Stabilizing Developers' Cash Flow: A Key Priority in China's Real Estate Market

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Abstract: *Over the past two years, the downward correction in China's real estate industry has been reasonable, but it still deviates significantly from the trend. Unlike real estate market crises abroad, the recent corrections in China's market are not due to risks in the residential sector but in the real estate companies. Frequent risk events in these companies in the past year have led to reduced government-led spending and a decline in real estate-related credit, exacerbating a lack of demand. The most urgent issue facing developers is their short-term cash flow shortage. The immediate priority is to stabilize the financing cash flow of these enterprises, requiring both their own efforts and policy support. Policy support should focus on both supply and demand, and it should be implemented as soon as possible.*

The past two-plus years of correction in the real estate market have significantly deviated from the trend.

In 2023, China's real estate market showed overall weakness, with significant negative growth in both sales and investment. Real estate companies faced widespread liquidity difficulties. Data from the National Bureau of Statistics showed that from January to November, the national commercial housing sales area decreased by 8.0% year-on-year, real estate development investment fell by 9.4%, and the funds in place for real estate development enterprises decreased by 13.4%. A new concern in 2023 was whether large, operationally stable real estate companies could repay their debts on time.

China's real estate industry has passed its peak development period and is now experiencing a trend of downward correction. Real estate companies have accumulated excessive debt, with generally high debt-to-equity ratios, far exceeding those of foreign counterparts and other industries.

In this context, the downward correction of the real estate industry has its reasonable aspects. However, the correction of the real estate market over the past two-plus years has been too intense and significantly deviated from trend values.

Financial institutions withdrawing loans from real estate companies and the significant drop of bond prices of these companies are rational on an individual basis. However, when combined, these micro-level actions lead to a fallacy of composition, creating a negative cycle among the real estate market, financial market, and macroeconomic operations. Without strong external intervention, this negative cycle could lead to a spiral, excessively deepening the downturn and negatively impacting the economy.

The Impact of Real Estate Corrections on China's Economy

Over the past two-plus years, the real estate market has been undergoing a deep correction, dragging down the stability of the macroeconomy. In 2023, with the end of the pandemic, the market expected a strong, revengeful economic recovery. However, a year later, the recovery has not been as robust as anticipated, primarily due to insufficient demand. This shortfall in demand can be broken down into private-sector demand and government-led demand. In 2023, a more prominent manifestation of this was a significant decline in government-led spending, including general public budget spending, government fund spending, and government-led investment project expenditures. The substantial decline in government-led spending not only directly reduced total expenditure but also indirectly reduced private sector income and spending.

The main reason for the decline in government-led spending was the drop in government land revenue, closely related to the real estate market operations in 2023. Real estate companies, busy with self-rescue and inventory digestion, lacked the capability and willingness to acquire land, leading to a sharp decrease in local government land sale revenue. According to the government work report, the target for broad fiscal spending (general public budget and government fund expenditures) in 2023 was 6%. However, data from the first 11 months showed that the national general public budget expenditure was nearly 24 trillion yuan, up 4.9% year-on-year, while government fund budget expenditure was 8.3 trillion yuan, down 13.3% year-on-year. The combined year-on-year growth rate was about -0.5%, narrowing the gap with the target compared with that of the first three quarters, but still falling short. In the first 11 months, local government fund budget revenue was 4.8 trillion yuan, down 14.4% year-on-year, with land transfer revenue at 4.2 trillion yuan, down 17.9%. Land transfer revenue accounted for nearly 90% of the local government fund revenue during this period.

Although governments at all levels are seeking new financing channels for local governments, these are still limited compared to past land sale revenues. Therefore, local governments have had to cut spending. Under this transmission mechanism, the real economy sector has been the most severely affected, impacting new employment, resident income, corporate profits, and social expectations. China's recent deep correction of the real estate market differs from the general real estate market crises abroad. In foreign countries, the typical scenario involves a real estate price bubble burst, plunging numerous home-buyers into debt difficulties and trapping lending financial institutions and the financial market in trouble, leading to financial tightening and further contagion to the real economy sector. Our situation is not like this. In the past few years, China's houselold sector has not used high leverage for property speculation, and the current round of housing price corrections has been relatively moderate, keeping the overall household balance sheet relatively healthy.

