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Recent Revival In China's Property Sector Is Likely To Lose Steam

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HONG KONG (S&P Global Ratings) Sept. 8, 2016--The revival in China's property sector in the past 12-18 months is likely to lose steam. S&P Global Ratings expects the sector's growth to slow down over the next 12 months as a result of tapering effect of supportive government policies, a high base, and rising land prices. That's according to a report, titled "China Property Watch: Soaring Land Prices And Slowing Sales Prospects To Curtail Recovery," that S&P Global Ratings published today.

"Rapid price increases in prime cities in China have fueled fears about the health of the property market," said S&P Global Ratings credit analyst Matthew Kong. Some local governments have therefore tightened home and land purchase requirements in the past few months to cool down the market.

Strong sales have also led property developers to reinvest their cash flows into new projects, the report notes. Many rated developers have stepped up land acquisitions and expansion plans, pushing land prices to record highs in many tier-1 and tier-2 cities.

Organic expansion in China's property sector is increasingly giving way to consolidation as the country's economic growth has slowed to its lowest level in two and a half decades. Developers are increasingly procuring land by acquiring project companies and smaller developers.

"We believe the land grabbing frenzy will hurt profitability and cash flows of more aggressive developers," said Mr. Kong. "Any faltering in property prices could place those developers between a rock and a hard place."

S&P Global Ratings believes the financial risk profiles of developers haven't recovered in line with the recovery in sales so far in 2016. Rather, credit profiles have deteriorated for many developers that rushed into the next cycle of investment by expanding land banks and construction. The credit ratios of a number of developers may continue to weaken, as their interim results already reflected.

"The rating trend for the next 12 months continues to have a negative bias," said Mr. Kong. "We see a low likelihood of significant deleveraging by developers, given their strong aspirations for scale growth."

In our view, a solid recovery of Chinese developers' credit profiles will depend not just on good sales execution but a commitment to disciplined land banking and proactive leverage control. These characteristics will differentiate speculative-grade as well as investment-grade developers, possibly leading to more fallen angels and rising stars, and changing the competitive landscape.

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