Analysis of Financing Channels of Real Estate Companies in China

Shang Cui*

School of Economics and Management, Beijing Forestry University, Beijing, China

* Corresponding Author Email: Cs210405301.bjfu.edu.cn

Abstract. With the continuous development of China's economy, the real estate industry plays an important role in it, which witnesses booming growth. However, with its rapid development, it has also brought great problems and challenges, such as blocked funding sources and high financing costs. Therefore, this article will study the financing channels of several listed real estate companies, China Fortune Land Development CO, Poly Development Co., Ltd. since 2014 to 2018, comparing and analyzing the financing channels of private and state-owned enterprises. By extracting information about funding costs and risks from financial and public debt information, the differences in WACC values, cash flow status, and debt structures under different companies' financing plans will be compared. Accordingly, this study investigated possible reasons of choices made by these two enterprises. Enterprise decision-makers still need to make sufficient understanding and weigh the pros and cons before making financing decisions and should not finance blindly. These results of this article have reference significance for the financing of future real estate companies.

Keywords: Real estate companies, financing channels, WACC values.

1. Introduction

In today's rapidly developing economic environment, real estate companies, as an important force driving urban construction and development, undoubtedly require effective financing support for their operation and growth. The current main financing channels for real estate enterprises include: self-owned funds, advance receipts for real estate, bank loans, equity financing (such as listing, additional issuance, equity transfer), bond financing, trust loans, real estate investment trust funds (REITs), asset securitization (ABS), overseas financing, private equity financing (non-public fundraising), equity-like debt (mezzanine financing), perpetual debt (in the name of debt, but with the essence of equity), and so on [1]. However, as the country continues to strengthen its regulation of the real estate market, traditional financing methods are gradually becoming limited, which necessitates real estate companies to constantly explore new financing channels to meet their ever-increasing capital needs. On the one hand, since 2017, strict economic policy with regard to real estate business has been implemented by Ministry of Housing and Urban-Rural Development and People’s Bank of China, aiming to enhance financing supervision and prevent systematic financial risks [2]. With the cycle of real estate regulation, the financing policies for the real estate industry are also undergoing dynamic changes. Given the generally high debt ratios of real estate enterprises, financing policies have a significant impact on their financial situations, further affecting their land acquisition, development, and sales. In particular, the "Three Red Lines" policy for real estate issued in August 2020 placed constraints on the growth rate of real estate loan scales. Then, the "Loan Concentration Management" policy for real estate released in December 2020 further tightened the control over real estate financing from the supply side. Contemporarily, the financing environment for the real estate industry remains severe [1].

According to Hou, although China's real estate enterprises have diversified financing channels, most of them cannot play a good role in the financing practice of real estate enterprises, resulting in the over-reliance of China's real estate enterprises on bank loans and self-raised funds for financing channels [3]. As discovered by Ji, the real estate industry has been continuously heating up, with housing prices remaining high. However, the financing methods of China's real estate enterprises are extremely monotonous. Many financing methods abroad are only theoretical in China and have not been well supported and applied. In addition, China's real estate enterprises are facing limitations in the financing environment, so they are facing some urgent difficulties in financing. For example, it is difficult for enterprises to break through the traditional methods when choosing financial financing, and the high cost and risk of innovative financing methods prevent real estate enterprises from raising funds through diversified financing channels [4].

The diversity and innovation of financing channels for real estate companies are crucial to their sustained development. These financing channels not only affect the liquidity of real estate companies' funds but also directly relate to the speed of project progression and market competitiveness. Therefore, it is extremely important for real estate companies to conduct thorough research and understand the characteristics, advantages, and risks of various financing channels. To embark on a comprehensive understanding of the current landscape of real estate financing avenues in China, this study aims to conduct a case-based analysis, commencing with the selection of two publicly listed real estate corporations, namely Fortune Land Development, Poly Development, analyzing the operating mechanisms, as well as applicable scenarios of these financing channels through case studies, aiming to provide more comprehensive and insightful financing strategy suggestions for real estate companies.

