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Evergrande's Last Chapter? Prospects and Implications

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THE WIND-UP ORDER, AT LAST

On 29 January 2024, the Hong Kong High Court ordered the liquidation of China Evergrande¹ (hereafter “Evergrande”) and appointed Alvarez & Marsal, the liquidator. Alvarez & Marsal is renowned for its leading role in the 2008 Lehman Brothers liquidation process. The decision followed a series of delays, where the court hearing had been postponed seven times since a petition had been made by a strategic investor 18 months earlier, in June 2022.²

The court's decision is hardly surprising as the company was apparently in dire straits after Evergrande Chairman Hui Ka Yan was reportedly placed under police surveillance on 28 September 2023.³ Following the court decision, Evergrande's shares (3333.HK) plummeted by 21% shortly after the market opened the following day. Its US dollar-denominated bonds, listed on the Singapore Exchange, sank to 0.8-1.7 cents per dollar face value, signalling bleak compensation prospects even though they are secured high-yield corporate bonds.⁴

¹ China Evergrande was incorporated in the Cayman Islands and listed on the Hong Kong Stock Exchange (3333.HK). However, there is limited public documentation concerning its business operations and holding structure.

² In June 2022, Top Shine Global Limited of Intershore Consult (Samoa) Limited initiated a winding-up petition against Evergrande, available at <https://www.reuters.com/business/china-evergrande-faces-winding-up-lawsuit-hong-kong-2022-06-27/>, accessed 12 February 2024.

³ <https://www.bloomberg.com/news/articles/2023-09-27/evergrande-s-billionaire-chairman-hui-is-under-police-surveillance>, accessed 16 February 2024.

⁴ Currently, Evergrande has nine US dollar-denominated bonds with a total face value of \$14.1 billion. Listed on the Singapore Exchange, the bonds are all in default status. Available at <https://www.bondsupermart.com/bsm/general-search/evergrande>, accessed 14 February 2024.

Evergrande was once China's top-selling developer who has, to some, degenerated to become the world's most indebted developer.⁵ The liquidation has evoked two grave concerns. The first is how and to what extent will Evergrande's impending liquidation ripple through the rest of China's real estate sector. Evergrande's high debt-to-asset ratio is a common phenomenon across China's property sector. As such, the liquidation could exacerbate financial pressure for other struggling real estate firms and further dampen China's overall market confidence and weaken the broader economy.

The second is how this liquidation order could be exercised, given challenges such as differences in legal practices between Hong Kong and mainland China. If the Chinese government could execute the court order well and timely, it signifies the government's determination to improve its business environment and reduce uncertainties, as abiding by the rule of law is one of the most important components of a good business environment.

HOW BAD A CRISIS IS EVERGRANDE AND CHINA'S REAL ESTATE SECTOR FACING?

Without doubt, Evergrande's debt burden is massive. According to its own report, as of 30 June 2023, with total asset value of 1.7 trillion yuan and total liabilities of 2.4 trillion yuan,⁶ Evergrande is severely insolvent. Creditors predominantly comprise homeowners (604 billion yuan), suppliers (596 billion yuan), banks (426 billion yuan) and bondholders (190 billion yuan). In addition to a broad spectrum of debtors, Evergrande's debt scale far surpasses those of Anbang and HNA Group, China's top two bankruptcy cases in terms of total debt values. Anbang's liquidation process began in 2020 with a debt of 1.37 trillion yuan and HNA Group underwent restructuring in 2022 with a debt of 1.2 trillion yuan. Based on World Bank's WDI data, out of over 195 countries and regions, merely 44 had a gross domestic product (GDP) surpassing 2.4 trillion yuan in 2022.

The company is also facing a growing number of legal challenges. As of November 2023, there were a total of 2,053 pending lawsuits against Evergrande, each involving sums exceeding 30 million yuan.⁷ The aggregate sum amounted to approximately 4.9 trillion yuan.

