

SECTOR IN-DEPTH

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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.

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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 rate¹, 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:

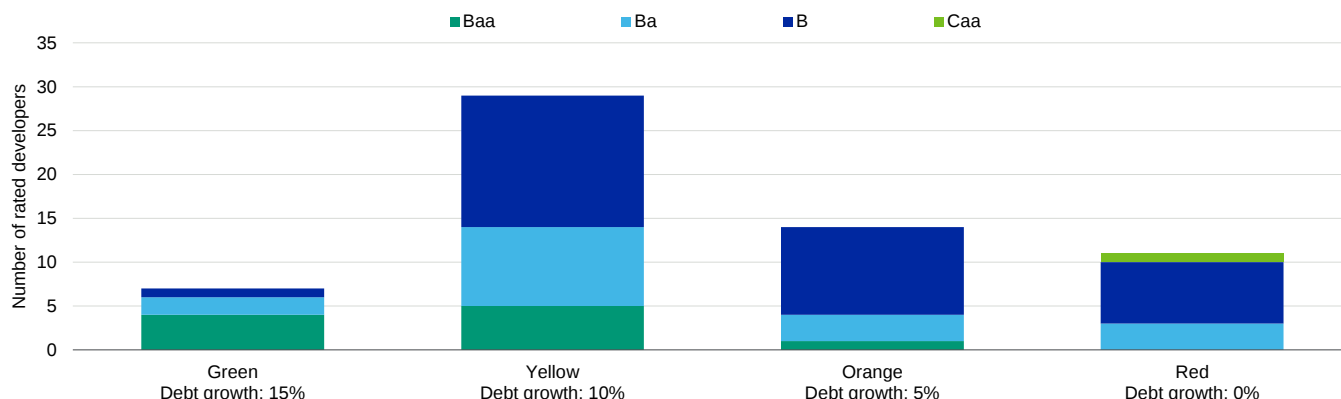
Total liabilities (excluding contracted liabilities)/ Total assets (excluding contracted liabilities)	≤70%
Net debt/Equity	≤100%
Unrestricted cash/Short-term debt	≥100%

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.

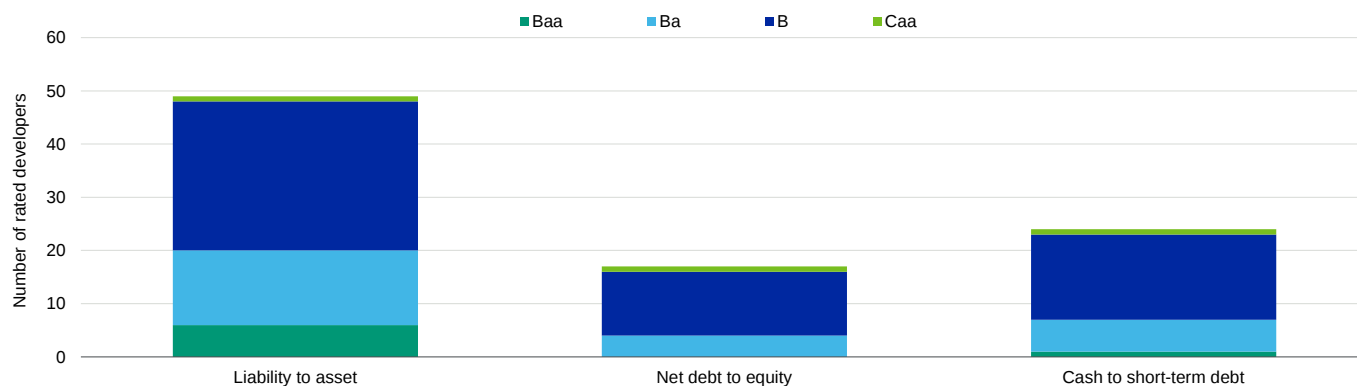
[2] The results of the tests based on the rated developers' financial results for 2019 do not have material difference from that of H1 2020.

