Analysis of the Cause of Recent Mortgage Boycotts in the Chinese Real Estate Market

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Abstract. China, as one of the most populous countries in the world, has a substantial proportion of its real estate industry in its GDP. Millions of people are closely related to real estate, and most Chinese generally believe that only real estate property can provide the foundation of a home. However, recently, real estate companies have encountered severe problems, one after another, and many unfinished properties have been stopped building. Lots of consumers are worried that even if they pay off their loans, they will still not be able to obtain real estate, so they choose to stop paying their loans. With decreasing confidence in the market, we wanted to analyze what caused the situation. In this article, we explain the industry's history, the recent problems they encountered and combine recent news to determine the cause of the incident. The excessive development of the real estate industry in a short period of time, extremely high rate of mortgage loans, overly optimistic market expectations, and the impact of the economic environment have produced a series of results. We also proposed recommendations to help authorities and consumers navigate the current situation.

Keywords: Real Estate industry · Mortgage · Market expectations

1 Introduction

Real estate, as one of China's pillar industries, has flourished for decades, but many hidden problems have been exposed after the impact of Covid-19. Due to the lack of funds for developers, lots of real estate projects still need to be completed, and many home buyers need help to ensure their own interests and rights, so they choose to cut off the loan repayment in the summer of 2022. This article analyzes the real estate history, current situation, and possible causes. Finally, we propose relatively reliable solutions.

2 History and Cause

China's regime and policies have changed dramatically over time, leading to changes in the real estate market. China's real estate market history can be divided into 5 phases. The first section is about the period between 1949 and 1978. During the planned economy period, the nation allocated real estate to enterprises and provided housing according

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to the conditions of different employees at a meager cost. The second part, between 1978 and 1987, employs a new approach the government, firms, and individuals all pay one-third of the total cost of housing. Until now, the ownership of the land where real estate is built on is still owned by the nation. The third stage was from 1987 to 1991, when the real estate marketization began. Due to the revision of the constitutional amendment, some provincial governments started to sell and transfer the right to use the land. The country also began to experiment with the feasibility of a Public Accumulation Fund, the subsidy that still works as a component of social welfare today. The fourth stage, between 1992 and 1997, started with the implementation of the Urban Real Estate Law. With the relaxation of conditions for transferring land use rights, many real estate brokerage companies and property management agencies were established. This process marked China's real estate gradually entering the process of free marketization. At the same time, welfare housing had slowly withdrawn from history. From 1998 to today is the last and fastest developing stage for China's real estate market. In 1998, welfare housing was stopped entirely, and people had to use their savings and wages to buy real estate. This prompted the real estate market to start developing rapidly.

In just 20 years, countless skyscrapers have been erected in the city center, and housing prices have risen rapidly. In the central area of big cities, house prices have increased at least eight times in 20 years, far higher than inflation [1]. At the same time, the presale of commodity buildings enables the developer to have the rights to develop, charge an advance payment (usually 30%) from the attracted buyers, and then use the land and the advance payment to pay for the financing from the bank for the project. For example, in 2017, a third-tier city in Shandong province Weifang, real estate prices rose about 2,000 yuan per square meter and there was still a shortage of real estate inventory. Even though some new developments are under construction, many consumers have already paid the deposit to reserve the property [2]. This would have been a financially sound approach to get low-cost capital if appropriately managed. However, the developers can also choose to utilize the funds from the banks to purchase more land, design more real estate cases, and repeat this operation. Banks also positively lend them money as it is a substantial and steady source of income. However, potential hidden dangers may cause the initial plot to be completed without sufficient funds and thus evolve into an unfinished building, thus laying the foundation for future problems (Fig. 1).

3 The Upcoming Problems

In China, real estate is one of the essential pillar industries which has driven and promoted economic growth in the past 20 years. The real estate industry includes not only real estate developers but also many subdivisions, such as material suppliers, including cement and steel, builders including construction workers, decorators including wall spraying, plumbing suppliers, including water pipes and cables, home appliance suppliers, including air conditioners and refrigerators, and so on. Mass demand creates millions of jobs in the market. In recent years, real estate and surrounding industries have accounted for around 29% of China's GDP [1], which undoubtedly makes any downturn in the sector could lead to potential dangers for the broader economy.

