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Research on Risk Characteristics and Preventive Measures of the Real Estate Trust Business in China

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***Abstract*—The real estate trust business is one of the important businesses of the trust companies in China. This paper analyzes the development process of real estate trust business in China, summarizes the risk characteristics of real estate trust business, investigates the risk factors of real estate trust business, and proposes recommendations on the measures of avoiding risks in real estate trust business.**

Keywords—Risk characteristics; Real estate trust business; Preventive measures; Trust companies

I. INTRODUCTION

The real estate industry is one of the pillar industries of the national economy. It is characterized by large scale, strong industrial relevance, and high financing demands. The real estate trust business is the traditional business of trust companies in my country, and it has always occupied a high proportion in the business structure. The earliest real estate trust product was firstly issued in 2002, and afterwards became one business field generally involved by trust companies in China. Hereafter, because of being affected by the real estate regulation and control policies, the investment and financing channels of the real estate industry suffered from great restrictions. As a result, trust product has become a keen alternative financing channel for real estate developers due to its obvious system superiority. In the meanwhile, because of the high and stable yield of trust product, it is favored by investors.

In recent thirty years, the development of the real estate trust business in China demonstrates an obvious counter-cyclical characteristic. It roughly experiences three stages:

The first stage is from 2002 to 2008, during which, the GDP of China maintained a high-speed development, especially from 2005 to 2008, the average economic growth speed reached 11.4%, and the lowest growth speed was 9.8% occurred in the third quarter of 2005. However, the scale of the newly established real estate trust of the same period always maintained at the quantity level of dozens of billions.

The second stage is from 2009 to 2013, which is a high-speed growth period of the real estate trust scale. Because of the concerns about the negative impact of the global financial crisis in 2008, the Chinese government published a series of stimulating policies to support the development of the real estate market. As the real estate market gradually warms up, the real estate trust business grows rapidly accordingly. However, there was an economic overheat phenomenon in China in the first quarter of 2010, the decision-making layer accelerated to exit from the stimulating policies, including the publishing of the most severe real estate regulation and control policies, thereby tightening the traditional real estate financing channels. As a result, the establishment scale of the real estate trust had slight adjustment and declined in 2012. However, because of the flexibility strength of the trust system and the bank crowding-out effect, it still maintains a high heat. In 2013, the trust establishment scale rebounded to RMB 402.5 billion.

The third stage is from 2014 to now, during which, the real estate trust entered the adjustment period. With the economic downturn and because of the impact of regulatory effectiveness, the issuance scale of real estate trust has been adjusted, and the inventory proportion has continued to reduce to a low level. During this period, the real estate market has faded its fever, real estate sales prices and transaction volumes have all fallen to a low point, and real estate partial risks continue to ferment. Due to the redemption pressure of the real estate trust, various trust companies have lifted the admittance barrier for real estate projects, with risk management as the main task. The real estate market has entered a stage of regional differentiation and development, making the development of real estate trusts enter a value discovery and stationary phase.

The real estate trust business has numerous modes, mainly including credit trust, equity trust, combination trust and property income trust. In addition, due to the flexibility of the trust system, the operation mode of the trust of the same property can be flexible and variable, such as introducing the limited partnership format to help investors directly participate in project equity investment and so on. Just the flexible strength of the trust system promotes the rapid development of the real estate trust in recent years, thus effectively realizing the financing function of the real estate enterprises.

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II. Risk Characteristics of the Real Estate Trust Business

As the traditional business of the trust company, the real estate trust business is developed relatively mature, and its risk control measure is relatively perfect. The risk characteristics of the real estate trust business are mainly reflected by:

First of all, the real estate market has price fluctuation and the real estate enterprise has capital chain rupture, thus affecting the punctual payment of the trust capital, such as, the real estate development project is unable to be completed smoothly or has sales lagging, and the commercial real estate project has business attraction difficulty and so on. Because the real estate industry has a long industrial chain and a wide range of connections, not only the fluctuations in the upstream land prices, construction materials prices, and labor prices will cause changes in the real estate market prices, but also the changes in downstream consumer demand can also cause fluctuations in real estate prices. Therefore, the complex situation of the real estate market, coupled with the cyclical characteristics of the real estate market and the impact of real estate regulation and control policies, the risk of market price fluctuations is greater.

