

## Special Comment

## Centralized land supply policy will accelerate credit divergence of real estate companies

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Hong Kong, 1 March 2021 — China Chengxin (Asia Pacific) Credit Ratings Co., Ltd. ("CCXAP") says that the centralized land supply policy will accelerate the credit divergence of real estate companies. The Ministry of Natural Resources of the People's Republic of China recently released a notice on the classification and regulation of residential land supply for 2021, requesting all parts of the country to actively take measures to muster rational competition in the residential land market. The residential land transfer policy will set measures to control land premiums, the number of bidding rounds, and the maximum price on land sales. The policy targeted 22 key domestic cities, including four first-tier cities (Beijing, Shanghai, Guangzhou, Shenzhen) and eighteen second-tier cities (Nanjing, Suzhou, Hangzhou, Xiamen, Fuzhou, Chongqing, Chengdu, Wuhan, Zhengzhou, Qingdao, Jinan, Hefei, Changsha, Shenyang, Ningbo, Changchun, Tianjin, Wuxi). The new policy required local governments to reasonably arrange the timing of auction as well as control the listing of residential land sales, implementing the so-called "two centralizations" policy. The "two centralizations" policy required the local government to fulfill two things. One was to centrally issue the land transfer announcements, which could not be issued more than 3 times in 2021; the second was to centrally organize land transfer activities.

The policy has been implemented and promoted in some regions. Zhengzhou, Tianjin, Qingdao, Jinan, and other places issued relevant internal documents or announcements in accordance with the notice from the Ministry of Natural Resources. On 23 February, the Zhengzhou's Bureau of Natural Resources and Planning issued the "Emergency Notice Concerning the Unified Organization of Announcement of Residential Land Assignment" 《关于统一组织住宅用地挂牌出让公告发布的紧急通知》, withdrawing the residential land sale right in some areas, and the future land sale announcement will be only organized by Zhengzhou's Bureau of Natural Resources and Planning. On the same day, Tianjin's Bureau of Natural Resources and Planning issued the "Notice on Doing a Good Job in the Centralized Transfer of Residential Land in 2021" 《关于做好2021年住宅用地集中出让有关工作的通知》 and decided to publish land sale announcement in three designated days including the middle of March, June and September. On February 24, Qingdao's Bureau of Natural Resources and Planning issued a document requiring strict implementation of the policies published by the Ministry of Natural Resources' notice on residential land supply classification and preparation for the proposed residential land supply. The announcements of residential land sales will be issued three times only throughout the year in order to guide the market to compete rationally. On February 25, Jinan's Bureau of Natural Resources and

Planning arranged a special meeting to study how to deploy the residential land supply regulation and control in 2021. At the same time, Jinan's Public Resources Exchange Center terminated nine land transactions which were previously announced.

The centralized land supply policy came out after the "three red lines" policy in August 2020, which aimed for controlling debt growth of real estate companies. The new policy reaffirmed the government's policy stand of "houses are for living in, not for speculation" and targeted to stabilize land prices, control land premium rates, and establish a reasonable supply-demand relationship so as to promote the long-term development of the real estate market. CCXAP believes that the centralized land supply policy may accelerate the credit differentiation of real estate companies. We expect that the changes in the real estate industry under the new policy include: (1) higher requirement on real estate companies' capital control and project management, and large enterprises with more readily available funds to have distinct advantages; (2) pressure on the profitability of real estate projects and the destocking of inventories, thus poorly performed real estate companies, especially for those with small- and medium-size may be merged; and (3) cooperation projects to be increased that will widen project implementation risks and off-balance-sheet financial risks.

### **Centralized land supply has higher requirements on capital control and project management, benefiting large enterprises**

Under the new policy, local governments in different regions will only release land announcement three times a year. It will test a real estate enterprise in the ability of investment analysis in the early stage and project management in the later stage. In addition, companies need to prepare sufficient funds during the period of centralized land supply. Small and medium-sized real estate companies with weaker financial position and limited financing capabilities will be more difficult to participate in the land auction. On the contrary, it is easier for those with strong cash flow management and financing capabilities, such as central enterprises, state-owned enterprises and leading real estate enterprises, which will have great advantages in land acquisition. At the same time, considering the debt control policy of the "three red lines" on real estate sector, we believe the domestic real estate companies will enter a deleveraging stage. Funding of land investment will be more relied on their own cash generation capabilities. Land acquisitions of small and medium-sized real estate companies will be further compressed, and the differentiation between large and small real estate companies will be intensified.

### **Profit margins may be narrowed as project launching to be centralized to meet with the timing of land supply**

Under the new policy, due to the simultaneous launch of many land projects, the subsequent housing supply will increase as well. If a large number of new properties are listed in the market in a short period, market competition will be intensified. Some developers may sell at a discounted rate in order to accelerate cash collection, which will impose pressure on property price. In addition, low-quality projects may find difficult to sell and it will challenge the company's profits and cash collection. We believe tolerance on decision-making error for real estate companies to be lower in the future, and the room of development for small and medium-sized real estate companies to be compressed. And the possibility of small-scale real estate companies with operational problems will be more likely to be acquired by larger real estate companies.

**Cooperation projects to be increased that will widen project implementation risks and off-balance-sheet financial risks**

Under the new policy, land supply will be rolled out in designated time, and companies need to prepare large funds to participate in land bidding. In order to participate more auctions, increase the success rate of land bidding as well as diversify project risks, we expect that real estate companies will more eager to cooperate with other companies in land bidding and project development. However, under the current collaboration model of multiple developers, especially in joint-management projects, due to the different development requirements, measurement standards, judgments of project positioning of other real estate companies, and differences in corporate culture, it will increase the cost of the project, reduce the efficiency of cooperation, and delay the progression of the project. In addition, there may be problems with the responsibilities in the later stage of the cooperation project, such as the completion and delivery of houses and properties. We believe that we need to pay attention to the implementation of cooperation projects and the efficiency of operation between different companies. For companies with more exposure to collaborative projects, the scale of off-balance sheet assets and liabilities is relatively large, which will weaken the reliability of financial analysis on them.

In conclusion, CCXAP believes that the centralized land supply policy will accelerate the credit divergence of real estate companies. Due to the higher requirements of the policy on capital control and project management of real estate companies, the pressure on small and medium-sized real estate companies with weaker operating conditions under the environment of reduced financial leverage has increased. In contrast, companies with strong cash flow management and financing capabilities, such as central enterprises, state-owned enterprises, and leading real estate companies, will have a more obvious advantage in land acquisition. We are also concerned that under the new policy, the profit margins of companies may shrink, destocking pressures may appear in certain regions, mergers and acquisitions and cooperation



projects may increase. We need to pay attention to small real estate enterprises with weak business operations, limited financing, and inferior liquidity. We believe that the policy on new borrowings restriction on real estate companies continues. The peak of real estate dollar debt maturity will come in 2021 and 2022. CCXAP will closely monitor the impact of the credit differentiation of real estate companies in onshore capital market under the new policy.

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