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# Research on the Development of Small and Medium-Sized Housing Enterprises Under the Downward Trend of Real Estate Industry

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**Abstract:**

The real estate industry in China, once a key driver of economic growth, now faces significant challenges following the implementation of the "Three Red Lines" policy in 2021. This policy, aimed at controlling the debt levels of real estate companies, has particularly impacted small and medium-sized enterprises (SMEs), exacerbating their pre-existing issues such as limited financing channels, poor internal governance, and low corporate credibility. SMEs are now compelled to navigate a market downturn while meeting stringent regulatory requirements, making their survival and growth increasingly difficult. This study investigates the strategies that SMEs in the real estate sector can adopt to thrive under these conditions. It explores potential avenues such as entering less saturated markets, innovating business models, and leveraging local opportunities. The research underscores the importance of policy compliance, improving internal management, and strategic innovation. By adopting these strategies, SMEs can enhance their resilience and adaptability, contributing to the sustainable development of China's real estate market. The findings offer valuable insights for policymakers and industry stakeholders aiming to support the sector's stability and growth.

**Keywords:** Long-term rental market; Financing challenges; "Three Red Lines" policy; Small and medium-sized real estate enterprises.

## 1. Introduction

The real estate industry holds a significant position in the development of China's national economy, with its future development also exerting a considerable impact on people's lives. Since the reforms of 1998, the Chinese real estate industry has entered a market-oriented stage. Over the past two decades, the real estate sector in China has experienced rapid growth, injecting vitality into local economies and becoming the locomotive driving the entire Chinese economy. However, the implementation of the "Three Red Lines" policy on January 1, 2021, dealt a significant blow to the real estate industry across China, making the operation and financing of real estate enterprises more challenging [1]. Against the backdrop of a downward trend in the real estate market, the development of small and medium-sized real estate enterprises has become an important issue.

Small and medium-sized real estate enterprises are facing many unprecedented or long-standing challenges. Foremost among these is their financing problem. Due to the overall weakness of the comprehensive strength of small and medium-sized real estate enterprises, the relative lack of scientific internal governance structure, and the generally low corporate credibility, they are facing severe difficulties such as narrow financing channels, structural financing problems, inability to fully introduce foreign capital, and lack of long-term stable sources of funding [2]. Financing is the core of the real estate industry, and due to the inherent disadvantages of small-scale, small and medium-sized real estate enterprises find it difficult to solve the key problem of financing difficulty compared to large-scale real estate enterprises. The "Three Red Lines" policy introduced in 2021 has made matters worse for these enterprises. From the perspective of compliance, many of the companies that meet the requirements are private enterprises, with small and medium-sized enterprises accounting for the majority, while most of the companies that do not meet any of the requirements are state-owned and centrally-owned enterprises. From the perspective of financing costs, the financing costs of private enterprises are the highest, followed by state-owned enterprises, and centrally-owned enterprises are the lowest. Therefore, the disadvantages of private enterprises, especially small and medium-sized enterprises, in the financing process have become more prominent after the implementation of the "Three Red Lines" policy [3]. Small and medium-sized enterprises are far behind large enterprises in terms of funds, scale, and capabilities. Whether they can stand firm in the complex situation is the key to the survival of enterprises. In order to enhance the adaptability of enterprises to complex environments, it is best to achieve the following three points: long-term strategic vision, improve learning ability and make the enterprise more flexible [4].

Currently, most studies believe that small and medium-sized enterprises should lay a solid foundation, accumulate strength, comply with national policies, and first achieve “compliance”, that is, to ensure that after excluding advance receipts, the asset-liability ratio is less than or equal to 70%; ensure that the net debt ratio is less than 100%; ensure that the cash-to-short-term debt ratio is greater than or equal to one time. In addition, many small and medium-sized real estate enterprises have problems with unscientific fund management internally, especially some family-owned enterprises with weak legal awareness and imperfect corporate systems. In order to improve fund management, small and medium-sized real estate enterprises need to enhance fund management awareness, broaden financing channels, improve assessment mechanisms, and enhance risk prevention awareness [5]. In addition, in the new environment in recent years, small and medium-sized real estate enterprises have faced many new risks, such as tax risks, cost risks, supplier selection risks, financial policy change risks, information and Internet environment risks, and project product positioning risks. Strengthening the enterprise’s risk response capability is also one of the compulsory courses for enterprises [6].

Overall, the current situation of small and medium-sized real estate enterprises is not optimistic. They originally had many problems themselves, and in recent years, they have encountered a downturn in the entire industry. Many local enterprises could not withstand the pressure and applied for bankruptcy, including many old enterprises that have been in business for more than twenty years. For those struggling enterprises, what opportunities exist in the future and how to get through the current difficulties are questions worth exploring.

