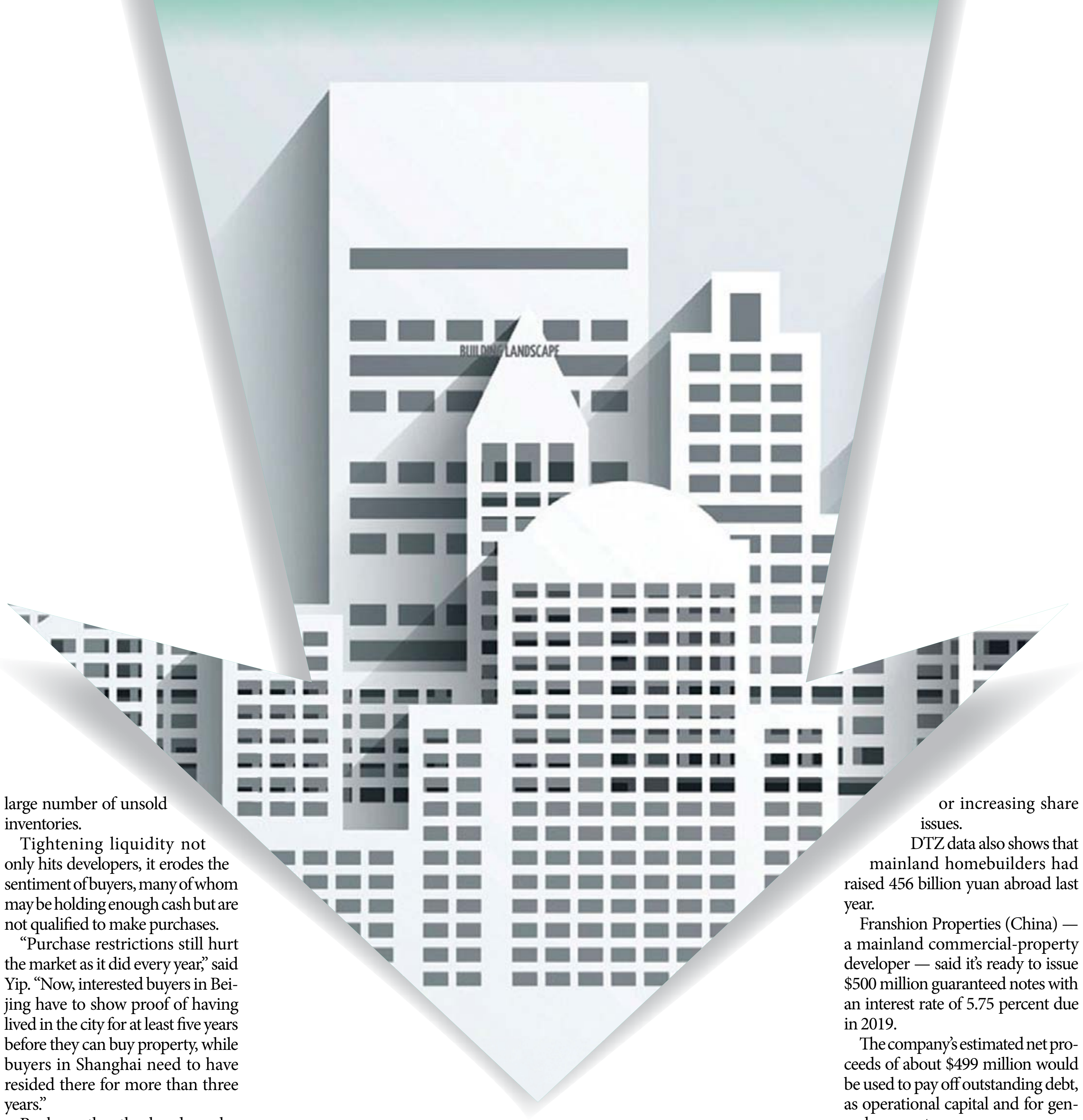
Bubbling under

As mainland property developers struggle with liquidity woes and dwindling home sales, heavy price discounting is the order of the day. In a bid to defuse the situation, the central bank is urging banks to lend to first-time homebuyers to give builders a lift. Lin Jing reports.



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> ALVIN YIP
> DIRECTOR OF CHINA INVESTMENT, DTZ

Amid a nationwide slowdown in residential property sales, the central bank, the People's Bank of China (PBOC), has stepped in, telling banks to increase mortgage lending to homebuyers, particularly first-time homeowners.

The move comes as builders slash their prices to dispose of properties to get themselves out of a cash crunch, fueled by tightening liquidity.