2. Fortune Land Development

China Fortune Land Development Co., Ltd. (stock code: 600340), founded in 1998 and listed on the A-share market in 2003, is a leading industrial new town service provider in China. The company insists on the dual-driven model of industrial new towns and related businesses, as well as commercial office and related businesses. By the end of June 2019, the company's asset scale exceeded 450 billion yuan.

For China Fortune Land Development (CFLD), the most critical source of financing is sales collections, that is, the sales of residential properties, which plays a pivotal role in the company's growth and development. Since its successful backdoor listing in 2012, CFLD has only adopted one financing method, namely private placement, to raise funds. To alleviate the financial strain, in July 2018, CFLD introduced Ping An Asset Management Co., Ltd. as a strategic investor. Besides, CFLD has also signed long-term strategic cooperation agreements with Minsheng Bank for bank loans, entrusted loans, short-term financing bonds, and issued corporate bonds and medium-term notes for debt financing. It has also utilized relatively large-scale trust loans, mezzanine financing with equity in disguise, and used Wuxi Dinghong's underground pipeline network in the Wuxi Industrial Park for after-sale leaseback. CFLD separated the equity income rights and transferred them to financial institutions as targets, agreeing on the repurchase period and repurchase premium rate. After the expiration of the term, CFLD would repurchase the equity income rights. The financing method of equity income rights transfer is actually a loan using future equity income as collateral. At the same time, CFLD also transferred the receivables income rights generated from mortgage loans to Ping An Trust and Everbright Trust when homebuyers purchased properties. Additionally, it transferred the income rights corresponding to receivables from local governments. Furthermore, CFLD utilized over 20 financing methods, including asset securitization, special trust plans, debt transfers, and perpetual bonds [5]. For China Fortune Land Development (CFLD), PPP project asset securitization financing is crucial. After the country issued policies related to PPP asset securitization, CFLD actively responded and successfully launched "CFLD ABS", which was the first PPP asset securitization product in China. CFLD raised funds through various PPP bonds, with interest rates ranging from 3.63% to 7.30%, indicating that the funding source for such bonds is relatively cheap and can also reduce some interest expenses, which greatly benefits CFLD's capital structure [6].

Over the span of four years from 2014 to 2018, China Fortune Land Development exhibited significant growth in both its revenue and net profit. Specifically, its revenue escalated from 26.886 billion yuan to a remarkable 83.799 billion yuan, marking a staggering 312% increase. This significant jump in revenue underscores the robust development of the company's industrial new towns. Parallel to this, its net profit also experienced a corresponding surge, from 3.801 billion yuan to 11.803 billion yuan, with an identical 312% growth rate. The consistent and substantial growth in both revenue and net profit suggests that China Fortune Land Development has undergone significant enhancements in its corporate governance and operational efficiency management over the past five years. These improvements have undoubtedly contributed to the company's ability to expand and generate higher profits. Moreover, the company's total assets underwent a significant expansion, increasing from 113.964 billion yuan in 2014 to 409.712 billion yuan in 2018. However, a closer analysis reveals that this expansion in assets was predominantly funded by an increase in long-term loans, which grew from 9.48 billion yuan to 53 billion yuan during the same period. This significant reliance on debt financing indicates that China Fortune Land Development adopted an expansionary development strategy, heavily leveraging its debt ratio. While this approach enabled rapid growth, it also exposes the company to higher financial risks. The amount of cash flow from operating activities declined from -4.954 billion yuan in 2014 to -7.427 billion yuan in 2018, indicating that the industrial new towns of China Fortune Land Development generated very little cash flow and there was even a possibility of a cash flow disruption. Table 1 shows the financial situation of China Fortune Land Development over the past five years.

