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Property – China

# Scenario Analysis: New guidelines would control developers' leverage buildup

» **New guidelines to control debt growth, if implemented, would improve Chinese developers' credit quality, a credit positive.** According to media reports, Chinese regulators are considering imposing measures on Chinese developers to control new debt growth. These measures, if implemented, would enhance the developers' credit quality over the next 2-3 years by limiting their use of debt to fund business growth, which would effectively control leverage buildup, especially for highly geared developers.

» **New measures would target new debt growth but not the refinancing of existing debt.** The new guidelines are unlikely to materially inhibit developers' ability to raise debt for refinancing because the measures target new debt growth and we expect the authorities will continue to maintain stable development of the property sector in the long term.

» **Highly leveraged developers would see their growth constrained, while financially strong developers would benefit.** Developers with high leverage would be restricted from using debt to fund growth, limiting their ability to grow their business. On the other hand, financially healthy developers, usually with better liquidity and low leverage, would have more flexibility to raise debt to fund growth, and could therefore acquire market share from weaker peers.

» **Scenario analysis shows most rated developers can still raise new debt.** We ran two scenario analyses by testing three financial parameters of rated developers: liability to asset ratio (debt leverage); net debt to equity ratio (capital structure); and cash to short-term debt ratio (liquidity). Based on the results, most rated developers can grow their debt by 5%-10% in the next 12 months under scenario 1 and by 15% under scenario 2. Such levels of growth are lower than the 15%-25% recorded in 2019 and 2018, and the rapid 39% in 2017.

» **Actual impact of the new guidelines would largely depend on the implementation details.** Chinese regulators are likely to continue to implement and fine-tune regulatory measures to control property developers' access to debt funding and, consequently, their debt leverage. The actual impact on individual developers would largely depend on the details of any new policies and ultimately the execution of the policies. Nevertheless, we expect our rated developers will slow their debt-funded growth in view of the tenuous economic recovery and slow property sales growth.

## New guidelines to control debt growth, if implemented, would improve Chinese developers' credit quality, a credit positive

According to media reports, Chinese regulators are considering imposing measures on Chinese developers to control the growth of new debt, with 12 large developers selected in a pilot scheme to be tested on their financial position based on three parameters: liability to asset ratio (debt leverage); net debt to equity ratio (capital structure); and cash to short-term debt ratio (liquidity). Their ability to raise new debt will be dependent on the result of the test. It was also reported that the new controls could be extended to a larger group of developers in the future.

These measures, if implemented, would enhance the developers' credit quality over the next 2-3 years by limiting their use of debt to fund business growth, which would effectively control leverage buildup, especially for highly geared developers.

The measures would also slow developers' business growth because their more restrictive access to debt funding would limit their ability to aggressively bid for land and subsequently pursue fast sales growth.

## New measures would target new debt growth but not the refinancing of existing debt

While the potential new measures would restrict developers' access to new debt, they are unlikely to materially inhibit developers' ability to raise debt for refinancing and put pressure on their liquidity. Our expectation is based on the assumption that the regulators would continue to aim at maintaining stable development of the property sector in the long term given the importance of the sector to the overall economy. Any disruption to the liquidity of developers and the sector as a whole could have an adverse impact on the economy.

According to the media reports, the amount of new debt that developers can raise would be limited, depending on a series of tests (please refer to the details of the tests in the scenario test section). If developers breach all three parameters, they will not be allowed to increase their total debt beyond the levels of the previous year, indicating that regulators would still allow the developers to raise debt for refinancing purposes.

## Highly leveraged developers would see their growth constrained, while financially strong developers would benefit, accelerating industry consolidation

Under the new guidelines, developers with high leverage would be restricted from using debt to fund growth. This in turn would limit their ability to grow their business, compared with peers with a healthier financial position and low leverage.

