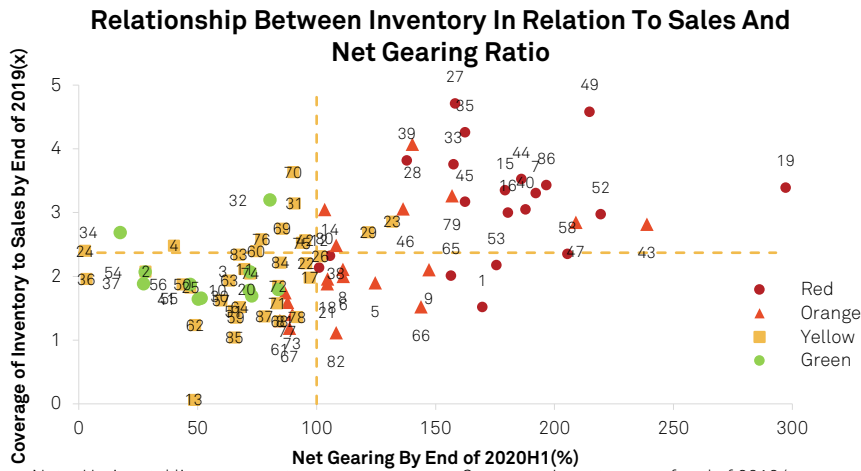
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Paradoxically, we expect developers with low or high inventory levels to all bear the brunt of increased liquidity risk, due to insufficient cash collection.

For property developers with insufficient inventory at hand, when interest-bearing debt hits the ceiling under the new regulations, cash inflow from sales may not be enough to cover necessary cash outflow on areas such as short-term matured debts, construction expenses, land acquisition and investment. The implementation of the new financing rules is set to usher in rising short-term liquidity risk.

Certain developers, on the other hand, have excessive inventory that far outweighs their sales. This may be due to such developers having weaker competitive advantage and lower operating efficiency, rendering them unable to achieve and sustain rapid cash collection from sales. Excessive inventory may also stem from geographic concentration or the developer holding a lot of unsold property in third, fourth and lower tier cities, or being based in regions with their own specific policy restrictions or low market demand. In our view, converting such low-quality inventories into cash would be the key for property developers under the new regulations.

Chart 3



Note: Horizontal line represents average coverage. Coverage=Inventory as of end of 2019/ Consolidated sales in 2019. Consolidated sales in 2019 for onshore listed developers=2019 cash received from selling goods and providing services. For offshore listed developers=2019 Advance-2018 Advance +2019 Revenue*(1+5%).
 Source: Company announcements, Wind, S&P Global (China) Ratings.
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This report does not constitute a rating action.

Appendix

List of Sampled Companies

No.	Entity Name	Abbreviated Name
1	Greenland Holding Group Company Limited	Greenland Group
2	China Vanke Co.,Ltd.	Vanke
3	Poly Developments and Holdings Group Co., Ltd.	Poly
4	China Merchants Shekou Industrial Zone Holdings Co.,Ltd	China Merchants Shekou
5	Jinke Property Group Co.,Ltd.	Jinke
6	Shenzhen Overseas Chinese Town Co.,Ltd.	Overseas Chinese Town
7	China Fortune Land Development Co.,Ltd.	China Fortune Land
8	Yango Group Co.,Ltd	Yango Group
9	Jiangsu Zhongnan Construction Group Co.,Ltd	Zhongnan Construction
10	Gemdale Corporation	Gemdale
11	Midea Real Estate Group Limited	Midea Real Estate Group
12	Risesun Real Estate Development Co.,Ltd	Risesun
13	Dalian Wanda Commercial Properties Co.,Ltd	Dalian Wanda
14	Sichuan Languang Development Co., Ltd.	Sichuan Languang Development
15	Beijing Capital Development Co.,Ltd.	Beijing Capital Development
16	Huafa Industrial Co.,Ltd.Zhuhai	Huafa Industrial Zhuhai
17	Hangzhou Binjiang Real Estate Group Co.,Ltd.	Hangzhou Binjiang Real Estate Group
18	Grandjoy Holdings Group Co.,Ltd.	Grandjoy Holdings Group
19	China Railway Real Estate Group Corporation Ltd.	China Railway Real Estate Group Corporation
20	Sichuan New Hope Real Estate Development Co.,Ltd.	Sichuan New Hope
21	Junfa Group Limited	Junfa Group
22	Lianfa Group Co.,Ltd	Lianfa Group
23	Rong Qiao Group Co.,Ltd	Rong Qiao Group
24	Sinic Real Estate Co.,Ltd	Sinic Real Estate
25	DIMA HOLDINGS Co.,Ltd.	DIMA HOLDINGS
26	Guangzhou Pearl River Enterprises Group Ltd.	Guangzhou Pearl River Enterprises Group
27	PowerChina Real Estate Group Ltd	PowerChina Real Estate Group Ltd
28	Beijing Urban Construction Investment & Development Co.,Ltd.	Beijing Urban Construction Investment & Development
29	Pomegranate Real Estate Group Co.,Ltd.	Pomegranate Real Estate Group
30	Chongqing HuaYu Group Co.,Ltd	Chongqing HuaYu Group
31	Beijing North Star Company Limited	Beijing North Star

