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Instant Thoughts

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Nothing Like Home

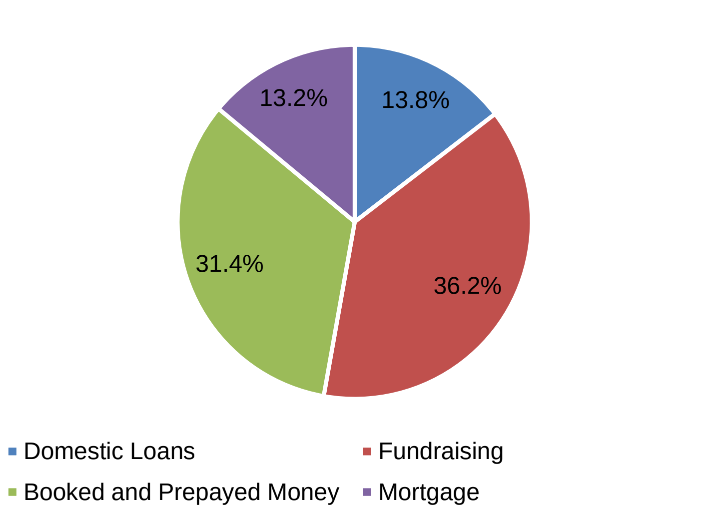
- **The Mainland authorities have recently rolled out an epoch-making reform package, marking the end of the prevailing presales model in the housing sector.**
- **By postponing the disbursement triggers of mortgage funding to completion filings, either developers' own funding, bank loans and funds raised from capital market will have to fill the void. Developers could stay hesitant for land acquisition.**
- **Homebuyers, on the other hand, will begin servicing their mortgages only when a home is completed, liberating themselves from construction uncertainty. Being candid about the possibility of failed delivery is itself a healthy dose of a confidence booster.**

Even more so than usual, Mainland's landscape is evolving. Over the weekend, the regulatory trio - Ministry of Housing and Urban-Rural Development, Ministry of Natural Resources, and National Financial Regulatory Administration - jointly issued an epoch-making plan to revamp the housing sector. It essentially put an end to the prevailing presales model.

From now on, presales will only be permitted once a project's main structure has topped out. The authorities tightened the screw further by making it clear that property loans are now assessed and dedicated at the project level, departing from developer-based credit. And funds are ring-fenced to prevent freewheeling developers from misusing.

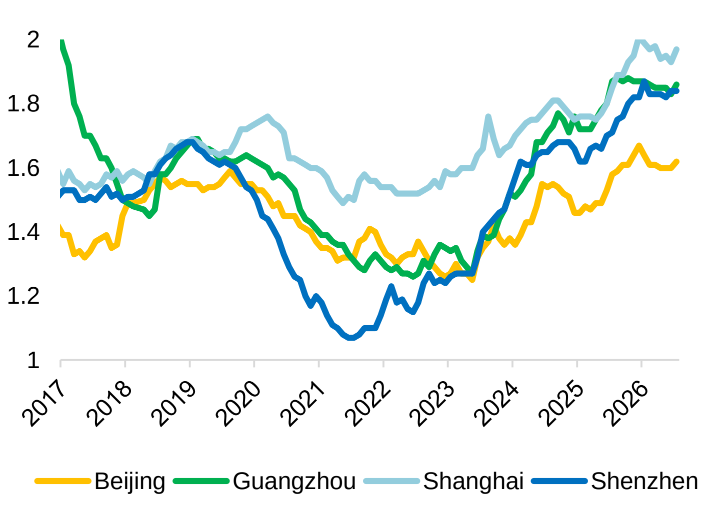
There nevertheless remain undercurrent tensions in the deal. Presales related funds played a commanding role in construction financing, accounting for 45% of developers' funding (Exhibit 1). By postponing the disbursement triggers of mortgage funding to completion filings, either developers' own funding, bank loans, or funds raised from capital market will have to fill the void. Clock's ticking. Squeezed by stringent upfront funding requirements and longer lead times, ill-equipped developers could stay hesitant for land acquisitions. Not everyone of them is ready to face the annual ordeal of refinancing. It provides fertile soil for M&A opportunities.

Exhibit 1: Funding Source of Developers (% Share)



Source:: National Bureau of Statistics of China, Shanghai Commercial Bank

Exhibit 2: Residential Rental Yield (%)



Source: Centaline, Bloomberg, Shanghai Commercial Bank

Shall developers' bond owners scurry for cover? Not necessarily. The reform package takes a large chunk of the burden off the homebuyers. Buyers are required to service their mortgages only until a home is completed, thereby liberating themselves from construction uncertainty. Being candid about the possibility of failed delivery is itself a healthy dose of a confidence booster.

But the mental nudge comes with challenges too. A housing market won't budge on a flourishing deposits base is telling. We don't have a buyer problem, we have a price problem. Behind all these lurk the self-preserving mentality - Being early is as punishing as being wrong. So prospective homebuyer's safe move appears to be to keep holding cash. The way out is, or should be, obvious. If rental income can fully cover mortgage expenses, the miasma will be thinned and homeownership won't be read as losing one's nerve.

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