Table 1. Financial Statement of China Fortune Land Development from 2014 to 2018 (Yuan Billion)

Column heading	2018	2017	2016	2015	2014
total revenue	83.799	59.6.35	53.8.21	38.3.35	26.86
total assets	409.712	375.865	249.903	168.623	113.964
Long-Term loans	53	37.1	20.3	20.6	9.48
Bond payable	58.1	39	31.3	7.93	6.03
Quick ratio	0.47	0.52	0.48	0.47	0.35
Asset-liability ratio	0.87	0.81	0.85	0.85	0.85
Cash flows from financing activities	77.4	101.6	71.2	56.6	29.5
The amount of cash flow from operating activities	-7.427	-16.227	7.763	7.449	-4.954

According to the annual report, China Fortune Land Development's financing scale in 2017 reached 110.542 billion yuan, hitting a peak since its establishment. Bank loans have always been a crucial financing method for China Fortune Land Development, rising from 7.015 billion yuan in 2014 to 41.248 billion yuan in 2017. In 2017, bank loans accounted for 37% of the total financing. Corporate bonds, a new financing method introduced by China Fortune Land Development in 2015, increased from 8 billion yuan to 49.855 billion yuan, representing the fastest-growing financing method for the company. Since 2016, corporate bonds have become the most important financing channel for China Fortune Land Development, accounting for the highest proportion of financing. The financing method through trust and asset management has decreased from 23.12 billion yuan in 2014 to 20.339 billion yuan in 2017, indicating that China Fortune Land Development has been controlling and reducing its usage of this financing method. In 2017, the proportion of financing through trust and asset management accounted for 19% of the total financing. The continuous expansion of financing scale has undoubtedly provided important financial support for the rapid expansion of China Fortune Land Development [7].

3. Poly Development

Poly Real Estate's full name is Poly Development and Holdings Group Co., Ltd., which was established in Guangzhou in 1992 as a large central enterprise under the management of the State-owned Assets Supervision and Administration Commission (SASAC). On July 31, 2006, Poly Development and Holdings Group Co., Ltd. was listed on the Shanghai Stock Exchange, with the stock abbreviation of Poly Real Estate (now known as Poly Development) and the stock code of 600048. It became the first real estate company to be listed in the IPO market after the resumption of the equity split reform. Since its listing, its total assets have grown from 16.5 billion to over one trillion; revenue has grown from 4 billion to over 240 billion, with a compound growth rate of over 34%; gross profit margin has remained between 30% and 40%, and weighted average ROE has remained above 15%. Moreover, unlike traditional central enterprises, Poly is a leader in promoting market-oriented mechanisms among central enterprises.

The debt financing model of Poly Real Estate mainly includes bond financing and bank loans. According to the types of bonds, it comprises corporate bonds and medium-term notes. Additionally, Poly Real Estate is also preparing to issue bonds overseas to raise funds. Bank credit is the most significant financing method for Poly Real Estate. Currently, project development loans are the primary loan type that Poly Real Estate can obtain, typically with a term less than three years. After receiving approval from the China Securities Regulatory Commission, Poly Real Estate issued a five-year bond in 2018 with a total issuance amount of 4.3 billion yuan, a coupon rate of 7% on the face value, and Poly Real Estate serving as the credit guarantee. At the same time, Poly Real Estate raises funds through issuing corporate bonds, medium-term notes, and overseas bonds. It utilizes IPOs and private placements and collects funds in a non-public manner through private commercial real estate equity funds. Nowadays, as most large enterprises gradually transform into urban operators, they not only own traditional commercial real estate but also have many diversified businesses such as long-term rental apartments and logistics services. Under such conditions, asset securitization has developed. Poly Real Estate primarily uses CMBS (Commercial Mortgage-Backed Securities) and REITs-like products for asset securitization financin [8]. CMBS has underlying assets that are purchased through multiple mortgage loans, such as hotels, office buildings, and commercial buildings. It uses structural design methods to bundle and sell the future cash flows of these underlying assets. Secondly, REITs-like products, also known as commercial real estate trust investment funds, adopt a "stock plus bond" approach to obtain the equity and debt of project companies by holding private equity and trust interests, thus gaining ownership of the underlying assets [8]. In 2017, China issued policies to encourage and support the pilot issuance of REITs. Poly Development seized the opportunity of the times and actively responded to the national call, issuing the first REITs for rental housing issued by a centrally administered state-owned enterprise. On March 13, 2018, Poly Real Estate successfully issued the "Poly No. 1" special plan jointly with Zhonglian Guoxin, which was the first shelf-style apartment REITs issued by a centrally administered state-owned enterprise in China. The total shelf size was 5 billion yuan, with an initial issuance size of 1.717 billion yuan. The types of asset-backed securities were divided into priority and junior levels, with a hierarchical ratio of 9:1. The priority level had a size of 1.5453 billion yuan and an issuance interest rate of 5.50% [9].

