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Analysis of Real Estate Risk Analysis & Countermeasures Based on the Chinese Market

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Abstract: Chinese real estate is an important pillar of the economy, and the risk of it has shown a greater risk potential in recent years due to the impact of COVID-19. This study investigates the risks of Chinese real estate market and analyzes the corresponding risk-solving countermeasures in combination with government policies to achieve the smooth operation of the real estate market. Firstly, the study summarizes and investigates the risks of the real estate market in recent years, and comes up with four risk factors of the real estate market in China. Secondly, the study searches government policies in Chinese real estate industry through qualitative analysis and then analyzes the effects of their implementation. On this basis, the paper proposes a series of targeted countermeasure suggestions. According to the analysis, it is expected to put forward feasible proposals and preventive measures for the risks in Chinese real estate market, in order to promote the sound development of real estate enterprises.

Keywords: real estate, risk prevention, local strategy

1. Introduction

In the past twenty years, China's property market has developed rapidly and the real estate market has become a pillar industry for China's economic development. Now, the real estate market has become one of the core industries for China's economic growth. In 2022, the added value of China's real estate industry reached 7382.13 billion yuan, and the investment in real estate development reached 13289.5 billion yuan. Meanwhile, with the rapid development of China’s property economy, the financial attributes of China's property industry are increasingly strengthening. With the rise of commercial housing, the leverage attribute of the property industry has also significantly increased [1]. The Central Economic Work Conference in 2023 pointed out that it is necessary to effectively prevent and resolve risks in key areas and promote the steady and healthy development of the real estate market. Therefore, exploring the internal and external risks of China's real estate market, improving the means of preventing and resolving risks, and establishing a long-term mechanism to respond to real estate economic risks can not only stabilize property prices and Suppress the Rising Speculative Demand for Commercial Housing, but also have important significance for maintaining the stable and healthy financial market in China and promoting the sustained and stable development of the national economy under the new economic situation.

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Real estate risk refers to the enormous pressure faced by the real estate industry in development, operation, financing, and other aspects. With the continuous expansion of China's real estate industry and the strengthening of its financial attributes, the risks in the real estate have increasingly become prominent and become an important issue in economic development. The real estate risks in China are mainly reflected in the high asset liability ratio and excess inventory. In 2021, the average asset liability ratio of Chinese commercial housing development enterprises has reached 80.3%. High leverage operations increase the vulnerability and risk hazards of real estate [2]. Meanwhile, the poor circulation of real estate has led to a continuous increase in the stock of commercial housing, which has become an important factor driving up real estate risks at present. In addition, the high inventory of real estate in China has led to operational difficulties for real estate enterprises, and some real estate enterprises are facing the risk of bankruptcy due to insolvency. Sometimes there may even be "unfinished buildings" or delayed delivery of properties [3].

Additionally, there are significant regional differences in China's real estate market. The real estate prices in first tier and some second-tier cities have increased significantly, while the inventory of real estate in third and fourth tier small and medium-sized cities is still growing [4]. The real estate risks in China exhibit significant spatial differentiation. Moreover, the real estate market in China is closely related to the policy environment, and national macroeconomic policy regulation can also cause financing risks for real estate enterprises [5]. The adjustment of government policies such as interest rate policies, land policies, and financing policies will also bring significant fluctuations to the real estate market.

This study starts with an overview of the risks present in the current real estate market in China. Based on the government's response policies to relevant real estate risks, analyze the effectiveness of government policies. Besides, this study combines with mature domestic and international risk response policies to form effective policy recommendations. Finally, this article will elaborate on the limitations of current research on real estate strategies in China and identify future research priorities.