# 2. Possible Institutional Development of the Real Estate Industry in the Future

## 2.1 Property Tax System

Property tax is a type of property tax levied on property owners based on the assessed value or rental income of the property. Currently, property tax is the largest source of revenue for local governments in the United States, accounting for 31.5% of total local tax revenue. The tax rates vary among states and regions, generally ranging between 0.8% and 3%. In Asian countries, Japan does not have a specific property tax but includes properties as a type of fixed asset tax. China has previously conducted property tax pilot programs in Shanghai and Chongqing, although the results were not ideal. However, the country may continue to promote property tax collection in the future. The reasons are as follows: First, property tax can stabilize housing prices, help alleviate real estate bubbles, and curb speculative practices. Second, property tax can help address wealth inequality by levying higher taxes on individuals who own multiple properties and using the additional revenue to improve the quality of life for the general public, thus giving back to society. Third, it can become another source of local fiscal revenue. Over the past twenty years, local governments have been making money through land sales, but with no more land available for sale, property tax can provide a continuous source of fiscal revenue [7]. Additionally, from the perspective of foreign real estate experiences, property tax collection may also be vigorously promoted in the future.

## 2.2 Balancing Supply and Demand

China’s current real estate market faces some supply and demand issues. Firstly, in recent years, although the urbanization growth rate has slowed down, the scale of urbanization is still expanding, and it is expected that the urbanization rate will reach nearly 80% by 2035. At the same time, economically developed big cities still have strong population attraction and a continuous demand for housing [8]. Secondly, the real estate market is transforming being primarily driven by new development to a time when new and existing properties coexist. The supply of new houses is gradually decreasing, while the second-hand housing market is becoming more active. This means that the structure of the real estate market is undergoing significant changes, and the future focus will be on the trading of existing properties and market vitality.

To address the supply and demand issues in China’s current real estate market, the government may adopt a series of differentiated control policies. This includes strengthening land supply management, promoting the development of a long-term rental market, optimizing the structure of the real estate market, and enhancing regulation of the second-hand housing market. These reform measures aim to adapt to the slowing urbanization process and the continued population attraction of economically developed cities, as well as the transition from a new supply-driven market to a market where new and existing properties coexist. Overall, these measures will contribute to achieving stability and healthy development in the real estate market, promoting market supply and demand balance, and improving the vitality and transparency of the housing market.

### 2.3 Developing the Long-term Rental Market

China is currently facing multiple real estate challenges, such as increasing home buying pressure, rising vacancy rates, growing demand for residential mobility, and an immature rental market. These factors are driving the real estate market toward long-term rentals. By developing the long-term rental market, it is possible not only to alleviate the pressure of home buying but also to utilize existing housing resources more efficiently, meet the mobility needs of residents, and make the rental market more regulated and mature, thereby protecting the rights of both tenants and landlords and promoting the healthy development of the real estate market.

The development of the long-term rental market helps meet the growing demand for housing, reduces home buying pressure, boosts economic vitality, maintains social stability, and promotes sustainable urban development. By offering a wider variety of flexible housing options, the long-term rental market can improve residents' quality of life, reduce resource waste, and enhance land use efficiency, becoming a key direction for the development of the real estate industry.

However, China's long-term rental market is currently in the development stage, facing multiple issues such as an inadequate legal system, a lack of standardized management, insufficient handling of violations, low rental returns, regional and equity differences in demand, limited financing channels, and a lack of diverse financial products [9].

To promote the development of the long-term rental market, the government can take the following measures: provide policy support, such as tax incentives and subsidies; reasonably plan and supply land; offer financial support, including low-interest loans and rental financial products; strengthen market supervision to combat violations in the rental market; improve the quality and service levels of rental housing; establish a rental market information-sharing platform to make rental information more transparent; and improve relevant laws and regulations to ensure the legal rights of tenants and landlords. These specific measures can increase market transparency, reduce rental costs, protect the rights of tenants and landlords, meet the diverse housing needs of residents, and promote the healthy development of the long-term rental market.

## 3. Feasible Development Strategy of Small and Medium-Sized Real Estate Enterprises Under the Current Situation

### 3.1 Actively Responding to Policies to Stabilize Enterprise Development

The "Three Red Lines" specifically refer to 1. The debt-to-asset ratio after excluding advance receipts is greater than 70%; 2. The net debt ratio is greater than 100%; 3. The cash-to-short-term debt ratio is less than one time. Those that have not touched the lines are in the green category, with the annual growth rate of interest-bearing debt not exceeding 15%; those that have touched one line are in the yellow category, with the annual growth rate of interest-bearing debt not exceeding 10%; those that have touched two lines are in the orange category, with the annual growth rate of interest-bearing debt not exceeding 5%; those that have touched all three red lines are in the red category, with the interest-bearing debt scale capped at the end of June 2019 and cannot increase.

According to the National Bureau of Statistics, in 2023, national real estate development investment totaled 11,091.3 billion yuan, a decrease of 9.6% compared to the previous year. The sales area of commercial housing was 1,117.35 million square meters, down 8.5% from the previous year, while the sales volume of commercial housing was 11,662.2 billion yuan, a decline of 6.5%. It is evident that the real estate industry has struggled to make significant progress in recent years. For small and medium-sized real estate enterprises, whose debt levels are relatively lower compared to larger enterprises at the brink of policy thresholds, the priority should be to optimize their capital structure. This can be achieved by increasing equity financing and optimizing debt structure to reduce debt ratios and comply with policy requirements. They should actively develop diversified financing channels and formulate targeted financing strategies based on their specific situations. The process of de-financialization and deleveraging in the real estate industry is imperative, making it wise for enterprises to implement national policies and foster risk control awareness [10]. Additionally, they could consider collaborating with other companies to share resources and risks, thereby enhancing overall competitiveness. In times of scarce external opportunities, enterprises should seize the chance to reform internally, strengthen management, and improve project execution and efficiency.