Table 2. Poly Real Estate Financial Data 2014-2018(Yuan Billion)

Column heading	2018	2017	2016	2015	2014
total revenue	194.6	146.7	154.8	123.4	109.1
Total asset	846.76	697.63	467.99	403.86	365.76
Long-Term loans	181.9	147.7	68.9	66.4	90.5
Bond payable	33.1	27.5	30.1	18.4	70.3
Quick ratio	0.66	0.57	0.53	0.43	0.45
Asset-liability ratio	0.78	0.77	0.75	0.76	0.78
Cash flows from financing activities	143.2	170.8	199.5	159.3	120.5
The amount of cash flow from operating activities	11.893	-29.261	34.053	17.784	-10.458

From Table 2, it can be concluded that total revenue from 2014 onwards, it has been increasing continuously, liabilities with interest was mostly composed of long-term loans, it is also the case. which growth by 100% from 2014 to 2018.Since 2014, a significant number of medium-term notes have been issued, involving funds of up to 20 billion yuan. The majority of the coupon rates range between 3.28% and 4.78%. In addition, Poly Real Estate utilized its overseas subsidiary, Hengli Properties, to issue bonds in the amount of USD 500 million between 2013 and 2014. The coupon rates for these bonds ranged from 4.5% to 5.2%. As a result, bond payable increased. Although the quick ratio has been increasing year by year, it remains below the average level, indicating a poor short-term debt paying ability. In relation to cash flows from financing activities, it has been continuously rising since 2014 but experienced a decline in 2018.

4. Comparison

Comparing the financing channels of Poly Development and China Fortune Land Development (CFLD), both companies adopted diversified financing strategies during this period. This includes utilizing various financing methods such as bank loans, bond issuance, trust, and asset management plans. This diversified financing strategy allows enterprises to flexibly choose financing methods based on market conditions and their own needs to meet their capital requirements. Both Poly Development and CFLD have actively responded to relevant national policies, such as the pilot issuance of REITs and the asset securitization of PPP projects. These policies provide new financing channels and tools for enterprises, helping to reduce financing costs and improve financing efficiency. At the same time, both companies focus on optimizing their capital structures by rationally allocating the proportions of equity and debt financing, thereby reducing the overall weighted average cost of capital (WACC) and enhancing their competitiveness and profitability. By the end of 2018, the Weighted Average Cost of Capital (WACC) was 4.34% for Fortune Land Development, in 2014, its WACC was still 5.64%. Poly Development's WACC has steadily declined from 5.83% in 2014 to 3.50%. This indicates that both companies are able to raise the required funds at a lower cost, reflecting the success of their financing strategies and financial health. At the same time, this enables the company to have stronger competitiveness. The company can utilize its funds more flexibly for project development, land banking, and other activities to gain more market share and profits.