Under the PBOC directive, banks are required to give priority to first-time homebuyers, offer reasonable mortgage rates and give timely approval and distribution of housing loans to eligible buyers.

Kaven Tsang, vice-president and senior analyst with Moody's Investors Service, hailed the development as "credit positive" for developers, especially those sitting on huge housing reserves.

"A quick loan approval process would lead to more timely disbursement of funding for homebuyers and subsequently boost developers' cash flow," he said.

Property sales on the mainland have been in the doldrums in the first quarter of 2014, with major developers resorting to price cuts to solve their cash flow as liquidity tightened.

Zhejiang Headway Holding Co, a property developer in the eastern coastal province of Zhejiang, said more than 160 of its flats will be sold at up to 32 percent discount, starting from last month.

China Vanke, the nation's largest developer by market value, also reduced its prices in April, with some projects seeing discounts of between 400,000 yuan ($64,040) and 500,000 yuan.

Widespread price cuts

Property price cuts have been widespread on the mainland, affecting the entire market sentiment. A research report by real estate consultancy Centaline Property shows that cities like Chengdu, Shenyang and Hangzhou had recorded property sales of only between 5 percent and 25 percent by April 30, especially in the high-end residential sector.

During the recent May Day "Golden Week", only 169 deals were signed, down by 60 percent compared to the lowest transactions in 2008, setting a seven-year bottom line.

One homebuilder in Fuzhou, Fujian Province, even accepted zero down payment for residential purchases. Fuzhou saw a 44 percent plunge in transactions from May 5 to May 11, compared with the previous week.

According to the National Bureau of Statistics (NBS), the national sales volume for homes reached 1,326.3 billion yuan in the first quarter of this year — down by 5.2 percent year-on-year. In 2013, the full-year growth was 26.6 percent.

Total investment in real estate amounted to 15.3 trillion yuan in the first quarter of 2014 — up by 16.8 percent compared with the same period last year, pointing to a sharp slowdown compared with last year's monthly 19 percent increase.

The property sector's underperformance in major cities has sparked concern over whether the bubble will burst this year.

Pan Shiyi, chairman of SOHO China — the country's largest prime office, real-estate developer — expressed concern over the future of the residential market, warning that more restrictive policies may be on the cards, further dampening the market. Such steps might include registration of real estate and a property tax by year-end.

He agreed that current property prices are too high for potential buyers, and more homebuilders might face a cash crisis.

Causes of slowdown

Alvin Yip, managing director of China investment at DTZ, a real-estate services company in Hong Kong, gave several reasons for the slowdown in the first quarter.

"Many cities have seen an oversupply in property within a short period of time, and tightening credit is negative for mainland property developers," he said.

Yip said there's already an abundance of empty residential buildings in many cities, including Huizhou in Guangdong Province. According to DTZ, Hubei's provincial capital Wuhan and Hunan's provincial capital Changsha have also seen a large number of unsold inventories.

Tightening liquidity not only hits developers, it erodes the sentiment of buyers, many of whom may be holding enough cash but are not qualified to make purchases.

"Purchase restrictions still hurt the market as it did every year," said Yip. "Now, interested buyers in Beijing have to show proof of having lived in the city for at least five years before they can buy property, while buyers in Shanghai need to have resided there for more than three years."

Banks, on the other hand, are also more cautious over extending mortgage loans, and this could go on for up to six months.

Yip said it may take some time to deal with developers' existing inventories. "The government wants the property (market) to stabilize instead of going up too high or falling too fast."

He predicted that property prices in first-tier cities will stay at almost the same level, while those in second-tier cities will be under pressure and will see price declines of up to 10 percent.

For developers with real estate as their secondary business, they may also face serious challenges.

Some big State-owned enterprises and private companies are using their own cash and bank loans to buy land or build residential homes, and expect to collect proceeds from sales of those inventories.

Fitch Ratings thinks that if the rate of construction remains the same as in the past seven years, the risk of a nationwide housing oversupply will be substantial by 2020, leading to a "hard landing", substantially hurting developers' sales and profit margins.

Yip pointed out that these enterprises have been relying too heavily on cash from sales, and will have cash-flow problems. "It's possible some of these enterprises will be knocked out of the industry for good."

Another issue haunting mainland developers is their funding ability. Property developers are highly leveraged to keep their operations ongoing. There have been cases of major developers trying to secure funding by getting themselves listed offshore and issuing bonds, or increasing share issues.

DTZ data also shows that mainland homebuilders had raised 456 billion yuan abroad last year.

