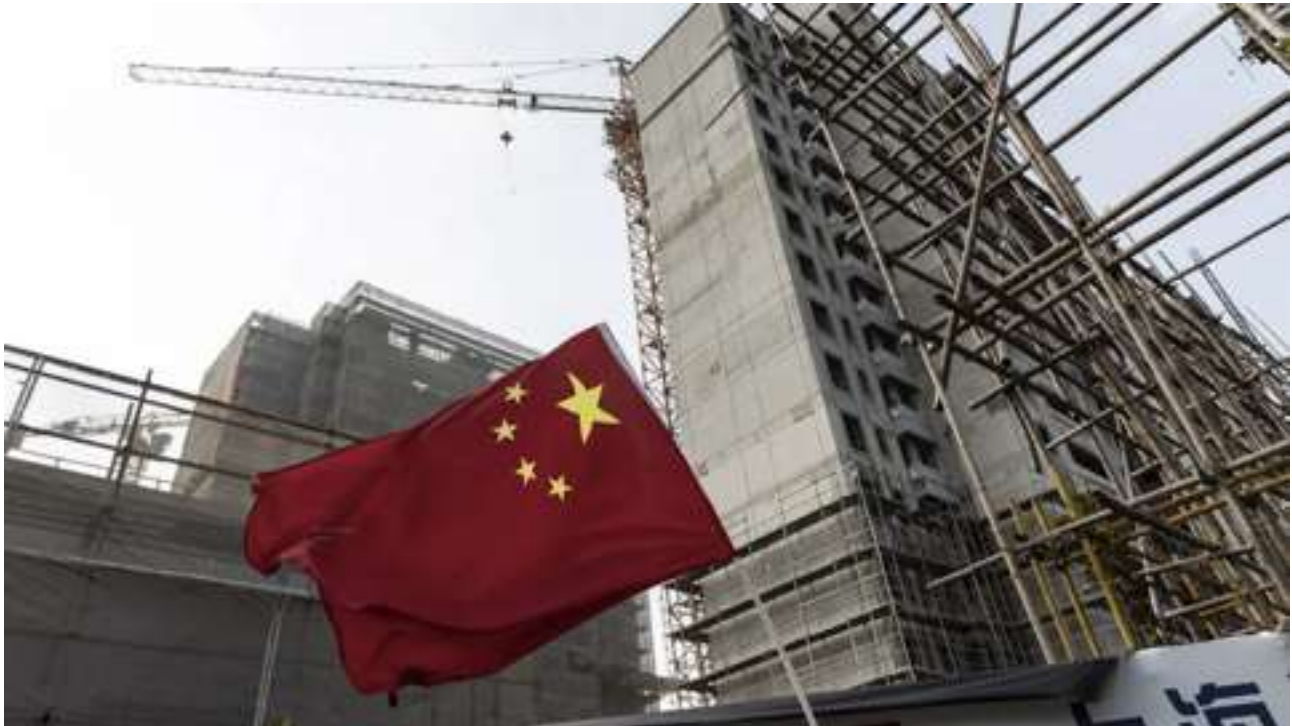


Beijing Supports Property Developers. How much will Buyers Lose?



The Chinese government has, in the last week or so, announced changes to escrow account rules, essentially giving real estate developers easier access to presale deposits for residential projects.

Chinese regulations permit developers to sell projects before completion, but they are required to deposit pre-sale proceeds in escrow accounts until an agreed stage - often completion of the development.

The cash held in these escrow accounts in China should be anything up to 70% of all pre-sale payments.

- Escrow is the use of a third party, which holds an asset or funds before they are transferred from one party to another, (from the buyer to the seller).
- The third-party holds the funds until both parties have fulfilled their contractual requirements.
- Escrow is associated with real estate transactions, but it can apply to any situation where funds will pass from one party to another.



Escrow accounts may be held by lawyers or any other agent that both buying and selling parties find acceptable.

However, in China, property developers use accounts overseen by city or county-level governments.

Clearly, the main aim of the escrow account is to protect those buyers who have shown commitment to the purchase by laying their money down, whilst at the same time, ensuring the developer honours his part of the deal before receiving payment.

The rule changes, according to Beijing, are intended to enable developers to access more of this cash, consisting of about 1.6 million buyer deposits.

New rules take into account materials costs amongst other items. With more capital available, Evergrande and other developers will complete more projects, and the real estate sector can get moving again.



However, until now, developers like Evergrande borrowed money to buy land, then borrowed more to develop the site.

Presale cash in escrow was never part of the funding structure. Nor should it be!

Using buyers' cash to pay for the build surely suggests the developer is trading in an illiquid state and is potentially bankrupt. These buyers' deposits were essentially the profits the developers made at the end of the build.

This early access to buyer deposits really begs several questions about buyer protection.

1. With Evergrande some US\$300 billion in debt, you must wonder if they and similar developers always handed over buyer deposits, or was some used as part of cash-flow?
2. Assuming the answer to question 1 is that all deposits are in escrow accounts, and all buyers are protected, why are the rules being changed now, just as these developers are in dire financial positions, defaulting on loan interest payments and bond coupons; and with some 1.6 million unfinished properties?

3. Surely, now would be the time for local governments to refund buyers' deposits, with so many defaults and incomplete developments. This is particularly pertinent with property prices, sales volumes and Chinese GDP all falling in unison now. Surely, this is exactly the buyer protection the original escrow rules were in place for.
4. The 'Three Red Lines' policy was introduced by the Beijing government about 18 months ago, to reign in developers like Evergrande, Kaisa and Shimao, as well as to try to limit spiralling property prices. Surely, these changes to escrow account rules are a complete contradiction, and at the expense of some 1.6 million would-be property buyers?
5. Does this feel like a Ponzi scheme? Those buyers near the top of the list are likely to have their homes completed using the newly available buyer deposits. However, those nearer the bottom are going to be disappointed. With only at most 70% of pre-sale deposits (maybe) sat in escrow, and loans and bonds already in default, what about those buyers in the bottom third of the list?



China's approach to property purchase using escrow accounts made a lot of sense.

It offered protection to would-be buyers, and at the same time, was intended to ensure developers did not use buyer deposits as cash-flow.

The new rule changes completely alter the landscape, and it seems buyers are now fully exposed to the bankruptcy of Evergrande in the same way as shareholders, and some will not be getting a single Renminbi back.

The few at the top of the list may get their apartment if they are very lucky, but the majority are likely to lose everything. In many cases this will be their life savings, or even worse, borrowings from several family members.



With the Chinese property market representing 25% of GDP, this really must be a political move to protect the big developer companies at the expense of buyers, and it is difficult to see how it is possible to justify this 'theft' of the escrow account protection for ordinary hard-working home-buyers.