In addition, in terms of financing costs, Poly Development's financing costs remained consistently lower than the average financing costs of the YH50 real estate enterprises from 2014 to mid-2018. At its lowest point in 2016, the financing cost was 4.4%, and by mid-2018, the financing cost had risen to 4.86%, still below the 6.01% of the YH50 enterprises [8]. This financing advantage allowed Poly Development to invest in land acquisition without worrying about insufficient funds or excessively high financing costs, providing convenience for its path of scale development. In terms of financing strategies, Poly Development, leveraging its status as a central enterprise, pursued a nationwide layout and expanded its land reserves, business scale, and market share through acquisitions and integrations, such as acquiring 50% of the equity of AVIC Real Estate and Poly Property, thus consolidating its leading position in the industry [8]. Nevertheless, in terms of financing structure, China Fortune Land Development's financing methods are more diverse compared to Poly Development, including bank loans, bond financing, trusts, asset management, and more than 20 other financing methods. Taking 2018 as an example, China Fortune Land Development's total financing amount was 139.039 billion yuan, of which bank loans accounted for 35%, and the scale of bond financing was large, reaching 79.162 billion yuan. In terms of asset-liability ratio, China Fortune Land Development's asset-liability ratio is relatively high, reaching 86.65% in 2018, an increase of 5.56% from the same period last year. This makes it difficult for the company to obtain bank loans and requires continuous innovation in financing channels to maintain capital turnover. In financing innovation, China Fortune Land Development actively responded to the national PPP policy and launched the country's first PPP asset securitization product, China Fortune Land ABS. Through PPP bonds, it raised funds with interest rates ranging from 3.63% to 7.30%, providing it with a relatively inexpensive source of capital. Regarding the differences in cash flow conditions, the two companies may exhibit varying cash inflow and outflow situations due to their different market strategies, project progress, and financial management. Poly Development likely achieved relatively stable cash flow growth by virtue of its robust operational strategies and excellent market reputation. However, China Fortune Land Development may have experienced more significant cash flow fluctuations due to its rapid expansion and diversified investments. From the perspective of debt structure, the two companies may also exhibit significant differences. Poly Development may focus more on the allocation of long-term debt and fixed-rate debt to reduce financing costs and financial risks. Conversely, China Fortune Land Development may prefer short-term debt and floating-rate debt to support its rapid expansion needs. This different debt structure will also impact the interest expenses and financial risks of the two companies.

The Chinese real estate capital market suffers from poor efficiency, high financing thresholds, long listing procedures, and strict regulations on fundraising. In response to the booming real estate market in 2016, regulators took measures to comprehensively control financing channels for real estate development companies, such as corporate bonds and medium-term notes. Consequently, financing from the capital market has become increasingly challenging for real estate development companies. Therefore, real estate enterprises should actively develop real estate trust funds and accelerate the promotion of real estate securitization [10].

5. Conclusion

In summary, by studying two listed real estate companies, Poly Development, a state-owned enterprise, and China Fortune Land Development, a privately-owned company, this research aims to investigate the financing channels in the Chinese real estate industry. Through comparing the financing methods of the two companies, the study intends to analyze the advantages and disadvantages of the choices made in financing channels. Nowadays, China's real estate industry has faced downward pressure due to the aging population and changing purchasing preferences of the new generation, leading to a decrease in demand for different types of housing. Meanwhile, rapid real estate development in some regions has resulted in market oversupply, especially against the backdrop of economic slowdown, where the decline in housing demand has put pressure on property prices. In the current downturn of China's real estate industry, the government plays a crucial role. The government can stabilize market expectations by introducing appropriate policies, such as adjusting real estate tax policies, optimizing land supply strategies, and moderately relaxing restrictions on home purchases and loans, to promote the steady and healthy development of the market. The government should also implement differentiated real estate policies tailored to the actual conditions of different cities. Meanwhile, companies can diversify their financing channels, not relying solely on bank loans, and devote more attention and effort to foster sustainable development, real estate developers are exploring novel financial products such as REITs. These innovative tools allow for broader capital raising, inclusive of the general public, thereby promoting the corporation's long-term growth and development.

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