Comparatively, financially healthy developers, usually with better liquidity, would have more flexibility to raise debt to fund growth. While many of them have reached a large operating scale, their better funding position would still allow them to grow their sales and acquire market share from their weaker and smaller peers.

## Scenario analysis shows most rated developers can still raise new debt, though at a slower pace

To date, there has been no official government announcement but, according to the media reports, developers will be tested on three financial parameters: liability to asset ratio (debt leverage); net debt to equity ratio (capital structure); and cash to short-term debt ratio (liquidity).

Developers' annual debt growth would be limited to a maximum of 15%. A breach of one parameter would result in a reduction of the growth rate by 5 percentage points.

The allowable annual growth in debt for various breaches are shown below:

| Breach of parameter | Color code | Allowable annual growth in debt |
|---|---|---|
| 0 | Green | 15% |
| 1 | Yellow | 10% |
| 2 | Orange | 5% |
| 3 | Red | 0% |

Given there has not yet been any official guidance on the calculation of the three parameters, we have devised two scenarios — one with stringent calibrations for the three parameters (Scenario 1) and the other with loose calibrations (Scenario 2).

We have run these scenario tests for a total of 61 rated developers, out of the 70 we rate[1], based on their financial information as of June 2020.

## Scenario 1 — based on stringent measures

Our assumptions on the calibrations of the three parameters under Scenario 1 are:

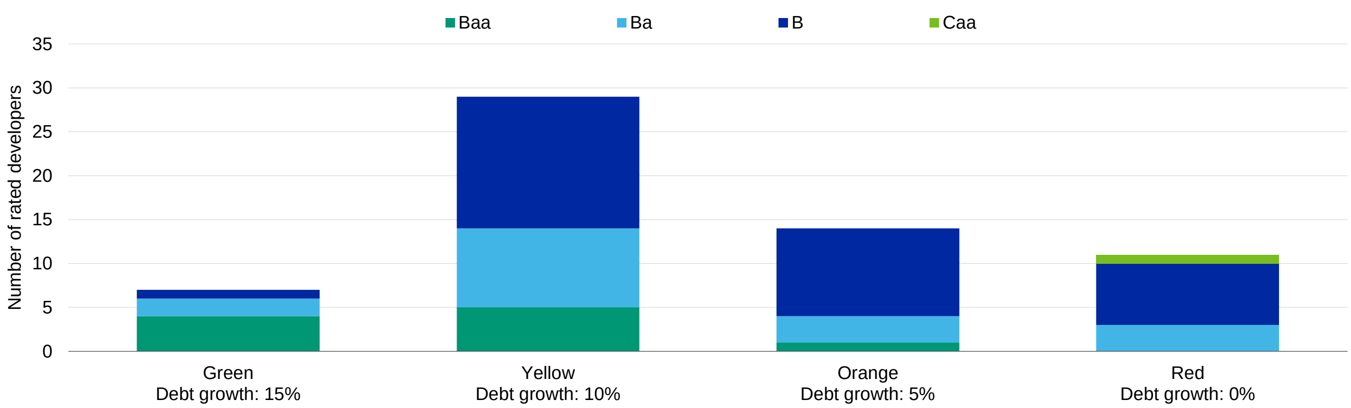
| | |
|---|---|
| Total liabilities (excluding contracted liabilities)/ Total assets (excluding contracted liabilities) | ≤70% |
| Net debt/Equity | ≤100% |
| Unrestricted cash/Short-term debt | ≥100% |

Note: We included lease liabilities in the calculation of debt and short-term debt, and this inclusion should not have a material impact on the result of the scenario analysis because of the small amount of lease liabilities relative to their total debt level.

Scenario 1 indicated that most rated developers can still grow their debt by a moderate pace of 5%-10% in the next 12 months from the date of their reported financials (Exhibit 1). Only 11 rated developers, mostly rated at single-B or below, would breach all three parameters and would not be able to increase debt at all.