Furthermore, the court order itself could exacerbate the company's debt problem. This is because, under Hong Kong's regulation,⁸ when a company enters a winding-up proceeding, its business activities would cease and assets liquidated to repay debts, with priority given to liquidation expenses, employee entitlements, secured creditors and so on. Thus, the liquidation order will heighten concerns among Evergrande's creditors and escalate lawsuits against Evergrande.

The liquidation order will also have important ripple effect for other beleaguered real estate firms in China. According to a study,⁹ overall debt-to-asset ratio of listed real estate companies in China is 79.3%, significantly higher than those in Japan (69%) and the United States (57%). As is shown, alongside Evergrande, a number of large Chinese real estate firms are also

⁵ <https://www.reuters.com/business/worsening-crisis-evergrande-worlds-most-indebted-developer-2024-01-29/>, accessed 16 February 2024.

⁶ <https://www.evergrande.com/ir/sc/reports.asp>, accessed 16 February 2024.

⁷ <https://doc.irasia.com/listco/hk/evergrande/announcement/ca231229.pdf>, accessed 13 February 2024.

⁸ https://www.elegislation.gov.hk/hk/cap32H?xpid=ID_1438403007786_002, accessed 12 February 2024.

⁹ http://www.cf40.org.cn/news_detail/12602.html, accessed 13 February 2024.

evidently in more dire situations than the industry average (Table 1). For instance, Country Garden, whose asset scale is comparable to Evergrande's, had a debt-to-asset ratio of 84% as of June 2023. On 28 February 2024, Country Garden also received its first liquidation petition filed to Hong Kong court.¹⁰ Meanwhile, Sunac China's debt-to-asset ratio approached one, indicating quite a tight debt situation. The liquidation order on Evergrande will likely increase debt collection pressure on these Chinese real estate companies.

TABLE 1 TOP CHINESE DEVELOPERS' ASSETS AND DEBT BY THE END OF JUNE 2023

Company	Total Assets (tri RMB)	Total Debt (tri RMB)	Debt/Assets
Evergrande Group	1.74	2.39	1.37
Vanke Group	1.68	1.28	0.76
Country Garden Holdings	1.62	1.36	0.84
Poly Developments	1.43	1.10	0.77
Greenland Holdings	1.20	1.03	0.86
Sunac China	1.07	1.00	0.94

Source: Wind.

The liquidation order will further erode homebuyers' confidence and weaken China's already fragile real estate market. Meanwhile, Evergrande's 2022 Annual Report indicates that as of 31 December 2022, the company had a land reserve of 210 million square metres. The liquidation of this land reserve will flood the market and pull down land prices which add negative shocks to both the confidence in the real estate market and local governments' fiscal standings. The combined impact of these factors will worsen the financial standings of other Chinese real estate firms and possibly lead to new bankruptcy cases or liquidation orders.

CHALLENGES AND IMPLICATIONS OF COURT ORDER'S EXECUTION

Evergrande's liquidation process will be long and challenging, due to not only its large size but also complexity in business operation. First, though the company is listed in Hong Kong, most of its assets is in mainland China. Significant differences between Hong Kong and mainland China's judicial system inevitably raise questions about enforcement. According to Evergrande's 2022 Annual Report, among its 176 major subsidiaries, 172 are in mainland China¹¹ where the majority of its assets are. Adding to the concern is the Evergrande's Chief Executive Officer Siu Shawn's claim that the Hong Kong court order pertains to only the Hong Kong listed China Evergrande (3333.HK), which does not cover the Evergrande Group or other onshore (within Chinese Mainland) and offshore (beyond Hong Kong and Chinese Mainland) subsidiaries, indicating that they are separate legal entities.¹²

On the other hand, in 2021, the Supreme People's Court of China designated the People's Courts of Shanghai, Xiamen and Shenzhen to conduct pilot projects for recognising and assisting Hong Kong bankruptcy proceedings.¹³ However, as indicated by Evergrande's 2022

¹⁰ For more details, please refer to <https://www.reuters.com/world/china/chinas-country-garden-faces-winding-up-petition-failure-pay-2045-mln-loan-2024-02-28/>, accessed 28 February 2024.

¹¹ <https://www.evergrande.com/ir/en/reports.asp>, accessed 22 February 2024.