The second point is the risk caused by excessive financial leverage of developers. Developers usually use a variety of financing methods such as bank loans and trust loans, which will result in excessive asset-liability ratios. However, developers using high financial leverage can use less of their own funds and increase the rate of return of the project. However, excessive leverage also means higher risks. Once there is a problem with a certain funding link, it will cause pressure on the redemption of trust projects. In addition, real estate developers often hide their credit and problems in project management for their own benefit, thus forming information asymmetry and becoming a hidden risk.

The third characteristic is that the value of the mortgaged assets is artificially high, and the role of the second source of repayment is difficult to play effectively. The main manifestations of trust property in the real estate trust business include land, houses, and equity, and the guarantee measures mainly include land and real estate mortgages. When the real estate market is sluggish, it is difficult for trust property or mortgage/guaranteed assets to complete transactions in a short period of time, and the trust company cannot be realized in a timely manner, causing liquidity risk.

III. Risk Factors of the Real Estate Trust Business

A. Macroeconomic and Financial Environment

The macroeconomic and financial environment mainly affects the credit risk, market risk and liquidity risk of trust companies. From the perspective of China's current macroeconomic environment, there are mainly the following ways of influence:

1) The slowdown of macroeconomic growth and the adjustment of economic structure have increased the credit risk of trust companies.

Since the reform and opening up, the Chinese economy has experienced sustained high-speed growth. After the financial crisis in 2018, the growth amplitude of the Chinese economy declined. From 2008 to 2015, the average growth rate of China's GDP was 8.6%, which was lower than 7% for the first time in 2015 and fell to 6.9%. The macro economy has changed from high-speed growth to medium-high growth. In addition, from other major economic indicators, import and export trade, investment and other indicators have declined to varying degrees.

Credit risk is the risk most directly affected by economic trends. According to the general principle of the cause of credit risk, when the economy begins to prosper, corporate profits gradually increase, asset values rise accordingly, consumer income expectations are also optimistic, and the expansion of total demand leads to a significant increase in the debt ratio. During the period of economic growth decline, consumer incomes decrease, borrowers have deteriorated credit, and a large number of non-performing assets appear. A large number of studies have shown when the macro economy has entered a downward cycle, the market demand will shrink, the corporate sales will drop, the capital turnover pressure will increase, and the credit risk of financing activity will also rise.

2) The disorderly development of private finance has become an important channel for transmitting risks to trust companies.

Nowadays, private finance plays an increasingly important role in the rural economy and private economy in China, and has become an important channel for meeting the financing demands of SMEs. Because of various reasons, for a long time, the private finance in China has been in a state of disorderly development, neither effectively supervised nor legally protected, and has been suppressed in a gray area for a long time. Among the risk events that have occurred in trust companies, not a few credit risks are related to private finance. In general, the credit status of trust company business objects is not as good as that of bank customers. Many SMEs will choose private finance to fill the funding gap when their funds are tight. Such information is often hidden, and it is difficult for trust companies to find it during due diligence. Some companies even directly defraud trust loans to pay off privately financed debts. These factors pose a great potential risk to the business of trust companies. Therefore, the hidden risks of private finance are closely related to the risks of trust companies.

B. Policy Risk Factors

Policy risk generally refers to the uncertainty of corporate assets facing gains or losses due to adjustments in national economic policies. The macroeconomic policies and industrial policies of a state will change with changes in the national economy. Therefore, for all enterprises, policy risk is always inevitable, and it will often have a greater impact on the operation of the enterprise. The economic policies that affect trust companies are mainly divided into three categories:

First of all, the adjustment of monetary and fiscal policies will lead to changes in the domestic investment environment, which will have an impact on the operating activities and risks of trust companies; secondly, under the regulatory system of the industry, changes in financial regulatory policies will directly affect the operating environment of the trust business, thereby increasing the operating risks of trust companies; thirdly, the adjustment of the industrial policy will affect the direction, scale and risks of trust investment. Through the adjustment of industrial policies, the state inhibits or supports the development of certain industries, which directly affects the financing behavior of these industries. For example, in recent years, the real estate industry in China has undoubtedly been the one suffering from the most stringent policy regulation. Therefore, trust companies with the real estate trust business as the emphasis have experienced greater risks in the process of several real estate regulation policies.

