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Analysis of China's Real Estate Enterprises' Financing Coordination Mechanism

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Abstract:

The real estate industry is very important to the Chinese economy. The domestic real estate industry is currently going through a period of adjustment, and several commercial housing projects that are being built and sold are having issues with financing and delivery. To solve the financial difficulties real estate companies confront, A coordination mechanism for financing urban real estate has been released by the Ministry of Housing and Urban-Rural Development and the State Administration of Financial Supervision. This report aims to organize the issues surrounding the financing environment of real estate enterprises, examine the definition and features of the real estate financing coordination mechanism, and assess the function of the mechanism in the current financing challenges faced by real estate enterprises. It is discovered that after analyzing the real estate financing coordination mechanism and combining the problems, China's real estate financing model can effectively solve the financing and capital needs of enterprises by combing and analyzing the problems of unreasonable financing structure, high financial risk, difficulty in listing financing, and financing difficulties of small and medium-sized real estate enterprises. One of the key sectors driving China's economic expansion is the real estate industry, and its growth has a major influence on the nation's economy.

Keywords: Real estate; financing difficulties; financing coordination.

1. Introduction

In recent years, Stricter real estate laws and regulations have been implemented in China, with guidelines like "housing for living, not speculation," "three red lines," and "housing loan concentration" have not only curbed the rapid rise in housing prices, but also restricted the financing of real estate enterprises. The large scale of debt of real estate enterprises has become an important factor affecting economic and financial stability. At the same time, with the expansion of interest-bearing liabilities, the narrowing of financing channels and the continuous decline in the prosperity of the housing market, the credit risk of real estate enterprises is constantly rising, and the debt repayment ability, capital turnover capacity and financing ability have weakened in an all-round way, but the debt repayment pressure remains at a high level.

The Notice on the Establishment of a Coordination Mechanism for Urban Real Estate Financing was jointly released in January 2024 by the State Administration of Financial Supervision and the Ministry of Housing and Urban-Rural Development. The urban real estate financing coordination mechanism is a creative way to address the reasonable financing needs of real estate businesses with different ownership systems and solve the real estate financing problems without discrimination. In the long run,it is a strong foundation for creating a new real estate development model, with funds following the project and the implementation of closed management of the project, this promotes the sound growth of the real estate industry. Following proposals from the State Administration of Financial Supervision and the Ministry of Housing and Urban Rural Development to create a coordinating framework for financing urban real estate in cities larger than prefectures, all localities and relevant financial institutions have been in full swing to implement it, and all localities have intensively pushed the “white list” of real estate projects [1].This mechanism is different from the previous direct docking between financial institutions and real estate development enterprises to promote financing, and there is great innovation in the specific implementation. Specifically, mechanism innovation is embodied in “precise policy”, and the support for real estate enterprises is not based on the group, but for specific projects. At the same time, the “white list” project is proposed on a city-by-city basis, strengthening the territorial responsibility of the city, and emphasizing the research and formulation of measures according to local conditions according to the actual local situation, which also means that with the support of “one project and one plan”, it can not only effectively alleviate the liquidity difficulties and risks of real estate enterprises, boost market confidence, but also help prevent delivery defaults in projects under construction and safeguard the legitimate rights and interests of home buyers.

The real estate sector is one of the main drivers of China’s economic growth, and its development has a significant influence on the country’s economy.

2. Problems in Urban Real Estate Financing

2.1 The Scale of its Own Funds is Small, and the Financing Structure is Unreasonable

The self-owned funds of real estate development companies make up a smaller portion of the ratio of self-financing than 60%, and the proportion of self-owned funds of real estate enterprises in China accounts for only about 18% of the total development investment. Obviously, the scale of China’s own funds is on the small side [2].

At this stage, the financing market of domestic real estate is not perfect, and real estate enterprises are also overly dependent on bank loans and have not improved their own financing structure, which not only increases the difficulty of capital turnover and financing costs of enterprises, but also faces great challenges in the company’s financial risks [2].

2.2 The Use of Financial Leverage is too Aggressive, Resulting in High Financial Risk

The term “financial leverage” describes the situation when a company’s earnings per share changes more slowly than its interest and tax rate prior to it because of a fixed cost of capital [2]. The volatility of equity capital returns can be fully reflected through financial leverage, which is used to evaluate the financial risk of enterprises. Real estate development enterprises usually carry out three stages of land reserve, project construction and housing sales at the same time, that is, to use the least amount of capital to drive the maximum investment income [2]. According to the ROF = net sales profit margin * asset turnover ratio * equity multiplier, the rolling development of real estate development enterprises is actually to virtually increase the asset turnover rate and equity multiplier and increase their own financial leverage. Financial leverage refers to using other people’s money to make money, which is equivalent to using less of its own funds to earn high profits [2]. Debt financing can be profited when the likelihood of making a profit outweighs the risk taken. Otherwise, you will suffer losses. This uncertainty is the financial risk caused by leverage [2].

2.3 It is Difficult to Go Public and Raise Funds

According to the statistics of the National Bureau of Statistics in 2019, there are a total of 97,938 real estate enterprises in China [3]. As of June 8, 2021, there were 128 real estate companies listed on the Main Board. Real estate companies listed in China accounted for 0.14% of the total, and 99.86% of real estate enterprises could not be listed in China. In line with the Securities Law, Business Law, and Administrative Procedures for Stock Listing and Initial Public Offering, the listing conditions are met only if the three contents of enterprise independence, subject qualification and finance and accounting are met [3].

