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An Analysis on Financing Channels of Large Real Estate Enterprises in China: Poly Development, China Merchants Shekou and Vanke

Chi Liu[1,a,*]

[1]*School of Finance, Renmin University of China, Beijing, 100872, China*
a. liuchi0307@ruc.edu.cn
**corresponding author*

Abstract: The financing problem of real estate enterprises is a hot issue in China. As the real estate industry is an important component in China's economy, helping real estate enterprises to continue operating during the economic downturn through financing is urgent. Previous researchers focused on the current situation of real estate industry financing, gave their suggestion to solve the common problems of the entire industry; or focused on the difficulties and risks of financing for small or medium-sized real estate companies, and proposed improvement measures; or focused on specific financing channels, analyzing their development and applications. However, there is still a research gap on the financing of large real estate enterprises. Therefore, this paper intends to analyze the financing channels of large real estate enterprises in China. Based on the annual financial statements of three largest real estate enterprises, this paper explores the existing states of current real estate financing channels via comparison over time and among enterprises. This study found that large real estate enterprises in China have the problem of financing dependence on credit and high debt ratio. These results suggest that enterprises broaden financing channels, improve balance sheets and reduce debt ratios.

Keywords: Real Estate Enterprises, Financing Channels, WACC.

1. Introduction

In 1992, the State Council pointed out that the real estate industry ‘will become one of the pillar industries for the development of the national economy’. China’s housing system began to transform into a market-oriented one. In the late 1990s, the welfare housing distribution system was abolished and housing mortgage loans were launched, which promoted the prompt development of China’s commercial housing market. The real estate industry is an critical part of Chinese economy, driving the output value of dozens of upstream and downstream industrial chains and is an important source of revenue for the Chinese government. Real estate firms are capital-intensive businesses with lengthy project development cycles and high demand. Financing is an important part of real estate project [1]. Self-raised money and sales outstanding are examples of Chinese real estate businesses' internal financing channels. Bank loans, listing financing, real estate trust are examples of their external financing channels. Among them, bank loans account for the highest proportion of financing for Chinese real estate companies.

In recent years, the real estate industry has been in turmoil, and policies have emerged, affecting the real estate market and enterprises. In 2008 and 2014, the central government put a large amount of money in real estate market, real estate prices fluctuated, and China's overall housing prices grew rapidly. The central government worked to strictly supervise the real estate market, restrict prices, and regulate the market from the supply and demand sides in 2017. The ‘3 red lines’ policy was developed by the central government in August 2020 and stipulated that the asset-liability ratio must be less than 70% regardless of advance payments, the net debt ratio must be less than 100% the cash to debt ratio must be larger than 1, then divided into four management models [2]. Legislative changes may also have an impact on the real estate market. One of the transition's initiatives is the gradual substitution of bank credit and other funding sources for equity building [3]. In May 2024, new real estate policies were introduced, including but not limited to relaxing purchase restrictions and canceling the lower limit of mortgage interest rates, which will benefit the real estate industry. In October 2024, the State Council Information Office announced a combination of ‘four cancellations’, ‘four reductions’ and ‘two increases’ to boost confidence and transaction volume in the real estate market and gradually aid in the recovery of the real estate market.

The financing of Chinese real estate firms has been significantly impacted since the ‘3 red lines’ regulation was put into place. The financing channels of real estate companies have become narrower, the financing environment has become stricter, and the financing costs and financial risks have increased [4]. Real estate businesses are challenging to run. The real estate industry needs to seek out counter measures to break the financing plight under the new policy. Especially for big real estate firms, which dominate the market and are the engine of China's economic growth, it is crucial to carry out reasonable financing.

This paper focuses on the financing situation of three real estate firms with the highest market value in China's A-shares, namely Poly Developments, China Merchants Shekou, and Vanke. Through a comparative analysis of the annual financial statement from 2021 to 2023, it draws conclusions about the financing channels of the above-mentioned real estate companies, looks forward to their future development, and gives corresponding conclusions and suggestions.

2. Financing Channels

The financing channels of real estate companies include bank credit, equity financing, financial leasing, real estate securitization, and real estate private equity funds. Bank loans are the primary source of funding for real estate businesses. Funds for bank credit come from a reliable source and come in substantial quantities. The proportion of real estate enterprises relying on bonds or stocks for financing is relatively small [5].