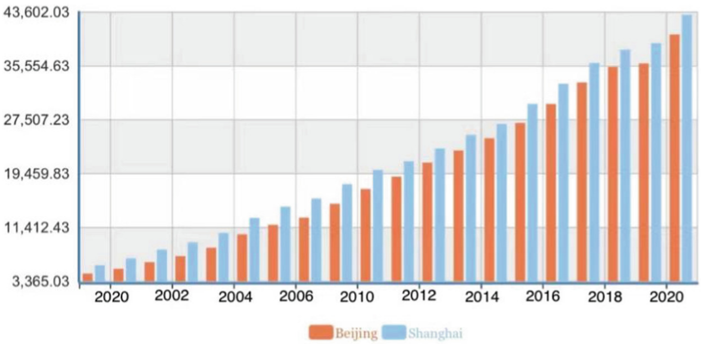

Fig. 1. The average sales price of residential and commercial housing in Beijing and Shanghai in the past 20 years (yuan/square meter) [1]

2001 was a critical year in China's economic history because China joined the WTO, which also represented the changes in the nationalization of real estate. The increase in China's housing prices in some areas is far ahead of the world, especially in coastal areas and economic centers. In 2000, the average new house price in Beijing was 5,029 yuan per square meter [3], while at the end of 2019, the average cost of new houses was 47,000 yuan per square meter [4], an increase of 8.4 times. The same thing happened in Shanghai. In 2000, Shanghai's housing price was around 3,326 yuan per square meter [5]. In 2021, the average price exceeded 54,000 yuan per square meter [6], an increase of 15 times, including many suburban properties. Even worse, the population per household has also continued to decline, from 3.44 in 2000 to 2.62 in 2020[7, 8]. It is attributable to tremendous life pressure and family planning in the early years. In modern China, the value of ordinary real estate often exhausts a family's lifetime savings. In some cities, one of the prerequisites for marriage is that the male owns real estate, possibly contributing to China's low marriage rate and low fertility rate in developed coastal cities.

At the same time, banks realize that real estate is a stable and high-yield investment, so they are willing to provide tons of loans to real estate developers to purchase massive land and develop. In the past 20 years, real estate companies have expanded rapidly, but they possess a vast debt ratio and a small cash scale. Due to the uninterrupted supply of the loan from the bank, these potential problems haven't been exposed.

In 2020, the Chinese government promulgated the three red-line policies to provide a healthy and sustainable environment for the real estate market. The three red lines are as follows: the asset-liability ratio should not be greater than 70%, the net debt ratio should be less than 100%, and the cash-to-short-term debt ratio should not be less than one time. These policies restrict banks from providing unlimited loans to large real estate companies. Even if all three lines are satisfied, the maximum debt growth is capped at 15% [9]. As a result, real estate companies have lost their stable capital source and started an uncontrollable thunderstorm. As a high-profile example, Evergrande Group, one of the largest real estate companies, claimed to default its bond. Evergrande could not pay its debts on time, needed more cash flow to continue building its properties, and things worsened. Many people bought Evergrande's pre-sale houses and watched the property build, expecting it to be delivered until they found out the construction site was shut down. The family's savings vanished instantly, and they had to pay the bank's mortgage loan. Under this double stimulus, they chose to cut off their mortgage payments.

4 Pessimistic Market Expectations

Another adverse observation is the deteriorating market sentiment. In 2020, under the influence of the COVID-19 pandemic and the three red lines policy, the market began to lose confidence in real estate companies. Evergrande announced a default on its bonds, which greatly affected its credit. The money developers could borrow was reduced on a large scale; the stock price plummeted, and the market's expectations changed. When the number of bad debts in real estate in the hands of banks increases, the market's prospects for banks begin to change, and stock prices of multiple banks indirectly lead to an overall decline in the Shanghai Stock Exchange Index. Investors lose money and start selling stocks, causing the market to decline further, slowly creating a vicious circle. Investors have criticized the profitability of China's stock market for so many years. In June 2001, the Shanghai Composite Index was 2,214.25; in October 2022, it was 2,893.48, an increase of 30.67 percent, which was not even higher than inflation. In contrast to the U.S. stock market, the Dow Jones was 10,447 in June and 28,725 in October 2022, an increase of 175 percent. The composite yield difference between the Chinese and U.S. stock markets is more than five times. As do real estate companies, most people cannot profit much in the stock market. Many real estate companies sell completed houses at lower prices to raise funds to reduce debt pressure. The downturn of the economy, the default of real estate developers, and the large-scale price cuts have led to a sharp drop in housing prices that everyone was optimistic about. In the past, people firmly believed that overall housing prices kept increasing [10], which could not fall to a large extent and that there might be some minor fluctuations in the price. Still, they were upset when they, especially consumers in small cities, found that the current housing prices were even less than what they needed to repay after paying the down payment (Fig. 2).