The financial risk in our real estate sector lies not in the household sector but in real estate development companies. The risk events frequently occurring in these companies over the past year have directly led to a decline in government-led spending and real estate-related credit, exacerbating the lack of demand. There has always been concern about whether the high growth of real estate loans squeezes the development of other sectors. In the CF40 working paper "New Citizens and New Models: Towards the Future Real Estate Market" published in June 2022, we argued that the current and future main concerns are not that the real estate industry is occupying too many credit resources, but rather the contraction of credit in this industry. Since 2012, related loans in the real estate industry (both mortgage and development loans) have supported overall social credit growth and purchasing power for goods and services for enterprises, playing a supporting rather than squeezing role in the development of other industries. The key is to look at the macroeconomic environment at that time. After 2012, China's capital-intensive industries passed their peak development period, and the market's endogenous credit demand from the corporate sector dropped sharply. The scarcest resources for corporate development are not credit, but income and profit. Under conditions of weak spontaneous credit demand in the market, the financial sector lacks quality credit customers, and loans created by the real estate industry generate income growth for enterprises, governments, and residents, supporting the growth of overall social purchasing power and the development of other sectors.

However, due to the high debt of real estate companies corresponding to a large amount of "sedimentary assets" that are difficult to generate cash flow, under current market conditions, the debt and interest pressure of real estate companies will continue to erode corporate cash flow, leaving real estate companies with little room for self-rescue. Real estate companies are struggling to operate normally due to accumulated debt and tight cash flow,, affecting the credit foundation of governments, industrial enterprises, and resident risk preferences, and restricting the expansion of credit in the entire society.

Major Challenges Faced by Real Estate Developers

The real estate market currently faces two main issues. The first and most urgent short-term problem is the cash flow shortage faced by real estate companies. The second is the difficulty for migrant workers in megacities to find affordable housing, with the housing situation of the middle and low-income groups remaining unresolved, making the issue of inadequate housing for these groups particularly prominent.

The cash flow shortage of real estate companies stems mainly from two reasons. First, there's a significant decline in sales revenue; many real estate companies in 2023 only achieved about half, or even less, of their average sales in the past few years. Second, there's the obstruction in corporate financing, with some even facing loan withdrawal by financial institutions.

The persistent challenge for migrant workers to find affordable housing in megacities is an old problem that hasn't been adequately resolved. The underlying causes of this issue are more complex, including a shortage of residential land supply in urban areas, insufficient public service support for migrant workers, and inadequate construction of affordable housing. Looking to the future, the real estate market needs to establish a comprehensive set of development logic that serves these new urban residents.

Real estate policies should be stronger.

Given the interaction between the real estate market and policy over the past two-plus years, the market has undergone a deep correction, and accordingly, real estate regulatory policies have been modified. However, the extent and impact of the market's downward correction often exceed expectations, making it challenging for policy responses to keep pace with market changes.

Leading the market with real estate control policies is highly challenging. This involves corrections in macroeconomic policy, financial regulation, and various real estate-related policies. It requires close coordination between multiple departments and differentiated approaches based on the specific conditions of different cities.

Stabilizing the real estate market is crucial for maintaining macroeconomic stability. Despite the significant challenges currently facing the real estate market, macroeconomic management authorities must be determined to implement more forceful policies that precede market trends to prevent the negative cycles mentioned earlier. This proactive approach is essential to steer the real estate market towards stability and, by extension, to stabilize the broader economy.

The top priority is to stabilize the cash flow of housing companies.

The immediate priority is to stabilize the financing cash flow of real estate enterprises. This requires both the efforts of the enterprises and support from policy measures. Policy support should focus on both supply and demand, and it should be implemented as soon as possible.

On the supply side, the main approach involves selectively purchasing assets or providing government credit endorsements to help real estate companies return to the financial markets for financing and resume normal operations.

On the demand side, considerations could include further lowering policy interest rates to drive down mortgage rates, encouraging competitive mortgage rate reductions by banks, lifting restrictions on purchasing and loan policies, and implementing temporary subsidy policies for the first homes of middle and low-income groups.

China's real estate market has significant internal differences, with each city facing unique challenges and requiring tailored solutions. Policy corrections in the real estate market should allow local governments room for maneuver, adhering to the principle of "one city, one policy." The central government can play a more significant role in mitigating the risks faced by real estate enterprises.