2. Contents of the Crisis

2.1. High Asset-liability Ratio

As a capital-intensive industry, real estate companies develop under the operating system of high leverage, high turnover, and low holding, i.e., they obtain loans from banks, use the loans to purchase land and construct buildings, and then use the land and buildings as collateral to obtain loans from banks to continue development after completion, and thus the real estate industry has a high gearing ratio. Currently, some Chinese real estate companies have gearing ratios in excess of 70%. 2022 gearing ratios for major real estate companies, as shown in Fig 1, are all well above the acceptable range of 40-60% gearing. Higher gearing can have a significant impact on corporate financing, especially when banks face funding problems or changes in business that reduce the amount of credit available for companies to borrow. With the reduction of credit supply and the restriction of external funding, it is difficult for real estate companies to develop new projects under the existing market conditions, reducing the profitability channels for real estate companies and preventing them from entering a virtuous stage of development. Some real estate companies even fall into difficulties in running their capital as a result, and eventually face the risk of bankruptcy.

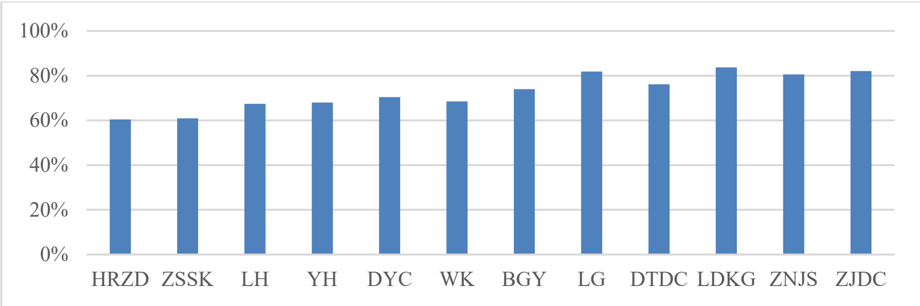

Figure 1: The asset-liability ratio of major real estate enterprises in 2022 after excluding advances.

2.2. High Financing Costs

China's real estate market is currently experiencing a deep adjustment. Due to policy measures such as the "three red lines", real estate developers are generally facing restricted access to financing, while some real estate companies are suffering from liquidity shortages and default risks. In recent years, the new crown pneumonia epidemic has gradually weakened public demand for housing, real estate sales have continued to decline, and real estate companies' investment yields have been affected, resulting in tighter lending conditions from banks and other financial institutions. Meanwhile, owing to the complex and severe situation of the prevention and control of the new crown pneumonia epidemic, the growth rate of real estate investment has slowed down, financing pressure has increased, and capital chain tension has intensified [6]. Difficulties in debt repayment of large real estate enterprises led to huge losses in financial credit for the entire real estate industry, and the credit ratings of many enterprises dropped, further increasing financing costs and making it difficult for real estate enterprises to restore liquidity in a timely manner. As the downward pressure on the economy intensifies, some real estate companies face the risk of capital chain breakage. If policy adjustments are not made in a timely manner to effectively alleviate the pressure, the risk of default by some real estate companies may spread to other real estate companies and the entire industry, leading to group bankruptcy and even triggering systemic financial risks.

2.3. Market Supply & Demand Imbalance

At present, there is a significant spatial difference between the supply and demand of real estate in China. There are significant differences between large and small cities, as well as between the eastern and central western regions. From a regional perspective, in the eastern coastal provinces of China, the prices of commercial housing and investment in real estate development are still showing a relatively stable increase, and housing prices are showing a high trend. On the other hand, the upward trend of housing prices in the central and western regions has significantly slowed down and is facing severe destocking pressure, resulting in a sluggish real estate circulation. From an urban perspective, the real estate market in large and medium-sized cities still maintains a high level of popularity. From 2020 to 2021, the growth rate of housing prices in major cities such as Beijing, Shanghai, and Hangzhou reached 10%, other small and medium-sized cities, there is a common situation where the supply of real estate exceeds the demand. Overall, the overall regional differences are gradually expanding [7]. The imbalanced regional development situation has increased the complexity of the real estate market and also brought difficulties to macroeconomic regulation and regulatory control of the property market. It greatly increases policy costs and also brings certain pressure to the business expansion and financing of real estate enterprises.

