

Analyzing the Roots and Mitigating the Risks: Debt Default Phenomena in Fujian's Real Estate Sector

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Abstract: This article examines the debt default phenomena in Fujian's real estate sector, highlighting the challenges and implications for the industry. It delves into the causes of these defaults, including economic factors, over-reliance on borrowing, and company-specific issues. The impact on the real estate market, investors, and the broader economy is analyzed. The paper proposes strategies for real estate companies, such as risk management and investment diversification, and suggests policy responses. It also underscores the need for further research in this critical area.

Keywords: Fujian, Real Estate, Debt Default.

1. Introduction

Over the past decade, real estate enterprises in Fujian, along with those in other Chinese regions, have experienced rapid growth and expansion. The real estate sector has significantly stimulated economic growth by promoting the development of the construction industry and related industries such as building materials, furniture, and decoration. It has directly and indirectly created a substantial number of employment opportunities and provided significant tax revenue for the government. However, this growth has frequently depended on high leverage and extensive borrowing, leading to fragile financial structures and limited risk resistance capacity within these enterprises.

Post-2019, the Chinese government implemented a series of regulatory measures to curb the rise in housing prices and prevent overheating of the market. Following the introduction of various control policies by the national and Fujian local governments, including purchase and sales restrictions, land supply and usage policies, financing supervision of real estate enterprises, and housing rental encouragement policies, the cash flow and sales situations of Fujian's real estate companies have been affected to varying degrees. Consequently, survival and development challenges for these enterprises have become increasingly evident. In recent years, numerous Fujian-based real estate companies, including Taihe Group, Country Garden Holdings, and Sunshine City, have experienced bond defaults and overdue debts, see Table 1.

Table 1. Debt Defaults and Bond Default Events in Fujian-Based Real Estate Companies (2018-2022)

Year	Company Name	Description of Default Event	Subsequent Measures Taken
2018	Taihe Group	Bond default occurred, triggering a debt restructuring plan.	Negotiations with creditors, progressing with asset and debt restructuring plans.
2019	Country Garden Holdings	Partial debt overdue, facing cash flow pressure.	Issuance of new bonds, adjustment of capital structure, and enhancement of cash flow management.
2020	Sunshine City Group	Bond default due to tight cash flow.	Implementation of cost control measures, seeking external financing, and strengthening project management.
2021	Fusheng Group	Multiple debt projects overdue, leading to a tight funding chain.	Asset sales, debt restructuring, and negotiation of solutions with creditors.
2022	China Housing & Land Development, Inc.	Debt default, facing a liquidity crisis.	Seeking government support, looking for strategic investors, and restructuring financial framework.

Consequently, investigating the causes of debt defaults among Fujian-based real estate enterprises, analyzing their impact on the economy and market, and proposing risk control strategies have become imperative.

2. The Causes of Debt Default in Real Estate Companies in Fujian Province

2.1. Economic Factors: Market Dynamics and Economic Policies

From the perspective of external economic environment,

the debt defaults of Fujian-based real estate companies can be attributed to a combination of high leverage, regulatory changes, economic downturns, liquidity issues, shifts in market demand, and global economic factors.

2.1.1. Regulatory Changes and Market Cooling Measures

In recent years, the Chinese government has implemented various regulatory measures to cool down the overheating real estate market. These include restrictions on speculative buying, limitations on the amount of loans that banks can extend for real estate, and tighter controls on the real estate activities of developers. Such policies, while aimed at

stabilizing the market, have led to reduced sales and cash flow issues for developers, impacting their ability to service debts.

2.1.2. Economic Slowdown and Reduced Demand

Based on the negative influence brought about by the COVID-19 epidemic, economic slowdowns in China and globally have reduced consumer spending power and demand for real estate. The reduction in property demand directly affects the revenue streams of real estate companies, making it difficult for them to manage existing debt levels.

Also, from the perspective of the global economy, international trade tensions, global economic uncertainties, and fluctuations in foreign investment also influence the real estate market. These factors can affect both the cost of borrowing for companies and the overall demand for real estate.

2.1.3. Liquidity Crisis and Credit Squeeze

Tightened credit conditions have led to a liquidity crisis for many real estate firms. As banks and other financial institutions become more cautious in lending, particularly to industries considered high-risk like real estate, companies find it challenging to refinance existing debts, leading to defaults.

2.2. Company-Specific Factors: Management, Financial Strategies, and Business Models

Company-specific factors like aggressive expansion, inadequate risk management, reliance on risky financing methods, inefficient capital use, dependency on presales, project management issues, lack of financial resilience, and weak corporate governance have significantly contributed to the debt defaults experienced by Fujian-based real estate companies. The above reasons are further developed as follows:

2.2.1. Aggressive Growth Strategies and Inadequate Risk Management

Many real estate companies in Fujian, mirroring a common trend in the industry, pursued aggressive growth and expansion strategies. This often involved launching multiple large-scale projects simultaneously, which required significant capital. Such expansion strategies can be risky, especially when market conditions change unfavorably, leading to over extension and financial strain.

