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China Relaxes Regulations for a Soft-landing of the Real Estate Sector

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China's real estate sector has been on a gradual decline since late 2021, a slow-motion contraction occasionally punctuated by crises involving giant property developers. The declining property market poses several challenges, including potential systemic financial risks, further unemployment pressure and risk of social instability. The Chinese authorities have responded with various policies such as lowering housing loan costs and easing restrictions on market participants primarily to confront short-term problems and stabilise the market. In essence, the goal is to mitigate the emerging risks and guide the sector towards a soft landing. The long-term goals are to meet genuine housing demand, curb speculative practices in the housing market and transition the sector into a secondary role in the economy rather than a primary driving force.

GIANT PROPERTY DEVELOPERS' CRISIS

China's major property developers, including Evergrande and Country Garden, continue to grapple with mounting financial challenges, indicating a further deterioration of China's real estate market. In July 2023, China's Evergrande Group finally released its long-delayed annual reports, revealing total liabilities of 2.4 trillion yuan, surpassing its total assets of 1.8 trillion yuan at the end of 2022.[1] Subsequently, Evergrande's situation continued to worsen, culminating in a bankruptcy filing in New York, a temporary suspension of its shares trading in Hong Kong and a critical default on interest payments. In September 2023, the Chinese authorities launched criminal investigations into Evergrande, its founder and the top executives of its parent company, exacerbating the debt crisis faced by the world's most indebted developer. Notably, Evergrande has a substantial stake in over 1,300 property projects across

[1] https://www.evergrande.com/ir/en/reports.asp, accessed 6 November 2023.

more than 280 Chinese cities, amplifying the potential socioeconomic ramifications of its financial struggles.

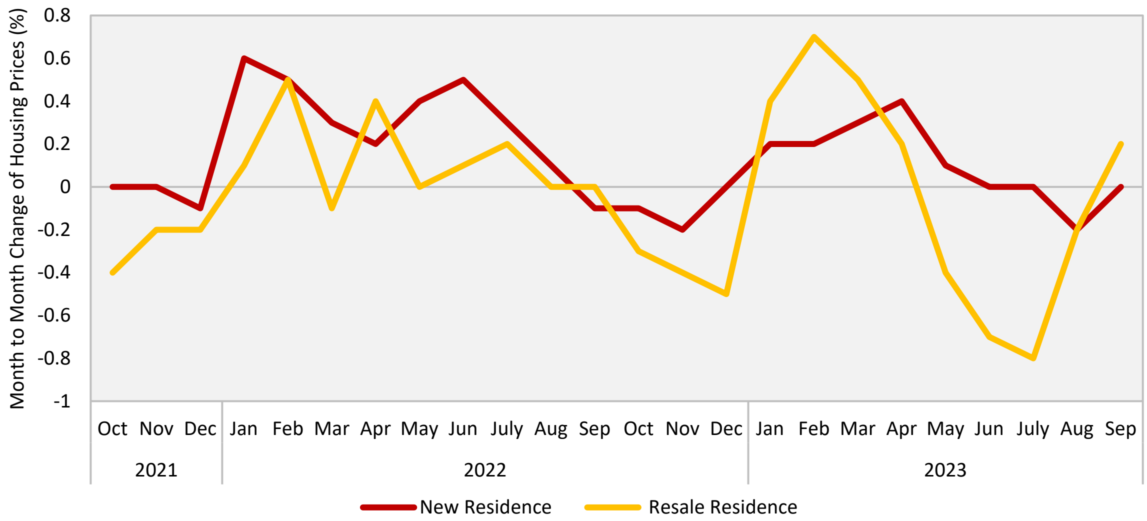
Country Garden, another prominent real estate player in China, has also reportedly encountered financial difficulties. In October 2023, it declared its inability to meet its offshore debt obligations due to slumping property sales in China. The company is burdened with approximately $10.9 billion in bonds and $5.8 billion in overseas loans. Additionally, it failed to fulfil a principal payment of HK$470 billion ($60 million) on certain debts in early October 2023.[2]

The substantial debt burden of these major developers is poised to exert a profound impact on China's beleaguered property market and the broader economy. Dozens of Chinese property developers have defaulted on debt payments since 2021, following the government's imposition of stringent financing constraints. The repercussions may extend to related sectors such as the banking industry, which allocates approximately 40% of its loans to the real estate sector.