Exhibit 1

**Scenario 1 — Most of rated developers can grow their debt by 5%-10%**

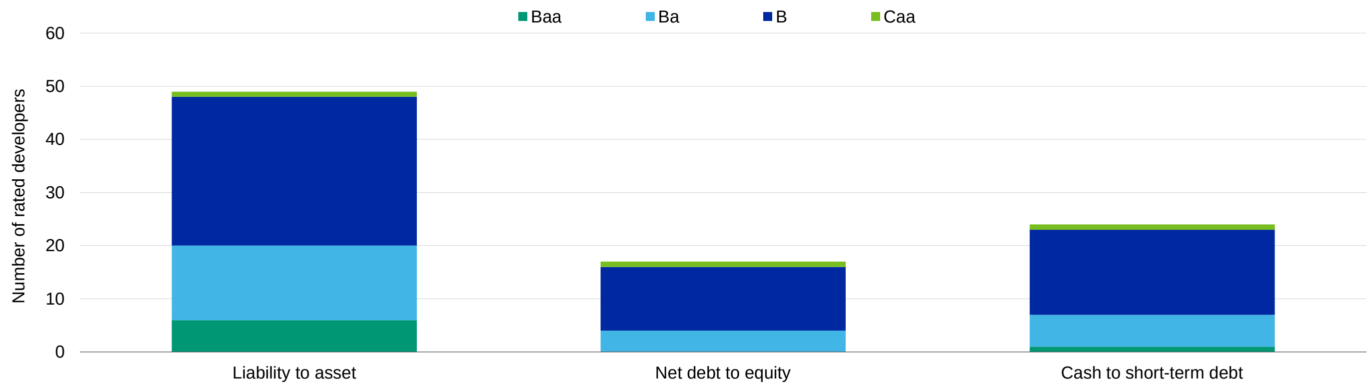



[1] The tests were performed based on the rated developers' financial results for H1 2020, except for China South City Holdings Limited, which has its fiscal year end at 31 March 2020.
[2] The results of the tests based on the rated developers' financial results for 2019 do not have material difference from that of H1 2020.
*Sources: Company information, Moody's Investors Service and Moody's Financial Metrics™*

Of the three ratios being tested in this scenario, the highest number of companies would breach the liability to asset ratio based on our analysis, reflecting developers' high usage of debt and other kinds of liabilities, including account and other payables, to fund their operations (Exhibit 2). Developers that have breached the net debt/equity ratio or cash to short-term debt ratio are mostly rated at single-B and below, reflecting their generally weaker capital structure and liquidity than their higher rated peers.

On the other hand, developers with no breach are mostly rated at Baa-level, such as China Overseas Land and Investment Limited (Baa1 stable), China Resources Land Limited (Baa1 stable), Poly Developments and Holdings Group Co., Ltd. (Baa2 stable) and Longfor Group Holdings Limited (Baa2 stable), which generally have strong financial profiles.

Exhibit 2
**Scenario 1 — Number of rated developers breaching each red line by rating category**




[1] The tests were performed based on the rated developers financial results for H1 2020 except for China South City Holdings Limited, which has fiscal year end at 31 March 2020.
[2] The results of the tests based on the rated developers' financial results for 2019 do not have material difference from that of H1 2020.
*Sources: Company information, Moody's Investors Service and Moody's Financial Metrics™*

## Scenario 2 — based on loose measures

In this scenario, we included the amount of contracted liabilities in the calculation of total assets. We also included restricted cash as a cash component in the calculation of the cash to short-term debt ratio (see table below), given that at least part of the restricted cash could be used for construction expenses or repayment of maturing construction loans.