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2.4. External Policy Risks

External policy risk refers to the risk changes brought about by macroeconomic policy adjustments and changes in China's commercial housing market. In recent years, with the continuous rise of property prices in China and the widespread existence of high-risk operating models with high assets and liabilities in real estate enterprises, the real estate market has become a hot topic in society. On this basis, China has formulated increasingly strict policies for financing, management, and operation of commercial house market. In the meantime, Chinese government policies have a significant say in real estate policies [8]. Therefore, external policies can bring certain risks to the real estate market. One is reflected in the financing of real estate enterprises. The state has strengthened the operation supervision of real estate enterprises. For example, the establishment of 'Three red lines' has strictly regulated the debt scale and debt growth of real estate enterprises, which has brought enormous operational pressure to real estate enterprises from the perspective of laws and policies. Many real estate companies are forced to shrink their business scale, and some companies are forced to withdraw from the market due to financial pressure. On the other hand, various regions in China have also implemented purchase and loan restrictions on commercial housing, suppressing speculative demand, which reduces the demand and brings more risks to enterprises.

3. Policy and Its Effectiveness Evaluation

3.1. Improve Financing Management & Prevent Financial Risks

In order to avoid large-scale debt default and bankruptcy of highly indebted and leveraged real estate enterprises, the Central Bank and the Ministry of Housing and Construction issued the "Three Red Lines" real estate financing management policy in August 2020, which was implemented on 1 January 2021. The policy stipulates that the gearing ratio of real estate enterprises, excluding advances, shall not be greater than 70%, the net debt ratio of real estate enterprises shall not be greater than 100% and the cash to short term debt ratio shall not be less than 1. Depending on how the "three red lines" are stepped on, real estate enterprises are divided into "red, orange, yellow and green "The red grade enterprises have all three indicators stepped on the line and their interest-bearing liabilities cannot be increased further; orange grade enterprises have two indicators stepped on the line and the annual growth rate of their interest-bearing liabilities cannot exceed 5%; yellow grade enterprises have only one indicator stepped on the line and the annual growth rate of their interest-bearing liabilities can be relaxed to 10%; green grade enterprises have all indicators met the requirements and the annual growth rate of their interest-bearing liabilities can be relaxed to 10%; green grade enterprises have all indicators stepped on the line and the annual growth rate of their interest-bearing liabilities can be relaxed to 10% [9]. If all indicators are met, the annual growth rate of interest-bearing liabilities can be relaxed to 15% [10]. Since the introduction of the 'three red lines' policy, more than half of the listed real estate companies have stepped on the red line. In order to protect their capital channels, real estate companies need to adapt to green-file companies to save themselves. Real estate is a capital-intensive industry that is highly sensitive to capital and policy guidance. By implementing the 'three red lines' policy, real estate companies have reduced their debt burden and land holdings, promoting the healthy and sustainable development of the industry as a whole. At the same time, however, the implementation of the policy has two sides. The continued tightening of financing policies has increased the debt pressure on real estate companies and restricted cash flow, leading to high default rates and making real estate risk higher.

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3.2. Strengthen Policy Support to Ease Inventory Pressure

On July 28, 2022, the Central Policy Bureau meeting stated, “stabilize the housing market, adhere to the concept that houses are for living and not for speculation, maximize the use of urban policy tools to stimulate a strong and good demand for housing, and strengthen local governments to protect housing supply and stabilize people's livelihoods”. In the first half of 2022, many local governments introduced a series of policies to ease supportive policies for housing financing pressure to prevent the credit boom from continuing, including easing housing supply and demand policies, lowering interest rates on deposits and loans, and requiring financial institutions to provide more support for people to purchase homes. Some local governments have focused on addressing the difficulty of buying homes for households below middle income, so that people with a genuine need to buy homes can do so without having to look ahead and deal more effectively with the difficult problem of large real estate inventories. In cities such as Beihai, Nanning and Yinchuan, housing reserve loan limits were raised and municipalities increased their lending by 15-20%. In cities such as Fuzhou, Zhangzhou and Shanwei, the pressure to ease people's down payments on commercial properties was eased by allowing people to withdraw their housing reserve funds [11].