THE SLUGGISH PROPERTY MARKET

China's property market has been sluggish since late 2021, despite a brief rebound in early 2023, following several rounds of government incentives and regulatory loosening. Overall weaknesses are shown in housing prices, home sales and developers' investments. The growth of housing prices came to a halt in the final quarter of 2021 across most Chinese cities. In 2022, both new and resale housing prices experienced a continued downward trend, with only a few select cities indicating modest growth in new housing prices. In 2023, the property market experienced a short-lived recovery in the earlier months before turning gloomy in June. Even in first-tier cities where the market has been buoyant, the housing market has lost its vigour (Figure 1).[3]

FIGURE 1 THE SLOW GROWTH OF HOUSING PRICES IN FIRST-TIER CITIES



Data source: National Statistics Bureau.

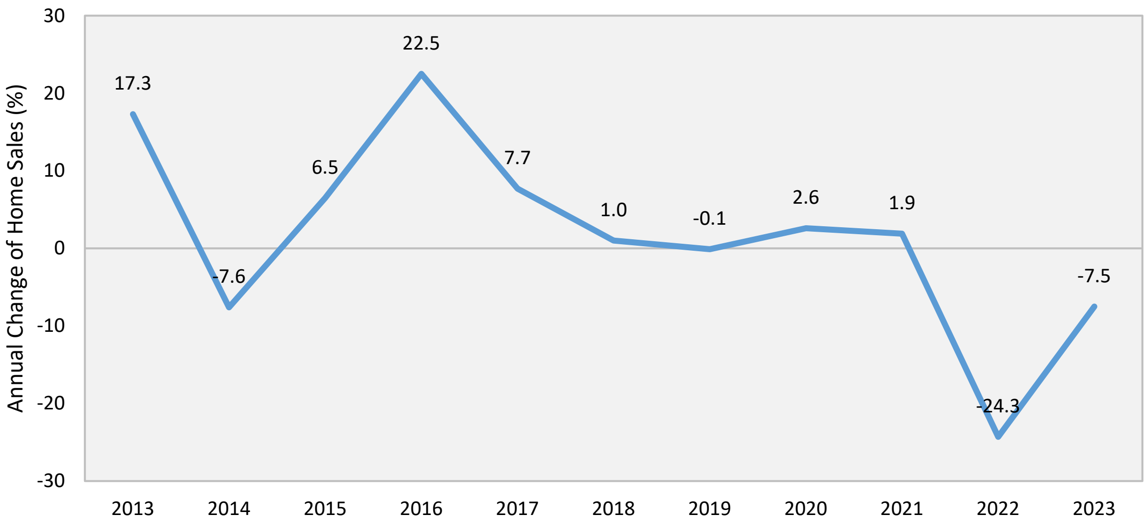
[2] https://www.reuters.com/world/china/country-garden-might-not-be-able-meet-all-offshore-payment-obligations-2023-10-10/, accessed 22 October 2023.

[3] A total of 70 cities, which are divided into three tiers, are regularly monitored. Tier one cities include Beijing, Shanghai, Guangzhou and Shenzhen.

Home sales area also witnessed a sharp decline of 24.3% in 2022, the most substantial decrease observed over the past decade. In 2023, the downward trend persisted, initially showing a slightly slower decline in the first five months before plummeting by 7.5% in September (Figure 2). Meanwhile, the growth rate of housing sales turnover exhibited a positive trend in the first half, before shifting to a negative trajectory, registering a decrease of 4.6 year-on-year in the third quarter.