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

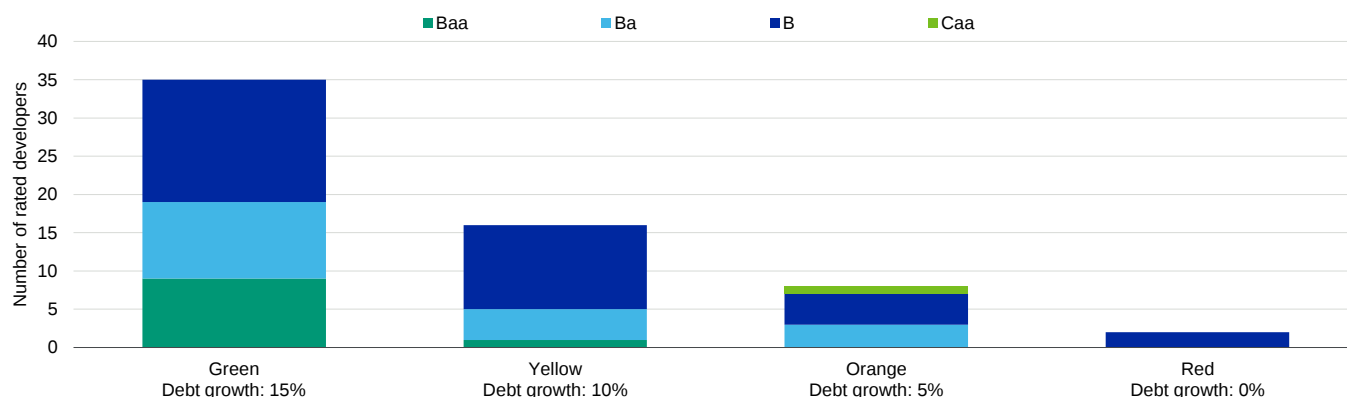
In this scenario, we included the amount of contracted liabilities in the calculation of total assets. We also included restricted cash as a cash component in the calculation of the cash to short-term debt ratio (see table below), given that at least part of the restricted cash could be used for construction 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 2019². 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

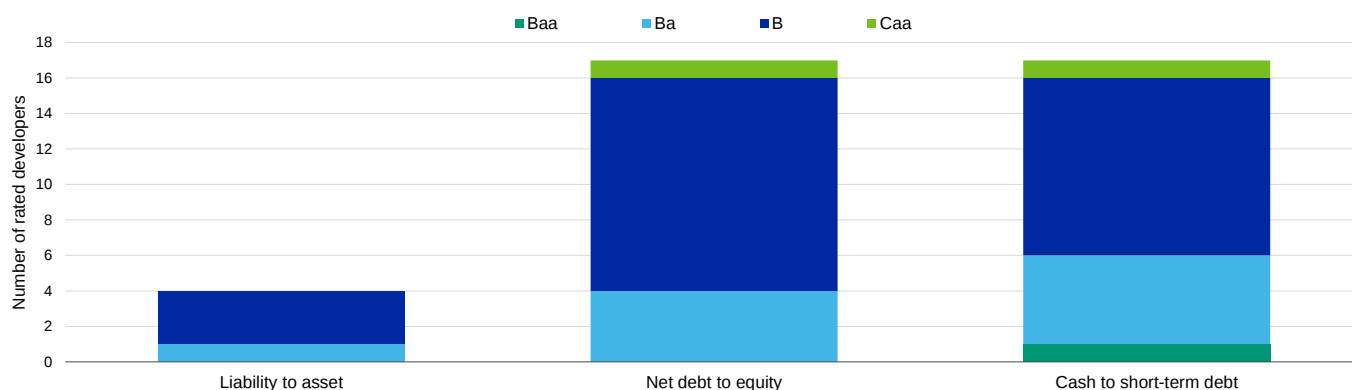
Scenario 2 — Most rated developers can grow their debt by the maximum of 15%

[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

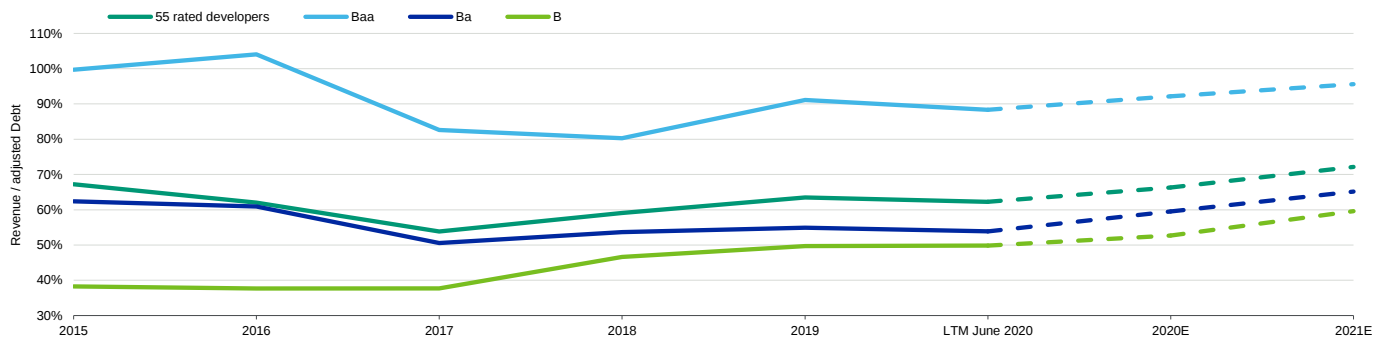
Chinese regulators are likely to continue to implement and fine-tune regulatory measures to control property developers' access to debt funding and, consequently, their debt leverage. These measures are aimed at maintaining the stability of the country's property sector and the health of the financial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