3.3. Strengthen Market Regulation

In recent years, with the rapid development of China's real estate market, the phenomenon of overheating in the real estate market has become a focus issue. In order to curb the overheated demand in the real estate market and stabilize financial order, China has gradually strengthened its supervision of the real estate market, strengthened risk assessment and early warning, covering multiple links such as banking, estate enterprises, and real estate brokerage business. The supervision has the characteristics of adapting to local conditions, classified supervision, and gradual progress [12]. In December 2020, the Chinese government introduced relevant regulations to ensure safe restrictions on the proportion of real estate loans to financial institutions. On the one hand, strict regulatory policies have standardized market order, playing an important role in reducing assets and liabilities and regulating enterprise operations. On the other hand, strict and frequent regulatory policies have also created certain policy risks, which have affected the operation and the sales of commercial housing to a certain extent. In 2022, the newly constructed housing area of real estate development enterprises in China was 1205.87 million square meters, a decrease of 50.6% compared to 2021, and the vitality of the real estate market was affected.

Figure 2: China’s Average Sales Price and Growth Rate of Commercial Housing from 2017 to 2021.

3.4. Suppress Speculative Demand & Stabilize Property Prices

China's housing sales market has adhered to the policy principle of ‘housing without speculation’, focused on curbing excessive speculative transactions in the real estate market, and taken measures to meet the rigid housing needs of residents in recent years. For a period of time, China has repeatedly lowered the down payment ratio for the first home and the interest rate for personal housing loans for the first home, and implemented policies such as tax incentives to accurately alleviate the pressure of housing needs. For speculative real estate demand, China has introduced multiple policies to adjust the housing supply structure and suppress speculative demand based on the different situations of different cities. The government plays a regulatory role in various aspects such as credit, taxation, and land supply. At the same time, China has implemented property tax policies in areas such as Shanghai and Chongqing, which have achieved good results[13]. From 2018 to 2022, the average sales price growth rates of housing in China have been 2.83%, 5.9%, 6.69%, 10.57%, and 5.56% (seen from Fig. 2), respectively, indicating a significant slowdown in the growth trend. Under the combination policy of suppressing speculative demand and stabilizing real estate prices in China, the phenomenon of excessive speculation has been curbed to a certain extent, and the financial risks have been effectively alleviated [14].

4. Suggestions & Implications

4.1. Prevent Financial Risks & Regulate Market Order

The real estate industry is huge and covers a wide range of areas, accounting for a large share of local fiscal revenues and total loans from financial institutions, thus having an important impact on maintaining economic and financial stability and preventing risks. In order to prevent the real estate crisis from negatively affecting people's lives and the national economy, the government must take active measures. The government should strengthen the supervision of the financial market in the real estate industry to ensure proper governance of financial institutions, prevent excessive funds from entering the real estate market and avoid the accumulation of financial risks. It should also improve real estate credit policies, prudently control the scale of real estate loans, and strengthen credit supervision for real estate developers and home buyers to avoid excessive credit and leverage effects.

The government has taken various support measures to relieve the pressure of real estate inventory, but the effect of real estate deleveraging decline is not obvious. Raising prices to reduce inventory is one of the main real estate strategies at the moment. Higher property prices have increased the willingness of those who have already purchased property to buy investment properties without fear of falling prices resulting in lower profits. At the same time, those who are already ready to buy accelerate their purchase decisions to avoid losses from further price increases. While rising house prices have had a positive impact on the reduction in property supply, the main driver of real property demand is the middle-income group, which has a strong desire to buy a home but lacks the purchasing power to do so. In recent years, housing prices have been rising and high prices have reduced their willingness to buy [15]. Therefore, the government needs to take measures to stabilize real estate market prices, increase real demand for real estate, achieve effective deleveraging, and ensure sustainable real estate development while promoting a healthy and stable national economy.