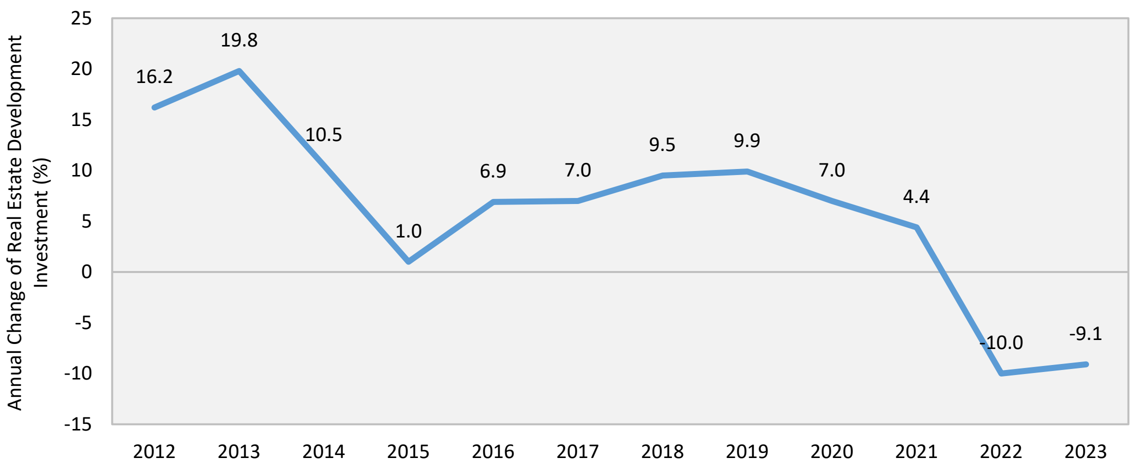
Real estate developers on the other hand have been hesitant about investing in recent years. While such investments had continued to grow in the previous decade, they fell by 10.1% in 2022 and by 9.1% from January to September in 2023 (Figure 3).

FIGURE 2 TREND IN THE DIP IN HOME SALES



Note: The home sales change for 2023 is based on sales data for the first nine months of 2022 and 2023.
Data source: National Statistics Bureau.

FIGURE 3 REAL ESTATE DEVELOPMENT INVESTMENT SLUMP IN THE PAST DECADE



Note: The investment change for 2023 is based on real estate development investment data for the first three quarters of 2022 and 2023.
Data source: National Statistics Bureau.

THE POLICY U-TURN

The implementation of several rounds of restrictive housing policies after the 2010s was one of the primary drivers behind the sluggish performance of the property market since 2021.[4] The authorities have, with effect from end-2022, reversed many of such policies/restrictions to stabilise the market and avert potential financial and social crises. Such policy reversal has so far led to a brief revival in market transactions, mostly in a few economically advanced cities and only for a few months.

Since the late 1990s, China's real estate sector has undergone rapid growth to become a significant driver of the country's economic expansion, largely propelled by market-oriented reforms in the housing system.[5] Along with the rapid growth are certain notable issues, such as the steep rise in housing prices, increase in speculative activities in the housing market and considerable reliance of local governments on land transfer revenues. Fearing the emergence of property bubbles and potential financial crises, the authorities implemented a series of regulations starting from the 2010s and bolstering them further in late 2016. These measures encompassed the implementation of housing purchase and sale restrictions, imposition of caps on housing prices and control of personal loans. Subsequently, the market began to stabilise and later stagnated.

Two crucial measures introduced in 2020 sounded the death knell for the real estate sector. The "three red lines" and "two red lines" restricted developers' financial capabilities. The "three red lines" governed annual increases in interest-bearing liabilities for developers based on financial metrics, including debt-to-asset ratios, net debt ratios and cash-to-short debt ratios. The "two red lines" policy compelled banks and financial institutions to establish lending limits for real estate developers and personal housing.