¹² <https://epaper.chinadaily.com.cn/a/202401/30/WS65b847d4a310d6ca3243fb8d.html>, accessed 22 February 2024.

¹³ In May 2021, the Supreme People's Court of China issued the "Opinions on Taking Forward a Pilot Measure in relation to the Recognition of and Assistance to Insolvency Proceedings in the Hong Kong Special

Annual Report, its mainland China headquarter is in Guangzhou, not one of the three pilot cities. Whether and how this court order could be exercised is still unknown.

A related recent development is the “Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region” (“Arrangement” hereafter) came into effect on 29 January 2024. However, Article 3 of the Arrangement¹⁴ states that it does not cover judgments on corporate insolvency and debt restructuring as well as personal insolvency.

Prior to the Evergrande case, the Hong Kong court had issued three winding-up orders against Chinese developers, including Jiayuan International (May 2023), Sunshine City International (October 2022) and New World Development (December 2022). Based on publicly available information, only New World Development has been delisted. Little progress has been made with the other cases.

Second, China’s regulators prioritise homeowner rights and emphasise localised financing mechanisms in order to manage risks. This adds complexity to liquidation proceedings. According to a government document,¹⁵ mainland China’s judicial system will prioritise safeguarding the rights of homeowners in any liquidation process. Meanwhile, by the end of January 2024, 170 cities in 26 provinces had established a white-list lending mechanism to facilitate financing of real estate companies and project completion. The first batch of the “white list”¹⁶ has 3,218 real estate-related projects that are strictly supervised by local authorities to ensure compartmented operation. Some Evergrande projects are included in the “white list” and it is unlikely that these projects would be affected by the Hong Kong court order.

At the industry level, the Chinese government does not want to indiscriminately bail out troubled real estate firms, but to ensure the completion of selected housing projects. Vice Minister Dong Jianguo for Housing and Urban-Rural Development emphasised¹⁷ that enterprises facing insolvency due to illegal activities or mismanagement should be dealt with according to principles of legality and marketisation, an approach that is very much in conformity with the market.

Much remains to be seen. Alvarez & Marsal will have to engineer an outcome for Evergrande that involves a slew of stakeholders, including creditors, authorities and homebuyers. The process and outcome of the liquidation case will undoubtedly have a long-term impact on the fundraising practices of Chinese enterprises overseas. Indeed, letting insolvent firms fail, such as through liquidation, is important to reinforce the role of the market and to reduce distortion. In other words, rule-based consolidation in the real estate sector should be tolerated to ensure

Administrative Region”. https://www.doj.gov.hk/sc/mainland_and_macao/pdf/RRECCJ_opinion_sc.pdf, accessed 13 February 2024.

¹⁴ https://www.doj.gov.hk/en/mainland_and_macao/pdf/Doc6_481354e.pdf, accessed 13 February 2024.

¹⁵ On 11 January 2022, the “Notice on Regulating the Preservation and Enforcement Measures of People’s Courts to Ensure that Presale Funds for Commercial Housing are Used for Project Construction” was jointly issued by the Supreme People’s Court, Ministry of Housing and Urban-Rural Development and People’s Bank of China. According to the Notice, both domestic and foreign creditors cannot file a law suit to freeze a company’s assets or withdraw funds from its presale account. These funds are prioritised for project completion (<http://gongbao.court.gov.cn/Details/00d8c155cb4a4093cb7451510ecac5.html>, accessed 13 February 2024).

¹⁶ https://www.mohurd.gov.cn/xinwen/gzdt/202402/20240205_776585.html, accessed 14 February 2024.

¹⁷ <http://finance.people.com.cn/n1/2023/1214/c1004-40138819.html>, accessed 16 February 2024.

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a better allocation of resources, a desirable long-term goal. At the same time, whether the bankruptcy proceedings can ensure equal treatment for domestic and foreign creditors as well as domestic creditors with different ownerships will be a crucial test of the Chinese government's determination to improve the business environment. This is crucial for confidence restoration and the long-term development of the Chinese economy.

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