The "housing is for living, not for speculation" concept addresses the real estate business model of the past two decades and aims to prevent further expansion of the real estate bubble, ensuring the welfare of the entire nation. This macro-control method, unique to China's context, should be better understood by enterprises as they seek paths for development in the new era.

### 3.2 Tap into Local Potential and Develop Specialized Real Estate

Currently, the real estate market in some first-tier cities and some second-tier cities in China may have already experienced a certain degree of saturation. Due to factors such as oversupply and weakened demand, the real estate market is experiencing excess supply, declining prices, and prolonged sales cycles. However, looking across China, there are still many cities or regions waiting to be developed, including second and third-tier cities, emerging cities, regional coordinated development zones in central and western regions, tourist cities, and resorts, which still have huge demand for housing and development space. Small and medium-sized enterprises entering these cities and regions for development can promote local economic development and urban construction, effectively avoiding the fierce competition in saturated areas of the real estate market, and from the perspective of fund scale, the development cost in these areas is relatively low and controllable, which may be a feasible development path for small and medium-sized enterprises. In addition, changes in China's population structure and economic structure may bring many opportunities and challenges to China's real estate market. For example, as aging intensifies, the elderly care real estate market and elderly apartments and other specialized real estate markets will rise, bringing into play the advantages of small and medium-sized real estate enterprises in being more flexible, agile, and quick to adapt to changing needs in different environments and markets compared to large real estate enterprises. This will be an attempt to combine the traditional real estate industry with the service and elderly care industries, as well as a feasible attempt to solve the development problems of small and medium-sized real estate enterprises.

### 3.3 Entering the Third-tier Market and Innovating Diversified Business

Many small and medium-sized real estate enterprises have been deeply involved in the secondary market for many years, focusing on real estate development and operations after obtaining land use rights. They are very familiar with this market and have accumulated rich experience and resources. However, following the introduction of the "Three Red Lines" policy, most real estate companies are likely to prioritize cash flow management. As a result, they may sell a large number of existing properties at low prices, leading to a sharp reduction in the number of new properties available on the market. Additionally, due to policy restrictions, these companies may find it difficult to expand their scale and increase the supply of new properties, which will further reduce the availability of new properties and affect homebuyers' choices.

In this scenario, homebuyers are likely to turn to the second-hand market, also known as the third-tier market, to find more options and opportunities. From this perspective, the third-tier market holds considerable development potential for the future. Small and medium-sized real estate enterprises can leverage their flexibility and agility to quickly engage in the third-tier market, diversify their business, and explore areas such as second-hand property trading, leasing management, and real estate investment to create more profit sources and business growth points.

Furthermore, providing excellent after-sales service and property management services is crucial when participating in the third-tier market. This not only enhances the reputation and competitiveness of enterprises but also attracts more customers and establishes long-term customer relationships. By delivering outstanding customer experiences and professional services, companies can stand out in the highly competitive market and gain a larger market share.

Innovation is the key driving force behind enterprise development. Small and medium-sized real estate enterprises should not only actively participate in the third-tier market but also closely monitor market trends and promptly adjust and innovate their products and services to meet the ever-changing market demands. By introducing new technologies, optimizing service processes, and offering personalized products, companies can improve their market responsiveness and increase customer satisfaction, thereby achieving sustainable development.

In conclusion, when facing policy changes and market challenges, small and medium-sized real estate enterprises should fully leverage their strengths, actively explore the potential of the third-tier market, provide excellent services, and continuously innovate to win more customers and market opportunities, thus propelling the enterprise to new stages of development.

## 4. Conclusion

In conclusion, the development of small and medium-sized housing enterprises in the declining real estate market presents key insights and future implications. These enterprises face significant challenges, particularly in securing financing, due to their smaller scale, weaker governance, and lower credibility. The "Three Red Lines" policy has intensified these difficulties, making funding and compliance more challenging. However, small and medium-sized enterprises can adapt by adopting long-term strategies, improving learning capabilities, and enhancing flexibility.

Diversification and innovation are crucial for these enterprises. By exploring third-tier markets and specialized real estate sectors, such as elderly care housing, they can find new growth opportunities. Additionally, developing the long-term rental market can help alleviate housing pressure, optimize housing resource use, and meet residents' mobility needs. This shift could lead to a more regulated and mature rental market, contributing to the stability and health of the real estate industry.

The future success of these enterprises depends on their ability to adapt to market changes, comply with policies, and innovate their business models. Government support through policies, market regulation, and financial facilitation will be essential for their growth. By focusing on these strategies, small and medium-sized housing enterprises can not only survive the current downturn but also achieve sustainable growth in the evolving real estate landscape.

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