C. Regulatory Risk of the Trust Business

Changes in regulatory policies will directly affect the trust business operations and increase the uncertainty of trust company operations. In 2014, the China Banking Regulatory Commission issued the Guiding Opinions on the Risk Supervision of Trust Companies (hereinafter referred to as "No. 99 Document"), which stipulates the risk prevention and control, transformation direction and supervision mechanism of trust companies. This document has become the overall outline on the supervision of trust companies in the recent period. The "No. 99 Document" and its detailed rules have affected trust companies in terms of sales channels, business management, and clearing of non-standard fund pools.

IV. Preventive Measures for the Risks of the Real Estate Trust Business

A. Enhance the Comprehensive Risk Management of the Trust Company

At present, the risk management of trust companies is mainly to carry out risk control according to business processes. This method only considers the needs of the business, and ignores the integrity of the risk system and the coordination of the various parts. It belongs to local emergency risk management, and it cannot design risk management methods for different characteristics of various risks, so it is more difficult to achieve the purpose of controlling risks. The comprehensive risk management process of a trust company is actually a series of risk management measures that the trust company uses to identify, evaluate, control or avoid potential risks in its operation, so as to achieve the purpose of controlling risks and reducing losses. The measures to strengthen the comprehensive risk management of trust companies include:

- Improve the key links of risk management, for example, clarify the risk strategy of trust companies, improve the quality of due diligence, and pay attention to tracking and monitoring risks.
- Strengthen the information construction of trust companies, and realize the management of all assets, all customers, all processes and all risk control of trust companies through information technology.
- Promote the construction of a risk management culture and enhance the risk management philosophy of all trust company personnel.

B. Perfect the External Supervision of the Risk of the Trust Company

The external supervision of trust company risk refers to the supervision department of the trust industry, financial and taxation authorities and relevant intermediaries conduct external supervision of the management risk control level of trust companies. The multiple rectifications of the domestic trust industry in history also indicate that the trust industry is more vulnerable than other financial industries. The multiple rectifications of the domestic trust industry in history also indicate that the trust industry is more vulnerable than other financial industries. With the large-scale growth of trust company assets, the difficulty of risk supervision has gradually increased. Regulators still have a lot of room for improvement in net capital management system, trust compensation reserve system, and trust company information disclosure system.

C. Construction and Improvement of the System in the Trust Industry

1) Improve the liquidity of trust products. The liquidity of trust products is one of the important mechanisms for mitigating the risks of trust products. Constructing an external, national trust product circulation market will help build the external risk buffer mechanism of the trust industry, help increase the social awareness of trust companies and trust products, establish and expand product marketing channels, and help regulate trust companies and trust product information disclosure, exert market restraint, and improve trust supervision system.

2) Promote the establishment of a standardized system in the trust industry. The establishment of a standardized system for the trust industry will help to improve the compliance operation, business processes and refined management within the trust company, promote the comprehensive and coordinated development of the trust industry, and cultivate the trust beneficiary circulation market.

3) Strengthen the risk education of investors. According to the relevant regulations of trust companies, "rigid redemption" is not the legal obligation of trust companies, but in reality, "rigid redemption" has become a major pressure for the development of trust companies. Investors are not clear about the legal responsibilities that trust companies should bear. Therefore, strengthening investor education to make investors clarify the relationship between the consignor and the trust company is also an important approach of rationally treating "rigid redemption".

V. Conclusion

As the traditional business of the trust company, the real estate trust business is developed relatively mature, and its risk control measure is relatively perfect. The real estate trust business has three risk characteristics: (1) the real estate market has price fluctuation and the real estate enterprise has capital chain rupture, thus affecting the punctual payment of the trust capital. (2) The risk caused by excessive financial leverage of developers. (3) the value of the mortgaged assets is artificially high, and the role of the second source of repayment is difficult to play effectively.

The real estate trust business has three risk factors: (1) macroeconomic and financial environment. (2) policy risk factors. (3) Regulatory risk of the trust business.

In order to prevent risk of the real estate trust business, we should: (1) enhance the comprehensive risk management of the trust company. (2) perfect the external supervision of the risk of the trust company. (3) construction and improvement of the system in the trust industry.

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