Franshion Properties (China) — a mainland commercial-property developer — said it's ready to issue $500 million guaranteed notes with an interest rate of 5.75 percent due in 2019.

The company's estimated net proceeds of about $499 million would be used to pay off outstanding debt, as operational capital and for general corporate purposes.

In the first three months of 2014, more than 30 mainland developers had applied to issue additional shares. Seven of them were allowed to issue a total of 15 billion yuan in stocks.

Potential risks warning

Fitch associate director Andy Chang, however, warned that this could create potential risks. "Any tightening of debt-funding sources, either onshore or offshore, will curtail the growth potential for many, given their reliance on debt to fund land acquisition and construction," he said.

Chang said offshore debt capital markets have continued the strong momentum at the beginning of the year as developers locked in interest rates. New bonds issued will help reduce developers' refinancing risks given that part of the proceeds will be used for repayment of their maturing offshore bonds.

"We expect bond issuances to slow down for the rest of 2014 as overall market sentiment cools down following the default by Zhejiang Xingrun Real Estate in March, and the US Federal Reserve trimming bond buybacks."

Chang said there's still abundant demand for housing, at least in the next five years, generated by rapid urbanization and improvement in the standard of living in cities.

The State Council published The National New Urbanization Plan (2014-2020) on March 16, 2014, targeting 60 percent urbanization.

Under the plan, 45 percent of people living in cities will have *hukou*, or household registration system, by the end of 2020.

The urbanization rate and the number of people with *hukou* in the cities stood at 53.7 percent and 36 percent, respectively, at the end of 2013.

According to the NBS, the mainland experienced a high speed of urbanization from 1996 to 2013, with an annual rise of above 1.2 percent.

There are currently an approximate 731 million people living in cities, generating substantial demand for housing.

"Urbanization and increases in people's disposable income will undoubtedly trigger demand for homes. Strong developers still have room to grow," said Chang.

Local governments are also gradually allowing couples, with one of the parents being a single child, to have two children to help alleviate looming demographic problems.

Yip said relaxation of the one-child policy will spur demand for housing in the long term.

China Vanke President Yu Liang said the company is prudently optimistic about the property market, adding that the urbanization process will guarantee benign development for the housing sector in the long run.

He estimated that total contract sales will be between 5 percent and 10 percent this year — compared with 12 percent in the first 11 months of 2013.

In general, the growth in third and fourth-tier metropolises will be less than those in first and second-tier cities due to weaker purchasing power and smaller populations, Chang said.

According to Moody's Investors Service, the 2013 financial results for 50 rated mainland property developers showed weakening credit trends, but most are strong enough financially to cushion off and withstand challenging business conditions this year.

It expects developers' sales growth to moderate this year from the unusually high levels seen in 2013.

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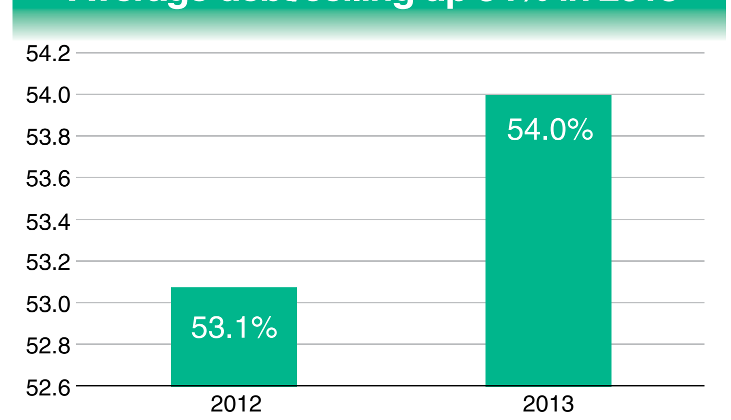
Average debt/ceiling up 54% in 2013



Source: Moody's Investors Service

Urbanization Rate

Unit(m)	Total population (estimated for 2020*)	People living in cities	Urbanization rate (%)
End-1999	1,258	437	35
End-2013	1,361	731	54
End-2020	1,408	846	60

*Assuming 0.492% of rate of natural increase in 2013 will continue until end-2020

Source: NBS

Cities with highest inventories since 2006

City	Unsold inventory – residential (as of Dec 2012)	Unsold inventory – residential (as of Dec 2013)	Unsold inventory – residential (as of Mar 2014)
Wuhan	13,887,000	14,395,000	14,045,000
Changsha	11,096,000	11,666,000	10,497,000
Shenzhen	3,863,000	5,356,000	5,296,000

Source: DTZ

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> ANDY CHANG
> ASSOCIATE DIRECTOR, FITCH RATINGS