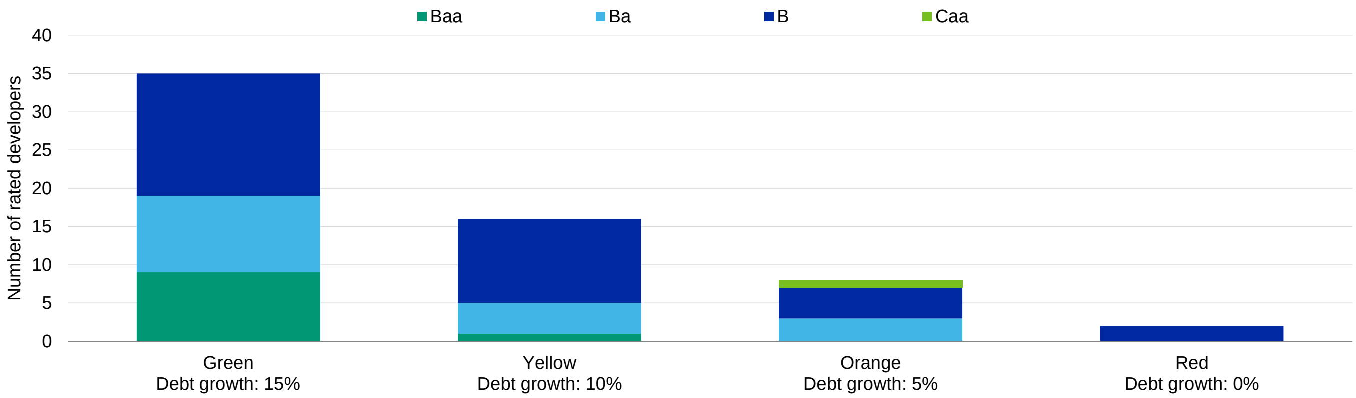
| | |
|---|---|
| Total liabilities (excluding contracted liabilities)/ Total assets | ≤70% |
| Net debt/Equity | ≤100% |
| Unrestricted and restricted cash/Short-term debt | ≥100% |

Note: We included lease liabilities in the calculation of debt and short-term debt, and this inclusion should not have a material impact on the result of the scenario analysis because of the small amount of lease liabilities relative to their total debt level.

In this scenario, most rated developers could grow their debt by the maximum of 15% (Exhibit 3). Nevertheless, this would be slower than the 15%-25% growth rates in 2018 and 2019[2]. The improvement in this scenario mainly comes from the much fewer number of breaches in the liabilities to asset test because of the inclusion of contracted liabilities in total assets (Exhibit 4).

Exhibit 3

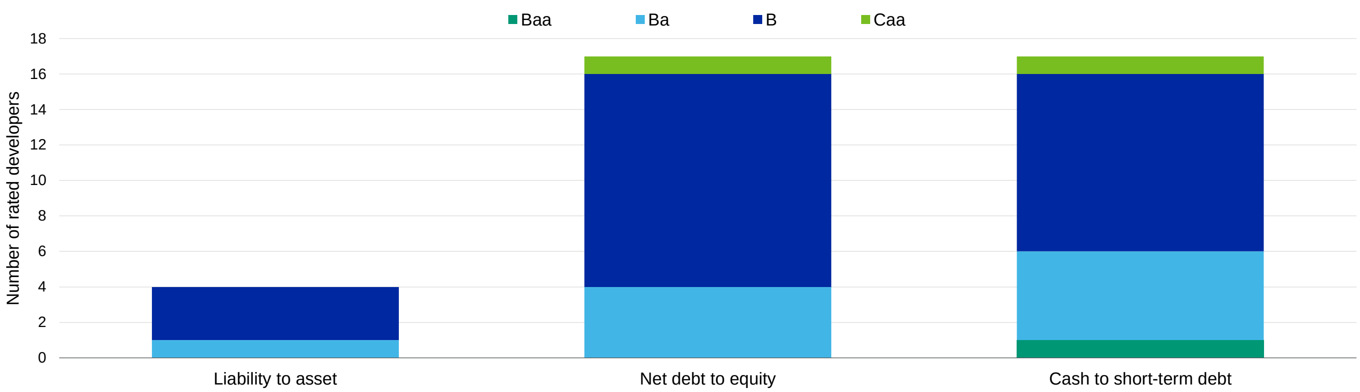
**Scenario 2 — Most rated developers can grow their debt by the maximum of 15%**