32	Cinda Real Estate Co.,Ltd.	Cinda Real Estate
33	Xinhu Zhongbao Co.,Ltd.	Xinhu Zhongbao
34	Shanghai Shimao Co.,Ltd	Shanghai Shimao
35	Guangdong Pearl River Investments Co.,Ltd	Guangdong Pearl River Investments
36	Modern Green Development Co.,Ltd.	Modern Green Development
37	Greatown Holdings Ltd.	Greatown Holdings
38	Xinyuan (China) Real Estate,Ltd	Xinyuan (China) Real Estate,Ltd
39	Tianjin Guangyu Development Co., Ltd.	Tianjin Guangyu Development
40	ChongQing Sincere YuanChuang Real Estate Development Co.,Ltd	ChongQing Sincere YuanChuang Real Estate Development
41	Guangzhou Panyu Hai Yi Real Estate Development Co.,Ltd	Guangzhou Panyu Hai Yi
42	Beijing Hongkun Weiye Real Estate Development Co.,Ltd	Beijing Hongkun Weiye Real Estate Development
43	CCCG Real Estate Corporation Limited	CCCG Real Estate Corporation
44	Zhongtian Financial Group Company Limited	Zhongtian Financial Group
45	Shantou Garden Group Co.,Ltd.	Shantou Garden Group
46	Shanghai Lujiazui Finance & Trade Zone Development Co.,Ltd.	Shanghai Lujiazui Finance & Trade Zone Development
47	Tande Co.,Ltd.	Tande
48	Yunnan Metropolitan RealEstate Development Co.,Ltd	Yunnan Metropolitan RealEstate Development
49	Gree Real Estate Co.,Ltd	Gree Real Estate
50	COFCO Commercial Property Investment Co.,Ltd	COFCO Commercial Property Investment
51	Country Garden Holdings Co. Ltd	Country Garden
52	China Evergrande Group	China Evergrande
53	Sunac China Holdings Limited	Sunac Holdings
54	China Overseas Land & Investment Ltd.	China Overseas
55	Longfor Group Holdings Limited	Longfor Group
56	China Resources Land Limited	China Resources Land
57	Shimao Group Holdings Limited	Shimao Group
58	Guangzhou R&F Properties Co.,Ltd.	R&F Properties
59	Seazen Group Limited	Seazen Group
60	Greentown China Holdings Limited	Greentown China Holdings
61	Agile Group Holdings Limited	Agile Group Holdings
62	Logan Group Company Limited	Logan Group
63	CIFI Holdings (Group) Co. Ltd.	CIFI Holdings (Group) .
64	Sino-Ocean Group Holding Limited	Sino-Ocean Group Holding

65	China Aoyuan Group Limited	China Aoyuan Group
66	Kaisa Group Holdings Limited	Kaisa Group Holdings
67	China Jinmao Holdings Group Limited	China Jinmao Holdings Group
68	Times China Holdings Limited	Times China Holdings
69	Yuxiu Property Company Limited	Yuxiu Property
70	Zhenro Properties Group Limited	Zhenro Properties Group
71	Central China Real Estate Ltd	Central China Real Estate Ltd
72	China Overseas Grand Oceans Group Limited	China Overseas Grand Oceans Group
73	Powerlong Real Estate Holdings Limited	Powerlong Real Estate Holdings
74	KWG Group Holdings Limited	KWG Group Holdings
75	Yuzhou Group Holdings Company Limited	Yuzhou Group
76	Road King Infrastructure Ltd.	Road King Infrastructure
77	China SCE Group Holdings Limited	China SCE Group Holdings
78	Fantasia Holdings Group Co., Limited	Fantasia Holdings Group Co.,
79	Beijing Capital Land Ltd.	Beijing Capital Land
80	Hopson Development Holdings Ltd.	Hopson Development Holdings
81	Jiayuan International Group Limited	Jiayuan International Group
82	Jingrui Holdings Limited	Jingrui Holdings
83	Shui On Land Limited	Shui On Land
84	Dexin China Holdings Company Limited	Dexin China Holdings
85	Landsea Green Properties Co., Ltd.	Landsea Green Properties
86	Sunshine 100 China Holdings Ltd	Sunshine 100 China Holdings Ltd
87	Zhong An Group Limited	Zhong An Group

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