Effective risk management is crucial for the sustainability of any business, more so in the volatile real estate sector. Some companies may have lacked robust risk management frameworks, leaving them ill-prepared to handle market downturns, regulatory changes, or liquidity crises.

2.2.2. Reliance on Off-Balance Sheet

Financing instruments and off-balance sheet financing (such as wealth management products and trust financing) to raise capital. While this can provide short-term liquidity, it often comes with high costs and risks, leading to financial vulnerabilities when market conditions shift.: Some real estate companies used complex financial instruments and off-balance sheet financing (such as wealth management products and trust financing) to raise capital. While this can provide short-term liquidity, it often comes with high costs and risks, leading to financial vulnerabilities when market conditions shift.

2.2.3. Inefficient Capital Allocation and High Dependency on Presales Revenue

Misallocation of capital into non-core or speculative investments can detract from a company's primary real estate

development objectives. Diversification into areas outside of a company's expertise without proper strategy can strain financial resources.

The business model of many real estate companies heavily relies on presales of projects to finance ongoing construction and new developments. A decline in market demand and regulatory limits on presales can severely impact cash flow and the ability to service debt.

2.2.4. Lack of Financial Resilience and Weak Corporate Governance Issues

Some companies may not have maintained sufficient cash reserves or flexible financial structures to weather downturns. This lack of financial resilience becomes apparent in challenging economic environments, where companies struggle to manage cash flow and debt obligations.

Weak corporate governance, including lack of transparency, poor decision-making processes, and inadequate checks and balances, can lead to strategic missteps and financial mismanagement, culminating in debt defaults.

2.3. External Factors: Global Economic Trends and Regulatory Changes

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3. Impact of Debt Defaults on the Real Estate Market and the Broader Economy

3.1. Impact on Investors and Other Stakeholders

The debt defaults of Fujian real estate companies have had a multifaceted impact on both the real estate market and its investors.

3.1.1. Impact on the Real Estate Market

First of all, the debt defaults can undermine market confidence, leading to a more cautious approach from buyers, investors, and financial institutions. This can result in a slowdown in sales and investment, impacting the overall health of the real estate market.

Secondly, From the factor of property prices and demand, a crisis in major real estate companies could lead to a drop in property prices, especially in regions where these companies have significant project holdings. There might be a temporary increase in supply due to stalled projects, impacting overall market demand.

Thirdly, financial institutions may become more cautious in lending to real estate developers, leading to tighter credit conditions. This can affect new and smaller developers particularly hard, as they might struggle to secure financing for projects.

Also, the defaults can prompt regulatory bodies to

implement stricter controls and oversight over real estate financing, aiming to prevent similar incidents in the future and ensure market stability.

3.1.2. Impact on Investors

For those equity and debt investors, they might face significant losses. Bondholders might suffer from defaults, and shareholders could see a decline in stock values. And the broader investor confidence in the real estate market can be shaken, leading to reduced investment flows into the sector. This could affect the financing of new projects and the overall growth of the market. And then, home buyers who have invested in pre-sale properties might face delays in project completion or, in worst-case scenarios, unfinished projects. This can lead to financial losses and legal challenges for consumers.

3.2. Consequences for the Provincial and National Economy

The debt defaults in Fujian's real estate sector have far-reaching consequences for both the provincial and national economies of China. These impacts can be analyzed from multiple perspectives:

3.2.1. Economic Growth and GDP Impact

The real estate sector is a significant contributor to China's GDP. In Fujian, where the sector is especially prominent, its downturn due to debt defaults could lead to a noticeable decline in provincial GDP growth.

At a national level, given the size of Fujian's economy, these defaults could marginally impact China's overall economic growth, especially considering the real estate sector's multiplier effect on related industries.

3.2.2. Banking and Financial Sector Stability

The defaults can strain the banking sector, which has substantial exposure to real estate loans. This can increase the risk of non-performing loans (NPLs), affecting the banks' profitability and capital adequacy ratios. If not managed properly, this could lead to a broader financial contagion, impacting national financial stability and potentially leading to tighter credit conditions, affecting other sectors and regions.

In the prospective of investment and market sentiment, investor confidence, both domestic and international, could be adversely affected. This may lead to reduced investment in not only real estate but also other sectors, as investors seek to mitigate risk. The ripple effects can include a slowdown in foreign direct investment (FDI) and portfolio investments, impacting national economic indicators such as foreign exchange reserves and currency stability.

3.2.3. Employment and Household Income

The real estate sector is a significant employer. Its downturn could lead to job losses, affecting household incomes and consumption patterns in Fujian. On the hand, reduced household consumption due to lower disposable income can further slow down economic activity, leading to a feedback loop that negatively impacts the national economy.

3.2.4. Government Revenues and Fiscal Policy

Local governments in China heavily rely on land sales to real estate developers as a source of revenue. Debt defaults can lead to a slowdown in land sales, impacting municipal finances and potentially leading to cuts in public spending or infrastructure projects.

