Evergrande and Beyond: Stakeholders, Conflicts, and China's Economic Transformation

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Abstract: *This case explores the irrational behaviors and financial risks within China's real estate sector, particularly focusing on the Evergrande Group debt default and bankruptcy. The crisis, triggered by the introduction of the "three red lines" policy, reveals the deep-rooted problems in the real estate market, including over-leveraging, speculative investments, and misaligned incentives among stakeholders. The case examines the roles of five key actors: the central government, local governments, real estate companies, financial institutions, and consumers. While the central government aimed to stabilize the market with the "three red lines" policy, the local governments that were heavily reliant on land sales for revenue instead encouraged rapid expansion and borrowing. Real estate companies, like Evergrande, took on excessive debt and financial institutions not only facilitated but worsened this by offering large loans. Consumers, motivated by rising property prices, continued to invest in real estate, fueling the market bubble. Compared with the main bank system in Japan, this paper will analyze the similarities and differences between the two countries. By analyzing the interplay between these stakeholders, the case highlights how their behaviors contributed to the creation of a real estate bubble and the systemic risks that eventually led to Evergrande's financial collapse.*

Keywords: Real Estate Financialization; Policy Regulation; Systemic Risk; Stakeholder Incentives.

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Introduction

Amid the rapid development of China's real estate market, the debt crisis of Evergrande Group has unveiled deep-rooted risks within the industry. This crisis, a symptom of accumulated vulnerabilities in the property sector, also reflects systemic issues driven by competing interests among various stakeholders. This case study mainly focuses on and aims to determine the causes and impacts of Evergrande's debt crisis by exploring the unique land finance model underpinning China's real estate market. It examines the roles of key stakeholders—including the central government, local governments, developers, financial institutions, and consumers—in amplifying and mitigating the real estate bubble. By exploring the interactions between the land finance model, central government policies, and market actors, this study strives to recommend future measures by the main characters and provide insights into China's economic transition.

The Evergrande Debacle: How China's Property Giant Fell

In August 2020, the People's Bank of China and the Ministry of Housing and Urban-Rural Development convened a critical meeting with representatives from 12 major real estate developers, including Evergrande, Country Garden, and Vanke. The objective was to introduce new regulations to improve financial discipline within the real estate sector. These regulations, known as the "three red lines," required companies to meet specific financial thresholds by January 1, 2021. The criteria were: an asset-liability ratio (excluding advance payments) of no more than 70%; a net debt ratio under 100%; and a cash-to-short-term debt ratio of at least 1.0. Based on their compliance, firms were classified into four categories—red, orange, yellow, and green—with varying degrees of restrictions on new debt issuance.[1]

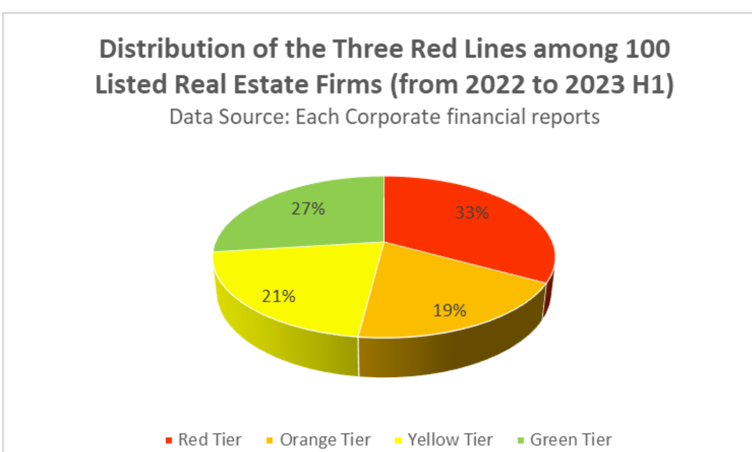
"Three Red Lines" Regulatory Rules		
Category	Number of Red Lines Triggered	Regulatory Rule
Red Tier	3	Interest-bearing debt cannot increase
Orange Tier	2	Annual growth rate of interest-bearing debt shall not exceed 5%
Yellow Tier	1	Annual growth rate of interest-bearing debt may be relaxed up to 10%
Green Tier	0	Annual growth rate of interest-bearing debt may be relaxed up to 15%