2.4 Small and medium-sized Real Estate Enterprises are difficult to get paid.

Currently, Small and medium-sized financial institutions that assist small and medium-sized real estate businesses are hard to come by, a low credit rating for these businesses, and an imperfect financial system to assist their growth [3].

Despite making up more than 70% of all real estate businesses in China, small and medium-sized businesses, it is very difficult for small and medium-sized real estate companies to obtain financing from financial institutions because of the imperfect development of China's real estate financial market system, such as too many restrictions by regulatory agencies, insufficient financial innovation and insufficient policy guidance [3].

3. The Meaning and Characteristics of the Urban Real Estate Financing Coordination Mechanism

3.1 Meaning

Over time, it is a potent foundation for creating a new real estate development model and quickening the connection between "people, real estate, land, and money"[4].

3.2 Peculiarity

Financing support will be given to the project as the carrier, and the policies will be implemented according to the city and the project. "Precise support" is one of the highlights of the Notice. Precision, embodied in the establishment of a coordination mechanism with the city as a unit. Precision, which is reflected in the project-based financing support.

For regular development and construction projects with enough collateral, realistic assets and liabilities, and sources of guaranteed repayment, the "Notice" highlights the word "fast", suggests creating a green route for credit, streamlining the approval procedure, cutting the approval period, and aggressively addressing acceptable financing demands; The "Circular" suggests instead of drawing loans blindly, stopping loans, or applying pressure to projects that can essentially balance funds but run into short-term development and construction difficulties, offering support through new loans, adjustments to repayment schedules, and extensions of current loans. Simultaneously, we should tighten up the closed management of loan money and severely prohibit the misappropriation of credit funds for investments or the purchase of land, and avoid the risk of misappropriation of financing funds at the source [5].

4. The Role of the Coordination Mechanism for Urban Real Estate Financing

According to the requirements of the coordination mechanism, financial institutions shall evaluate the coordination mechanism's support objects in line with the rule of law and marketization principles, and establish a green channel for loan extension for projects having sources of assured payback, appropriate collateral, reasonable assets and liabilities, and regular development and construction. Optimizing the approval process, shortening the approval time limit, and actively meeting reasonable financing needs can effectively alleviate the unreasonable financing structure

We will not haphazardly get loans for projects that have transient challenges during development and construction but can essentially balance funds, cut off loans, or pressure loans, but extend the term of existing loans and adjust repayment arrangements new loans and other forms of support. At the same time, we will tighten the controls on the closed management of loan funds and make sure that credit funds are never misused for investments or land purchases, and reduce financial risks [5].

As of right now, 297 cities nationwide that are higher than prefectures have set up a mechanism to coordinate real estate finance and put forth a "white list" of real estate projects that qualify for financing support that can be provided in batches to commercial banks. Commercial banks have authorized loans totaling 935 billion yuan for projects on the "white list" as of May 16. Large state-owned banks have played the role of the main force: ICBC has set up special working groups, formulated supporting policies, and given full play to the synergies between the front, middle and back offices, and adopted methods such as "joint due diligence" and "integrated review" for projects that meet the conditions of the coordination mechanism, so as to significantly shorten the time limit for review and approval. For projects that do not match the standards for the time being, we will provide timely feedback to enterprises and the city coordination mechanism and propose solutions, and have put forward targeted solutions for nearly 200 projects, and successfully helped nearly 30 projects meet the requirements of the "white list" and provide support. As of May 27, ICBC has docked with 247 city coordination mechanisms, approved more than 500 "white list" projects, and approved more than 150 billion yuan of loans, which will be gradually put into operation according to the progress of project construction. According to the appropriate person in charge of the Industrial and Commercial Bank of China, in compliance with the requirements of the coordination mechanism, it will further increase communication with government departments, increase financing support for projects on the "white list," strengthen precise docking with various real estate enterprises, enhance the bank's green approval channel, streamline the approval procedure, reduce the approval period, and lower financial risks while promoting the steady, healthy growth of the real estate sector [6-12].

5. Conclusion

There is often a close relationship between real estate financing and finance. Nowadays, many real estate companies have the problem of tightening funds. In the face of the current complex financing environment, real estate enterprises must be aware of the financing difficulties they are facing, and it is particularly important for the capital-intensive industry of real estate to correctly understand and play the maximum role of the real estate financing coordination mechanism. This paper analyzes the coordination mechanism of real estate financing through the difficulties of real estate financing, and the coordination mechanism of urban real estate financing is based on the city and meets the reasonable financing needs of real estate projects, which is an important measure and a strong guarantee to achieve a virtuous cycle of finance and real estate and improve market expectations. The urban real estate financing coordination mechanism is a crucial step toward implementing the fair financing requirements of real estate businesses with varying ownership without discrimination. It also serves as a strong foundation for resolving the present financing conundrum facing real estate businesses, an efficient way to protect the legal rights and interests of property purchasers, and a significant innovation to enhance the management of real estate projects. The quick implementation of the urban real estate financing coordination mechanism will provide timely funding support for real estate project development and construction. It will also successfully foster connections between the government, banks, and businesses and play a significant role in fostering the steady and healthy growth of the real estate market.

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