At present, the financing of the real estate industry faces a series of problems: First, the financing channel is single. It is found that nearly 70% of the funds come from bank loans and prepayments, and other sources of funds account for only about 30%. The main source of prepayments is mortgage loans from home buyers [2]. The ‘high turnover’ model makes real estate enterprises more dependent on internal financing. The ‘high turnover’ model means that the enterprise first obtains pre-sale qualifications, recovers a large amount of cash through the sales of pre-sale houses, and uses it for projects to achieve rapid turnover of funds. From 2012 to 2021, among the financing channels of real estate companies, the proportion of deposits and advance payments increased from 27.51% to 36.76%, and the proportion of personal mortgage loans increased from 10.90% to 16.10%. The proportion of domestic loans (including bank loans and non-bank loans) decreased from 15.3% to 11.58%, and the proportion of self-raised funds (including own funds, shareholder investment funds, and borrowed funds) decreased from 40.48% to 32.53%. The reliance of the financing of Chinese real estate companies on equity and debt has declined [6].

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Moreover, as the government tightens its policies on the real estate market and the public is concerned about its prospects, financial institutions have become more stringent in approving loans to real estate companies [7]. Mismanagement has also led to high financing costs for many real estate companies. For example, Evergrande Group and Kaisa Group defaulted on their debts due to excessive borrowing, which led to a sharp drop in credit ratings, increased liquidity risks and financing costs.

3. Poly Development

Poly Development, full name Poly Development Holdings Group Co., Ltd. (SH600048), is a large listed company controlled by China Poly Group. Poly Development is China's highest-valued real estate company, operating real estate investment and development, financial services and other businesses, involving education, culture& tourism, apartments, hotels, properties and other industries, mainly operating its business in the Greater Bay Area. Poly Development was listed on the Shanghai Stock Exchange in 2006. It is the first real estate company to be listed after the restart of IPO.

As shown in Table 1, in 2023, Poly Development's total assets reached 1,436.912 billion yuan, a decrease of 2.57%. The company's operating income reached 346.828 billion yuan, a decrease of 17.85%, because Poly Development's commercial housing sales fell from 534.9 billion yuan in 2021 to 422.2 billion yuan in 2023, a decrease of more than 20%; the sales area of commercial housing fell from 33.33 million square meters in 2021 to 23.86 million square meters in 2023, a decrease of nearly 30%. At the same time, the number of projects under construction has dropped from about 800 in 2021 to about 700 in 2023. From the perspective of financing costs, the company's WACC value has dropped from 5.4% to 4.5%, which means the financing cost has dropped, which is inseparable from the expectations of China's economic recovery and the improvement of the real estate industry in recent years. From the perspective of financing channels, long-term loans account for a high proportion, and the range is normal; accounts payable have increased significantly, indicating that the company has borrowed a large amount of short-term loans. From the perspective of debt paying ability, the company's debt ratio has decreased slightly, the current ratio has increased slightly, and the debt repayment ability has improved.

The company's bonds payable increased from 41.62 billion yuan to 57.716 billion yuan in 2021-2022, whose proportion to total assets increased from 2.97% to 3.93%. The reason is that the company has issued additional corporate bonds and medium-term notes: In 2022, Poly Development issued 11 new corporate bonds, with interest rates generally between 2% and 4%; and by 2023, its bonds payable dropped to 45.265 billion yuan, and the proportion of total asset also dropped to 3.15%. Long-term loans decreased in 2022-2023 due to a decrease in the company's projects under construction and a significant decrease in the proportion of notes payable to total assets, indicating that the company's business volume decreased that year and its borrowing demand decreased.

Table 1: Key financial data of Poly development (RMB Billion).

	2023	2022	2021	Change range
Accounts payable	173.44	162.05	130.13	33.3%
Bonds payable	45.27	57.72	41.62	8.76%
Long-term loan	235.25	242.48	231.90	1.44%
Current ratio	1.56	1.54	1.52	2.63%
Debt ratio	76.55%	78.09%	78.36%	-2.31%
WACC	4.5%	4.7%	5.4%	-16.67%

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4. China Merchants Shekou

China Merchants Shekou, full name China Merchants Shekou Industrial Zone Holdings Co., Ltd. (SZ001979), is a subsidiary of China Merchants Group and is engaged in urban comprehensive development and operation business. China Merchants Shekou was established at the beginning of reform and opening-up. With its policy and geographical advantages, it built China's first open industrial zone. China Merchants Shekou involves three types of business, development business, asset operation and urban services, covering multiple fields. China Merchants Shekou was listed on the Shenzhen Stock Exchange in 2015, and its market value once ranked first in the A-share real estate sector.