Table 1: "Three Red Lines" Regulatory rules

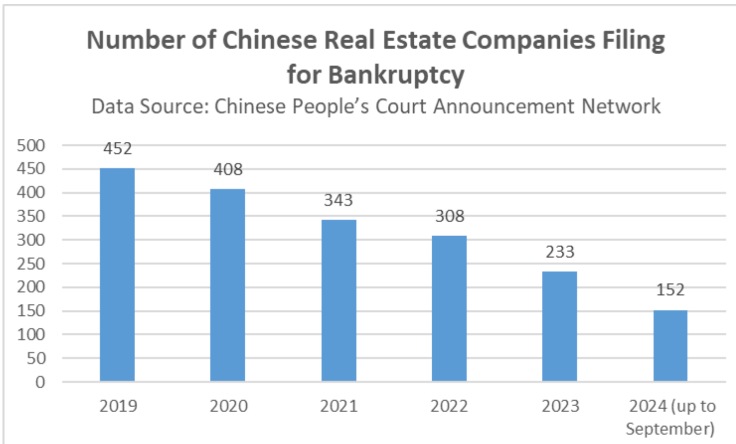
Evergrande, due to its high debt levels, failed to meet all three red lines, placing it in the "red tier" category. This classification meant that Evergrande was prohibited from acquiring any new debt, severely restricting its ability to finance its operations (see Table 1). The company responded by publicly announcing a plan to significantly reduce its liabilities, aiming to lower its interest-bearing debt to below 590 billion yuan by June 30, 2021, to below 450 billion yuan by June 30, 2022, and to below 350 billion yuan by June 30, 2023.[2] Despite these ambitious targets, the company's liquidity problems worsened, signaling deeper financial instability.

In late September 2020, a report claimed that Evergrande was seeking support for a major asset restructuring initiative.[3] Although the company quickly denied these reports, it became clear that Evergrande was struggling to manage its debt. By mid-2021, while Evergrande had managed to reduce its debt below the 590-billion-yuan target, further setbacks occurred. In June 2021, the company failed to make a payment of 513.7 million yuan, which led to the freezing of its assets by creditors, including a 1.32 billion yuan asset freeze by Guangfa Bank. Over the following months, Evergrande's situation worsened, with defaults on wealth management products and commercial paper becoming increasingly frequent. By the second half of 2021, the company faced a mounting debt crisis as $6.69 billion worth of debt matured. Despite narrowly avoiding default on two occasions, the company eventually announced on December 3, 2021, that it would be unable to meet its debt obligations, marking the official onset of its financial collapse.

The collapse of Evergrande sent shockwaves throughout the real estate sector in China. In the wake of the "three red lines" policy, numerous other developers also began experiencing financial distress (see Graph 1) . By 2020, over 14,000 real estate firms were reported to have negative credit information, and by the end of 2022, nearly 1,000 real estate companies had filed for bankruptcy (see Graph 2).[4] The combination of the policy and broader economic impacts caused by the COVID-19 pandemic exacerbated an already-cooling housing market, with prices plummeting and many ongoing construction projects halted due to cash flow problems (see Graph 3). This led to widespread delays in home deliveries, causing many consumers to be unable to receive their orders on time, thus increasing social instability.

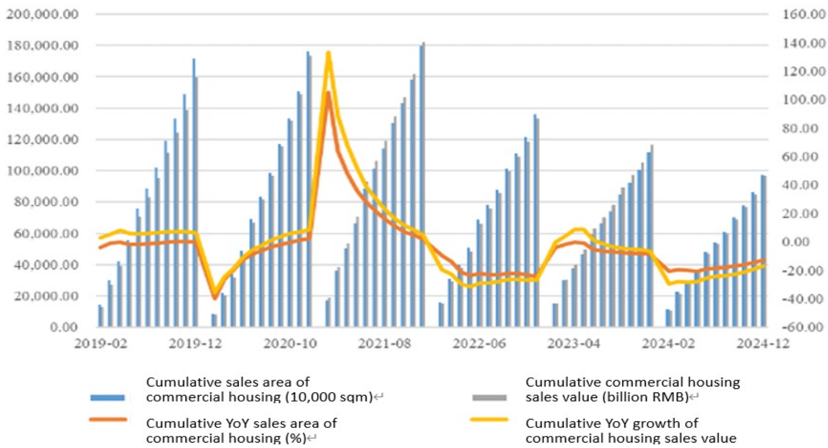


Graph 1: Distribution of the Three Red Lines among 100 Listed Real Estate Firms[5]



Graph 2: Number of Chinese Real Estate Companies Filing for Bankruptcy[6]