At the national level, this could necessitate adjustments in fiscal policy, potentially leading to increased borrowing or reallocation of funds to stabilize affected regions.

3.3. Long-term Structural Implications

These events might trigger a reassessment of the real estate-led growth model, prompting both provincial and national authorities to diversify their economic strategies. It could also lead to reforms in the real estate sector, focusing on sustainability, reducing over-reliance on debt, and encouraging responsible lending and borrowing practices.

Over the past three years, Fujian Province in China has made significant strides in investing in emerging technologies and encouraging innovation and entrepreneurship. The strategic focus has been on cultivating and developing strategic emerging industries, supported by the National Development and Reform Commission. This effort has led to remarkable growth in the scale of these industries, with major breakthroughs in key areas and a significant enhancement in independent innovation capabilities.

Fujian has focused on seven key areas under its strategic emerging industries plan: new generation information technology, high-end equipment, new materials, new energy, biology and new medicine, energy conservation and environmental protection, and marine high-tech. These areas also include prospective industries such as quantum information, 6G, block-chain, gene and biotechnology, and deep sea technology.

The province has set ambitious goals for these industries, aiming to achieve an added value of RMB 1 trillion by 2025, representing 17% of the regional GDP. This plan also includes the development of Southeast China (Fujian) Science City and Xiamen Science City as central tasks, focusing on building a high-quality science and technology new city and a scientific and technological achievement transformation center, respectively.

Furthermore, the "One, Ten, Hundred, Thousand, and Ten Thousand Project" has been implemented to promote industrial upgrading. This includes building platforms for strategic scientific and technological forces, promoting the construction of key strategic emerging industrial clusters, creating leading enterprises in more than 100 subdivided fields, cultivating thousands of specialized and refined SMEs, and implementing an RMB 1 trillion industrial investment promotion project.

Digital economy, marine economy, and green economy are the primary areas for the key layout of innovative resources, with a focus on the construction of Digital Fujian as a basic pilot program to promote high-quality development.

These initiatives indicate a strong commitment by Fujian Province to diversify its economy through the advancement of emerging technologies and the support of innovation and entrepreneurship, aiming to create a robust, modern industrial system.

In conclusion, the debt defaults in Fujian's real estate sector extend beyond local concerns, impacting the broader provincial and national economic landscape. These consequences highlight the need for coordinated policy responses and strategic measures to mitigate the impacts and ensure long-term economic stability and growth.

4. Conclusion

4.1. Suggestions for Real Estate Companies, Investors, and Policymakers

4.1.1. New Discoveries and Implications

The analysis of debt defaults in Fujian's real estate sector

reveals several critical insights. Firstly, the interconnections of the real estate sector with broader economic elements is profound. The impacts of these defaults extend beyond the immediate industry, affecting banking, investment, employment, and government fiscal policies. Secondly, the situation underscores the risks associated with over-reliance on debt-financed growth in the real estate sector. Lastly, the ripple effects of the crisis in a regionally significant province like Fujian highlight the vulnerability of local economies to sector-specific shocks and their potential to influence national economic stability.

4.1.2. Suggestions for the Real Estate Industry

It's imperative for real estate companies to prioritize robust risk management strategies and diversify investment portfolios, thereby reducing dependency on any single sector or market. Also, it is time to shift towards more sustainable financing models, reducing reliance on high leverage and speculative practices. With the diversity and rapid change of the current market environment, companies should remain agile and adaptable to fast-changing and competitive environments. Due to the requirement of quickly adjust to varying conditions, companies should consider to embrace innovation in construction technology, sustainable development, and customer-centric business models.

4.1.3. Suggestions for Other Related Industries

Industries connected to real estate, such as construction and materials, should focus on building resilience in their supply chains. Also they should enhanced sensitivity to market changes and diversification across different sectors can reduce vulnerability to real estate market fluctuations. Investing in workforce development can provide a buffer against employment shocks in the real estate sector.

4.2. Directions for Future Research

4.2.1. Economic Impact Analysis

Further research should quantitatively measure the specific impacts of real estate defaults on various economic indicators at both provincial and national levels.

4.2.2. Policy Effectiveness

A thorough evaluation of the effectiveness of various policy responses to these defaults is crucial to identify best practices for crisis management in the real estate sector.

4.2.3. International Comparisons

Comparative studies with other regions or countries that have experienced similar real estate challenges could yield valuable lessons and strategies.

4.2.4. Long-Term Sector Health

Research into long-term strategies for ensuring the health and sustainability of the real estate sector in China, considering global economic trends and environmental sustainability.

In summary, the debt defaults in Fujian's real estate sector offer important lessons for the industry and related sectors. Addressing these challenges requires a multifaceted approach involving prudent risk management, sustainable growth strategies, and collaborative policy initiatives. Future research should continue to explore these areas, providing deeper insights and guiding strategies for sustainable development.

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