As shown in Table 2, in 2023, China Merchants Shekou's total assets reached 908.508 billion yuan, up 6.11%; operating income reached 175.07 billion yuan, up 8.94%; WACC value dropped from 6.6% to 5.0%, and financing costs decreased. From the perspective of financing channels, the company's bonds payable increased rapidly, while accounts payable and long-term loans changed little, indicating that the company improved the company's financing channels and obtained liquidity through bond financing. From the perspective of debt paying ability, the company's current ratio and debt ratio have hardly fluctuated. Compared with the other two companies, the current ratio is higher and the debt ratio is lower. There is no problem of liquidity and debt repayment for now. In the period of tightening of the real estate market, China Merchants Shekou's financial data is quite impressive, and its operation and management are in good condition. In 2023, China Merchants Shekou increased its registered capital from RMB 7.739 billion to RMB 9.06 billion, improving its financing capacity.

From 2021 to 2023, China Merchants Shekou's bonds payable nearly doubled because the company issued a large number of corporate bonds during this period. In 2022 and 2023, the company issued bonds with approved listing amounts of RMB 15.74 billion and RMB 13.84 billion, respectively. The financing balance of the company's bonds increased from RMB 38.9 billion at the end of 2021 to RMB 64.7 billion at the end of 2023.

The company's WACC value decreased due to changes in its financing structure. From 2021 to 2023, the proportion of the company's bond financing balance in the total financing balance increased from 21.9% to 30.4%, and the proportion of bank loan financing balance in the total financing balance decreased from 66.1% to 56.4%. The interest rate of bond financing is lower, which helps companies reduce financing costs.

Table 2: Key financial data of China Merchants Shekou(RMB Billion).

	2023	2022	2021	Change range
Accounts payable	60.66	56.12	57.81	4.92%
Bonds payable	51.33	39.75	26.11	96.62%
Long-term loan	118.77	121.07	107.78	10.20%
Current ratio	1.56	1.55	1.53	1.96%
Debt ratio	67.34%	67.91%	67.68%	-0.50%
WACC	5.0%	6.1%	6.6%	-24.24%

5. Vanke

Vanke Co., Ltd. (SZ000002), referred to as Vanke, and its securities are referred to as Vanke A. Vanke Group is involved in multiple businesses, including real estate development, property services, rental housing, hotels, warehousing, commercial development and operation, etc. The company attaches importance to sustainable development, builds relevant structures, formulates relevant

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policies, and discloses relevant reports. Vanke issued shares to the public in 1988 and was listed on the Shenzhen Stock Exchange in 1993.

As shown in Table 3, in 2023, Vanke's total assets reached 1,504.85 billion yuan, a decrease of 22.38%; operating income reached 465.739 billion yuan, an increase of 8.94%. WACC dropped from 5.3% to 4.4%, which means that financing costs decreased. From the perspective of financing channels, the company's accounts payable decreased significantly, short-term liquidity increased; bonds payable and long-term loans increased, and the financing structure changed. From the perspective of debt paying ability, the company's current ratio continued to increase, the debt ratio continued to decrease, and both short-term and long-term debt paying abilities improved.

The increase in the company's current ratio is mainly due to the reduction of short-term loans in current liabilities. The company's short-term loans were 14.41 billion yuan in 2021, 4.13 billion yuan in 2022, and 1.06 billion yuan in 2023, a decrease of more than 90%. The company's rapid repayment of short-term loans reduced the risk of debt default. The reduction in the company's WACC value is also attributed to the company's reduction of short-term liabilities and increase of long-term liabilities, it optimizes its debt structure.

One of the main reasons for the rapid decline in Vanke's total assets is the decline in net profit, which is caused by the year-on-year decline in gross profit margin. From 2021 to 2023, the gross profit margin of Vanke's real estate development business was 23%, 20.4% and 15.7% respectively. At the same time, Vanke's return on net assets fell below 10% in 2021, the worst level in nearly 20 years. Under difficult operating conditions, the company improved its balance sheet, resulting in an increase in operating income in 2023 compared with 2021.

Table 3: Key financial data of Vanke (RMB Billion).