By late 2021, the risks of a property market collapse and systemic financial crises for the overall economy had escalated. Operational and financial problems for developers had triggered financial challenges to both upstream and downstream firms. Suspended projects and subsequent nationwide boycotts had also fuelled social unrest.[6] At the same time, a stagnant real estate sector implies a hefty reduction in land revenues and tax income for local governments, their major financial sources for years. For example, land transfer fees typically contributed to 30% to 40% of local government income. Such fees plummeted by 23.3% year-on-year in 2022 and by 19.8% in the first nine months of 2023.

The importance of the real estate sector to China's economy and the potential risks stemming from its decline became clear to the Chinese authorities who shifted their policies from tightening regulations to bolstering support for the market. Both the Party and the government underwent a fundamental shift in their stance towards the real estate sector, reaffirming its significance in the national economy and reinstating it as a pillar industry in late 2022. Following the 20th Congress of the Party, the new leadership underscored the sector's importance and announced the introduction of fresh measures to support the sector.

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4 For more details, please see Li Yao and Zhou Na, "China's Mortgage Boycotts Signal Deeper Problems in Its Real Estate Sector", EAI Commentary No. 57, 24 August 2022. Available at https://research.nus.edu.sg/eai/wp-content/uploads/sites/2/2022/11/EAIC-57-20220824.pdf, accessed 6 November 2023.

5 For more details, please refer to http://finance.china.com.cn/news/special/ggkf40years/20181114/4808825.shtml, accessed 9 November 2023.

6 For more details, please see Li Yao and Zhou Na, "China's Mortgage Boycotts Signal Deeper Problems in Its Real Estate Sector".

Former Vice Premier Liu He highlighted that the loans tied to the sector accounted for nearly 40% of bank lending, while constituting 60% of urban residents' assets. Additionally, it contributed approximately 50% of the comprehensive financial resources of local governments.[7] Liu cautioned against the systemic crises linked to a real estate gloom and expressed confidence that the housing demand of residents would strongly bolster the development of the sector.

A few more measures were introduced to back the property market. The "16-point rescue package" issued in late 2022 encompassed financing measures aimed at assisting cash-strapped developers, ensuring the progress of building construction and facilitating developers' mergers and acquisitions. From December 2022, the financial regulatory authorities have allowed cities, experiencing a three-month decline in housing prices, to adjust personal housing loan rates, particularly for first-time homebuyers. While some cities have lowered the minimum thresholds for such loans, some others have completely eliminated them. The revival of the housing market in the first half of 2023 was government policy-induced.

As challenges persist, the Party mandated adjustments to housing policies. During the Politburo's meeting in July 2023, the Party highlighted the necessity of averting risks in crucial sectors, notably the real estate industry, and emphasised the need to adapt housing policies to accommodate the shifting supply and demand dynamics in the property market. The Party has refrained from reiterating its previous principle that houses are primarily for living, not speculation, and stressed the importance of maintaining market stability and supporting reasonable housing demand.

In the latter half of 2023, the Party and central government further loosened market regulations by implementing measures to reduce the costs associated with housing loans. Much earlier in 2022, the central bank had lowered the five-year loan prime rate, a key reference rate for home mortgages, three times, bringing it down from 4.65% to 4.3%. In mid-2023, the rate was further reduced to 4.2% to stimulate housing demand and encourage investment and consumption as well.

Additionally, the government eased restrictions on first-time homebuyers who qualified for preferential mortgage rates and down payments in August 2023, allowing individuals to be categorised as first-time buyers regardless of their previous use of a home mortgage in any city. In the subsequent month, Chinese banks reduced mortgage rates for previous buyers who now met the criteria for first-time homebuyers under the new regulations.