[1] The tests were performed based on the rated developers' financial results for H1 2020, except for China South City Holdings Limited, which has its fiscal year end at 31 March 2020.
[2] The results of the tests based on the rated developers' financial results for 2019 do not have material difference from that of H1 2020.
*Sources: Company information, Moody's Investors Service and Moody's Financial Metrics™*

Exhibit 4

**Scenario 2 — Number of rated developers breaching each red line by rating category**




[1] The tests were performed based on the rated developers financial results for H1 2020 except for China South City Holdings Limited, which has fiscal year end at 31 March 2020.
[2] The results of the tests based on the rated developers' financial results for 2019 do not have material difference from that of H1 2020.
*Sources: Company information, Moody's Investors Service and Moody's Financial Metrics™*

## Actual impact of the new guidelines would largely depend on the implementation details

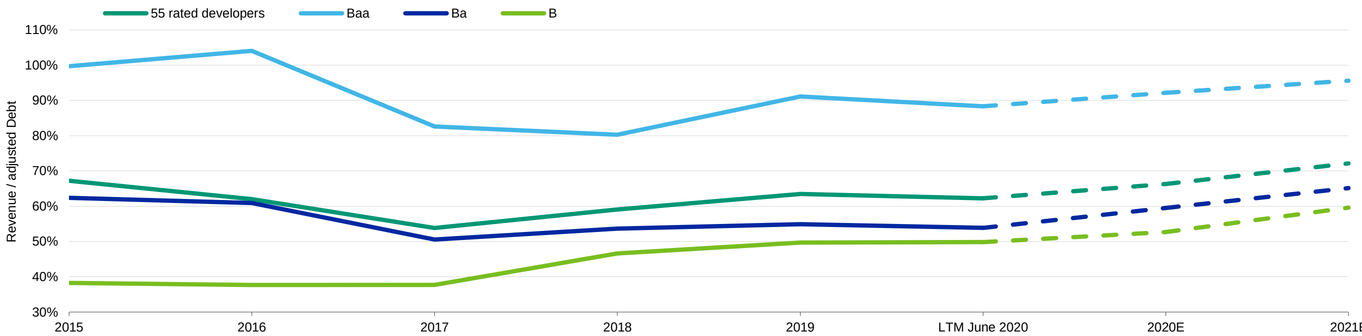
Chinese regulators are likely to continue to implement and fine-tune regulatory measures to control property developers' access to debt funding and, consequently, their debt leverage. These measures are aimed at maintaining the stability of the country's property sector and the health of the financial system, given the important role the property sector plays in China's economic growth.

As indicated by our scenario analysis above, the actual impact on the developers would largely depend on the details of any new policies and the execution of those policies. Such details include: the exact parameters; how they will be measured; the time horizon for measurement; how the control mechanism will be conducted; and whether off balance sheet financing will be included.

Nevertheless, we expect our rated developers' reported debt growth will slow to 5%-10% in 2021, down from the 15%-25% growth in 2018 and 2019, and from the rapid 39% growth in 2017. Accordingly, we expect our rated developers' leverage, measured by revenue/ adjusted debt, will improve in 2020-21 from the 12 months ended 30 June 2020 and full-year 2019 (Exhibit 5)[3]. This forecast mainly comes with the acknowledgment that economic recovery is tenuous and property sales growth will remain modest over the next 12-18 months.

Exhibit 5

**Weighted average revenue/adjusted debt will improve in 2020 and 2021 because of a pickup in revenue growth and controlled debt growth**




LTM = last 12 months. Data cover the 55 B- to Baa-rated Chinese property developers.
*Sources: Moody's Financial Metrics™ and Moody's Investors Service estimates*

We also expect many of our rated developers with strong financials will maintain their financial discipline while pursuing business growth, regardless of whether the regulatory restrictions are stringent or not.