Although there are significant regional differences in real estate across the country and the government needs to tailor policies to cities and local conditions. To promote the stability and healthy development of real estate, it is necessary for the central government to provide overall guidance on real estate policies, for example planning the overall situation and introducing some

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effective policies to ease the current pressure on real estate, so as to achieve the purpose of stabilizing house prices and curbing bubbles. Additionally, the development of policy synergy should be strengthened in all regions to ensure the coordination of real estate policies. It will help to reduce the excessive impact of policies on the market and maintain market stability. Once some of the pilot real estate policies have been successful, the government can then generalize them to the whole country, which includes introducing a real estate tax, accelerating land supply-side reforms to expand the supply of urban residential land, strengthening urban construction and improving software and hardware facilities, implementing a policy of equal rights for rent and purchase.

5. Limitations & Prospects

Currently, research on real estate risks mainly focuses on the financial field. From a macro perspective of the market, current research mainly discusses credit and financing systems. From the micro perspective of market entities, current research mainly focuses on the debt management of real estate enterprises, discussing from the perspectives of corporate debt ratio and real estate liquidity ratio. Therefore, the policy risks and regional differences in the real estate market have become limitations of research. On the other hand, current research on real estate market policies often uses econometric models to analyzing the effectiveness of market policies in practice, lacking an overview of the overall macro perspective.

The future focus of research will be on external policy risks and regional risk coordination. In terms of policy risks, in the future, one will further explore the impact of government policies on the property market and elaborate on the risks of real estate policy from both favorable and unfavorable aspects. At the same time, future research will also focus on regional risk coordination, exploring the risk characteristics and solutions previously faced by the eastern, central, and western regions of China, as well as the risk differences faced by large cities and small and medium-sized cities.

6. Conclusion

Currently, the property market in China is facing severe risks, mainly manifested as high inventory, high liabilities, and high costs. Moreover, another significant feature of the risk in China's real estate market is regional differentiation. There are significant differences in the types of real estate risks and the development of the real estate market between large and small cities. The real estate industry in China is closely related to financial investment, land finance, and residents' needs. Thus, the risk of the real estate market has become an important issue that needs to be urgently addressed.

In order to address various risks in the property market and establish a stable and healthy property market mechanism, China has adopted diversified real estate regulation policies. These policies can be summarized into four aspects: improving the financing management system, strengthening policy support, tightening market supervision mechanisms, and combating excessive speculative demand. However, these policies have a two-way influence. On the one hand, China's property policies have played an effective role in resolving market risks and stabilizing market confidence. Strict debt management and market regulation have effectively suppressed the uncontrolled expansion of real estate development business, greatly standardizing the operating mode of real estate enterprises. Meanwhile, policy support can play a role in reducing inventory, balancing supply and demand, and safeguarding residents' housing rights and interests. On the other hand, strict policies also bring certain policy risks. The financing management policy represented by the "Three red lines" has produced a large number of debt defaults, and at the same time caused a considerable number of enterprises to face severe Liquidity risk due to financing difficulties.

The real estate economy has made great contributions in China. Therefore, in the face of the complex real estate market risks in China, in addition to strict asset liability management, strengthened supervision and support, one should also focus on avoiding external policy risks. While suppressing speculative demand in the real estate market and stabilizing real estate prices, one should also maintain market vitality and avoid the phenomenon of bipolar reversal. Policy regulation should also pay attention to the current problem of increasing differentiation in China's real estate market. Targeted solutions should be taken to address the different real estate market pressures in large and small cities, and multiple measures should be taken to maintain the stability of China's real estate market.

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