5 Default House Loan and Its Consequence

With the impact of Covid-19, the global economy has fallen into a slump; people's wages have been more or less affected, and expectations for the future have decreased, causing the aggregate demand to drop. Far worse, the house people bought with most of their life savings was unfinished due to the real estate developer's lack of funds. Even if the construction of those unfinished houses is completed, in some cases, the current value of these properties is far less than their loan, even if they keep paying for months or years. Some properties' prices are now worth less than half their initial price [12]; no one knows when their properties will be finished. The economic downturn and unfinished housing increased their pressure on paying the mortgage. According to Citigroup Inc, buyers of at least 35 real estate projects in China decided to stop paying mortgages in July 2022 [13]. When the situation of supply cuts escalates, and news and social platforms continue to report, many people in other regions will follow suit, which will further cause economic and social turmoil. The decline in housing prices may bring further damage

Fig. 2. China's average commodity house price from 1997 to 2018(yuan/square meter) [11]

and crisis to the fragile real estate market. Moreover, the Real estate developers will also be caught in a more significant crisis- their cash gap is getting bigger and bigger. Agile Property announced allotment not long ago, even though its share price was meager. The total amount raised was less than one hundred million dollars, which implied they were in serious financial difficulties. Another giant real estate company, Country Garden, planned to raise about 500 million US dollars from the market through Allotment. Many other real estate companies try to sell bonds, but because the market believes that the probability of their default is very high, the prices of those selling bonds are generally low. They borrow a small amount of money but need to charge as high-interest rates, which cannot support their capital turnover.

6 Remedial Plan

The Chinese government has carried out a series of aggressive interventions to reduce market pessimism. After promulgating the "three red lines policy" to reduce market risk, they found that the market reaction was not as good as expected. The central bank launched an interest-free loan of 28 billion US dollars for Pledged Supplementary Lending [14], a particular loan for guaranteed complete the unfinished building. According to the estimation from S&P Global Ratings, the construction industry needs around $100 billion in funding to complete most of the unfinished buildings and projects [15]. Even if $28 billion does not satisfy the industry's demand, it's still a positive signal for all consumers, investors, and the market. Local governments are also trying to stimulate market demand for real estate. For example, Nanning, the capital of the Guangxi Zhuang Autonomous Region, launched an activity claiming that buying real estate gains free metro rides. If you purchase real estate under Nanning Rail Transit within a specific time, you can enjoy free subway rides for three users for ten years [16]. Undoubtedly, if this promotion can be implemented smoothly, it will increase market demand, reduce real estate inventory, attract the population, and increase long-term aggregate supply to a certain extent. Even though consumers may wrongly induce some activities, rational use of resources to attract consumers may be one way to reduce demand. Social security housing for talents is another way to attract consumers. Consumers can buy or lease these properties if they meet certain conditions, such as an academic degree or capability. For the government, Social security housing for talent can solve the backlog of real estate and attract talented workers or people to enhance the city's competitiveness. On the other hand, it is a benefit for qualified consumers because the price of talent housing is generally lower than that of adjacent properties, which can be concluded as a win-win situation.

7 Conclusion

Almost every industry is cyclical- an upswing period and a downswing period. After 20 years of rapid expansion and development, with the epidemic's impact, the housing market has been depressed, real estate companies have defaulted, and housing supply has exceeded demand. However, consumers do not need to be too pessimistic. Real estate companies actively obtain capital flow through various methods, and the government's new measures on the epidemic and housing industry have proved their attitude towards the real estate market. Therefore, we believe that in the near future, with the stability of the market and favorable policies, unfinished buildings will continue to be built, giving satisfactory results to all consumers.

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