On the other hand, rated developers with a weaker financial position and high leverage will see their ability to grow through debt funding constrained because banks and investors will prefer to provide funding to large developers with sound financial quality.

## Moody's-rated Chinese property developers as of 18 October 2020

| Issuer | Issuer Rating/Corporate Family Rating | Bond Rating | Outlook |
|---|---|---|---|
| China Overseas Land & Investment Limited (COLI)* | Baa1 | Baa1 | Stable |
| China Resources Land Limited* | Baa1 | Baa1 | Stable |
| China Vanke Co., Ltd.* | Baa1 | N/A | Stable |
| China Overseas Grand Oceans Group Ltd. (COGO)* | Baa2 | Baa2 | Stable |
| Poly Developments and Holdings Group., Ltd.* | Baa2 | N/A | Stable |
| Longfor Group Holdings Limited* | Baa2 | Baa2 | Stable |
| China Jinmao Holdings Group Limited* | Baa3 | Baa3 | Stable |
| Hengli (Hong Kong) Real Estate Limited | Baa3 | Baa3 | Stable |
| Sino-Ocean Group Holding Limited* | Baa3 | Baa3 | Stable |
| Yuexiu Property Company Limited* | Baa3 | Baa3 | Stable |
| Country Garden Holdings Company Limited* | Baa3 | Baa3 | Stable |
| Greenland Holding Group Company Limited* | Ba1 | Ba2^ | Stable |
| Shimao Group Holdings Limited* | Ba1 | N/A | Positive |
| Seazen Holdings Co., Ltd. | Ba2 | Ba2 | Stable |
| Greenland Hong Kong Holdings Limited | Ba2 | Ba3^ | Stable |
| Agile Group Holdings Limited* | Ba2 | Ba3^ | Negative |
| Seazen Group Limited* | Ba2 | Ba3^ | Stable |
| Yanlord Land Group Limited* | Ba2 | Ba3^ | Negative |
| Gemdale Corporation* | Ba2 | N/A | Stable |
| Greentown China Holdings Limited* | Ba3 | Ba3 | Stable |
| China Fortune Land Development Co., Ltd.* | Ba3 | Ba3 | Negative |
| Famous Commercial Limited | Ba3 | Ba3 | Stable |
| Road King Infrastructure Limited* | Ba3 | Ba3 | Stable |
| CIFI Holdings (Group) Co. Ltd.* | Ba3 | B1^ | Positive |
| Logan Group Company Limited* | Ba3 | B1^ | Positive |
| Central China Real Estate Limited* | Ba3 | B1^ | Stable |
| RiseSun Real Estate Development Co., Ltd.* | Ba3 | B1^ | Stable |
| Sunac China Holdings Limited* | Ba3 | B1^ | Stable |
| Times China Holdings Limited* | Ba3 | B1^ | Stable |
| Yuzhou Group Holdings Company Limited* | Ba3 | B1^ | Stable |
| Beijing Capital Land Limited* | Ba3 | N/A | Stable |
| Guangzhou R&F Properties Co., Ltd.* | B1 | N/A | Negative |
| International Financial Center Property Ltd. | B1 | B1 | Stable |
| China Aoyuan Group Limited* | B1 | B2^ | Positive |
| China Evergrande Group* | B1 | B2^ | Negative |
| China SCE Group Holdings Limited* | B1 | B2^ | Stable |
| Huayuan Property Co., Ltd.* | B1 | B2^ | Stable |
| Jinke Property Group Co., Ltd.* | B1 | B2^ | Stable |
| Kaisa Group Holdings Ltd* | B1 | B2^ | Stable |
| Powerlong Real Estate Holdings Limited* | B1 | B2^ | Positive |
| Ronshine China Holdings Limited* | B1 | B2^ | Stable |
| Yango Group Co., Ltd* | B1 | B2^ | Stable |
| Zensun Group Limited* | B1 | B2^ | Negative |