Locally, the central government allowed cities to cautiously revise their policies based on local market conditions, while protecting residents' real housing demand and limiting speculative activities. Chinese cities have implemented various measures to rejuvenate the housing market, such as adjusting buyer restrictions through lowering their residential thresholds and working requirements. Some cities supported first-time homebuyers in urban areas with preferential tax treatments and subsidies, while others loosened regulations on developers by extending payment period for land purchases and launching construction projects.

TO STABILISE RATHER THAN TO STIMULATE THE PROPERTY SECTOR

The recent policies have briefly restored housing demand in certain cities. They may likely lead to varying outcomes across cities. While the property markets in the first- and a few

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7 For more details, please see https://www.weforum.org/press/2023/01/chinese-vice-premier-liu-he-commits-to-deepening-market-liberalization-and-opening/, accessed 6 November 2023.

second-tier cities are anticipated to see a brief recovery, property market in the other cities, characterised by declining economic momentum and shrinking population, may continue to be sluggish, or potentially worsen.

However, the primary goals of the housing policies are seemingly to guide the real estate sector to a soft landing, by preventing further deterioration in the sector's financial health or potential social unrest, rather than to stimulate the sector. The Chinese authorities have reiterated the importance of potential financial risks associated with a sluggish property sector, at several important conferences. Nonetheless, there has been no mention of any direct government bailout or financial support to developers. Instead, efforts have been directed towards effective supervision over property developers, particularly regarding their debts and loans.[8]

In a recent effort to reinvigorate investor confidence that has been adversely affected by the woes in the real estate sector, Central Huijin Investment Ltd, one of China's sovereign wealth funds, acquired approximately $65 million worth of shares from the country's four major state banks in the open market in October 2023 and is poised to make further purchases over the next six months.[9]

These banks are grappling with the real estate sector's decline, which includes homeowners boycotting mortgages and an increase in bad loans from struggling developers. The support from the sovereign wealth fund, indicating government commitment to financial system stability, is anticipated to enhance investor confidence for both the banks and the real estate sector.

Meanwhile, the central government has also put forward plans to develop public housing, including rental properties, to adjust the supply structure in the market and reduce the predominant influence of commercial developers.[10] These plans aim to address housing issues in urban areas and support a healthier long-term development of the real estate sector.

On the other hand, China is trying to reduce the overall economic reliance on the real estate sector. For example, the Chinese authority plans to optimise the country's industrial structure by fostering a new type of industrialisation. The Party has prioritised the focus on technology and innovation, as well as the upgrading of manufacturing industries, with a strong emphasis on promoting the digital and green economy.[11]

The real estate sector is not likely to regain its previous levels of prosperity, due to ongoing demographic structural shifts and maxed-out urbanisation. Owing to the declining and ageing population, the long-term demand for houses and land is projected to decrease. The housing market in most cities is likely to contract. With housing prices stabilising or experiencing a slow decline, houses may no longer serve as investment instruments for ordinary individuals seeking to preserve their assets, as previously observed. Consequently, this sector may remain an important but not crucial industry for the national economy.

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8 See for example, https://www.gov.cn/yaowen/liebiao/202310/content_6912992.htm, accessed 2 November 2023.

9 https://www.zaobao.com.sg/finance/china/story20231012-1442171, accessed 28 October 2023.

10 https://house.cnr.cn/sl/20231030/t20231030_526468457.shtml, accessed 3 November 2023.

11 http://www.news.cn/politics/leaders/2023-09/23/c_1129879361.htm, accessed 1 November 2023.

Finally, the current overreliance of local governments on land-based financing is deemed unsustainable, particularly considering the contracting market. To alleviate short-term pressure on local government budgets, on 24 October 2023, China's Standing Committee of the National People's Congress approved a one trillion yuan ($137 billion) sovereign bond issue and passed a bill allowing local governments to pre-allocate a portion of their 2024 bond quotas. In order to enhance the country's fiscal system and reduce the role of land revenue in the long run, tax reforms have also been under consideration, including reconfiguring the fiscal revenue sharing system between central and local governments, as well as identifying alternative tax or fee sources for local administrations.

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