	2023	2022	2021	Difference
Accounts payable	221.69	289.22	330.41	-32.91%
Bonds payable	59.87	68.82	53.02	12.92%
Long-term loan	197.76	180.77	154.32	28.15%
Current ratio	1.40	1.31	1.22	14.75%
Debt ratio	73.22%	76.95%	79.74%	-8.18%
WACC	4.4%	4.3%	5.3%	-16.98%

6. Comparison and Discussion

From the perspective of financing costs, the proportion of debt financing of Poly Development and China Merchants Shekou has increased, while Vanke has reduced its overall debt level by improving its balance sheet, resulting in a decrease in financing costs. The average financing cost of listed real estate companies in China is about 6%. The WACC values of the three companies are significantly lower than the industry average, reducing the financial burden and interest repayment pressure of the companies [8]. For real estate projects, reliance on short-term loans will increase repayment pressure, while reliance on long-term debt will increase the capital cost faced by the company [9]. China Merchants Shekou has a relatively higher proportion of long-term debt (bonds payable and long-term loans) and higher financing costs. From the perspective of corporate governance, China Merchants Shekou has a lower proportion of independent directors, and the remuneration of independent directors is significantly lower than that of non-independent directors and company executives than the other two companies. The supervision they receive during the operation process may be insufficient, and their operating capabilities are defective, resulting in high financing costs.

The three businesses all fit the description of classic real estate corporations with high debt ratios when it comes to their capacity to pay off debt. Their asset-liability ratios in 2023 were higher than

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those of all Chinese listed non-financial enterprises, and they depend on credit for capital operations. However, the debt ratios of the three companies are all on a downward trend, which is conducive to easing the loan pressure of the enterprises.

The financing capacity of real estate businesses is significantly impacted by real estate sales. The primary source of cash flow for real estate businesses is operating income, which directly influences the strength of the capital chain and the ability of businesses to pay off debt [10]. From the perspective of business performance, the operating income of China Merchants Shekou and Vanke has increased, while the operating income of Poly Development has decreased significantly, which partly explains the fact that China Merchants Shekou and Vanke have optimized their financing situation through securities lending and repayment of short-term debts, as well as the fact that Poly Development has a high debt ratio.

From the perspective of real estate trusts, China Merchants Shekou will expand its REITs by 1.244 billion yuan in 2023; Vanke's ‘China Gold Indy Consumer REIT’ has been listed in April 2024, with a net amount of 3.26 billion yuan raised; while Poly Development is not active in financing through REITs. There are no laws or regulations pertaining to REITs in China. Since China's REITs are private from a funding perspective, investors face relatively high obstacles to entrance, and the lack of legal protection raises the potential risk for investors [11]. The market scale of China's REITs products is small and immature, and has not yet become a reliable way for real estate companies to raise funds. From an investment perspective, REITs will only invest in cities with a higher IRR, and not in cities with a lower IRR. To obtain a reasonable IRR, REITs need to establish a large national unified market [12].

For large real estate companies with strong capabilities, it is recommended to issue more real estate bonds or try REITs for financing; at the same time, in the economic downturn cycle, even if there were frequent policies that are favorable to the real estate industry recently, it is recommended that real estate companies improve their balance sheets and reduce their debt ratios to reduce financial risks.

7. Conclusion

This paper aims to summarize the current situation of financing of large real estate enterprises in China and give suggestions through the study of three companies: Poly Development, China Merchants Shekou, and Vanke. In recent years, China's real estate market policies have tightened, and the demand for real estate has tightened, resulting in an imbalance between supply and demand, which is not conducive to the profitability of real estate companies. Meanwhile, high leverage operations have caused great repayment pressure on real estate companies.

The study found that large real estate companies in China rely on credit in the financing process and obtain less financing through the issuance of bonds or REITs. In addition, these companies have high debt ratios and face greater operating risks. At the same time, large real estate companies have strong financing capabilities and low financing costs.

In recent years, China's real estate industry has faced serious difficulties, forming a ‘Chinese real estate crisis’. The high-leverage and high-debt operating model has caused real estate companies to face a debt crisis under the downward trend of the economy; at the same time, the tightening of government policies represented by the ‘3 red lines’ has made the operation of real estate companies more difficult. The rational use of financing can help real estate companies activate the capital chain, promote the completion of projects, and help real estate companies continue to operate in the economic downturn cycle.

Finally, this study failed to take into account the impact of a large number of favorable policies this year on financing of real estate companies; and did not use financial data from 2020 and before to study the impact of the ‘3 red lines’ policy, but only used it as a background introduction. In the

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future, improvements can be made on the above factors, which will be conducive to deep research on this topic.

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