| Issuer | Issuer Rating/Corporate Family Rating | Bond Rating | Outlook |
|---|---|---|---|
| Zhenro Properties Group Limited* | B1 | B2^ | Stable |
| Zhongliang Holdings Group Company Limited* | B1 | B2^ | Stable |
| Hengda Real Estate Group Company Limited | B1 | N/A | Negative |
| KWG Group Holdings Limited* | B1 | N/A | Stable |
| Sichuan Languang Development Co., Ltd.* | B1 | N/A | Stable |
| Jiangsu Zhongnan Construction Grp Co., Ltd.* | B1 | B2^ | Stable |
| R&F Properties (HK) Company Limited | B2 | N/A | Negative |
| Golden Wheel Tiandi Holdings Company Limited* | B2 | B2 | Stable |
| Tianji Holding Limited | B2 | B2 | Negative |
| Redsun Properties Group Limited* | B2 | B3^ | Positive |
| China South City Holdings Limited* | B2 | N/A | Stable |
| DaFa Properties Group Limited* | B2 | B3^ | Stable |
| Dexin China Holdings Company Limited* | B2 | B3^ | Stable |
| Fantasia Holdings Group Co., Limited* | B2 | B3^ | Stable |
| Guangzhou Fineland Real Estate Development* | B2 | B3^ | Stable |
| Helenbergh China Holdings Limited | B2 | B3^ | Stable |
| Jiayuan International Group Limited* | B2 | B3^ | Stable |
| Jingrui Holdings Limited* | B2 | B3^ | Stable |
| Landsea Green Properties Co., Ltd.* | B2 | B3^ | Stable |
| Modern Land (China) Co., Limited* | B2 | B3^ | Stable |
| Hopson Development Holdings Limited* | B2 | N/A | Stable |
| Rongan Property Co., Ltd.* | B2 | N/A | Stable |
| Sinic Holdings (Group) Company Limited* | B2 | N/A | Stable |
| Sunriver Holding Group Company Limited* | B2 | N/A | Stable |
| Yincheng International Holding Co., Ltd.* | B2 | N/A | Stable |
| Xinhu Zhongbao Co., Ltd.* | B3 | Caa1^ | Negative |
| Tahoe Group Co., Ltd* | Caa3 | Ca^ | Negative |

^ The lower bond rating reflects subordination risk. * Included in the scenario analysis.
*Source: Moody's Investors Service*

## Moody's related publications

### Outlook

- Property - China: Outlook returns to stable; sales resume slow growth as virus disruptions recede, 31 August 2020

### Sector Comments / Sector in-Depth:

- Property - China Rated developers' leverage will improve, but profit margin will contract through 2021, 25 September 2020
- High-yield bond covenants — China: Chinese property developers loosen debt covenants in 2020 amid pandemic, 22 September 2020
- Property - China: China Property Focus: Regulatory measures will continue amid sales recovery, 27 August 2020
- Property - China: Developers' credit metrics will be largely flat in 2020, improve slightly in 2021, 7 May 2020
- Property - China: Most high-yield developers can address bond maturities during next 12 months, 16 April 2020

### Topic Page

- China Growth & Credit
- Coronavirus Effects
- Coronavirus Policy Response

### Methodology

- Homebuilding and Property Development Industry, 26 January 2018

## Endnotes

1 Eight rated subsidiaries of their rated parent companies and one rated issuer, which has not yet released 2020 interim results, are excluded.

2 The latest property scorecard report "**Property — China: Rated developers' leverage will improve, but profit margin will contract through 2021**" was published on 25 September 2020.

3 The latest property scorecard report "**Property — China: Rated developers' leverage will improve, but profit margin will contract through 2021**" was published on 25 September 2020

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