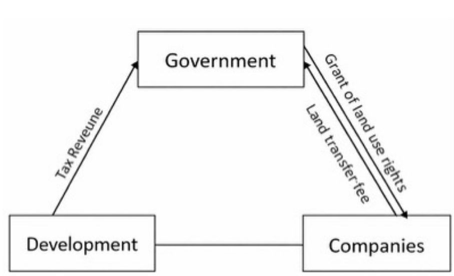
Graph 3: Recent Changes in Real Estate Development Investment, New Construction Area, and Completed Construction Area (YoY)[7]



Graph 4: Recent Sales Situation of Commercial Housing in China[8]

Land Finance: A Product of China's Tax-Sharing Reform

Land finance is a mode by which local governments in China obtain fiscal revenues by selling land as a state-owned asset. During the process, local governments sell the right to use state-owned land to real estate developers or other investors through bidding, auctioning, and listing, thus obtaining land premiums. These revenues have become one of the main sources of local finance,[9] especially when local governments suffer from a shortfall in revenue, and the land premiums have provided local governments with substantial financial support for public services and infrastructure development (see Graph 5). The land finance model has become the main means of revenue for local governments since China's 1994 tax-sharing reform and has become particularly significant in economically developed regions, where land premiums have accounted for more than 30 percent of fiscal revenue in some cities.[10]



Graph 5: Model of Land Financing Model[11]

Local governments are the main drivers of land finance. To achieve economic growth and performance targets, local governments tend to supply industrial land in large quantities at low prices to attract manufacturing investments. They further increase land value by rapidly expanding industrial parks and new urban areas. The rapid expansion of industrial parks drives the rising demand for housing, creating new growth points for the sales of commercial and residential properties, which ultimately fuels the booming real estate market (see Graph 4).[12] As a result, local governments gradually rely on the sale of commercial and residential land to generate substantial revenue.

The rising demand for housing fueled real estate developers' investment enthusiasm, leading them to purchase land use rights from local governments, accelerate construction, and sell properties in advance. As more developers entered the land auction market, local governments raised land prices to maximize profits. To secure higher returns, developers often pushed up housing prices, shifting the increased costs onto consumers.

Chinese homebuyers typically fall into two categories.[13] The first group, housing investors, view rising prices as an opportunity for speculative buying. This expectation of price increases encourages them to adopt a "buying into rising prices" mentality, intensifying market speculation. Many of these investment properties remain vacant as investors wait for prices to climb further before reselling.

The second group consists of end-users, who view housing as a necessity. For ordinary consumers, a large portion of family savings is directed toward down payments and mortgage loans, limiting funds for other investments and expenditures. In China, this situation is common-facing skyrocketing prices, many families deplete their savings to secure a home.

Banks are one of the heaviest supporters of the booming Chinese real estate market. Faced with continuously rising land and housing prices, developers and consumers rely on commercial banks for financing through loans and mortgages. On one hand, banks issue additional loans to large real estate developers with substantial land reserves and market share. During periods of strong housing demand, banks often loosen personal loan approval standards and increase loan limits. On the other hand, the expansion of the real estate market provides banks with a steady stream of interest income.

Japan's Main Bank System

Japan's real estate bubble was primarily caused by the main bank system. Under the main bank system, large banks form long-term ties with corporations: serving as both shareholders and primary creditors while participating in corporate decision-making. When members of the company incur losses and are unable to repay their debts, the main bank will usually give them a helping hand and continue to issue loans, resulting in the bank's bad debts getting bigger.[14] Following the Plaza Accord in the 1980s, Japan adopted loose monetary policies. Banks obtained vast amounts of low-cost capital and tended to increase the scale of lending.[15] To maintain client relationships, main banks aggressively expanded credit, directing substantial loans toward real estate-backed by land collateral and offering seemingly high returns. Amid widespread expectations that "land prices only rise, never fall," banks prioritized relationships and short-term gains over risk management. Companies similarly channeled funds into real estate and financial speculation, fueling a cycle of "credit expansion → rising property prices → improved balance sheets → further credit expansion."[16] The result was excessive capital flowing into the real estate sector. The main bank system amplified debt accumulation and speculative impulses, becoming one of the key institutional factors behind the formation and expansion of Japan's 1980s real estate bubble.

In the traditional concept of East Asian culture, establishing a home is the basis for settling down, and having a place to live is a family necessity.[17] For housing investors, the rapid rise in housing prices leads consumers to form expectations of continued price increases and stimulates their speculative behavior and the possibility of gaining more profit in the process. Before the bubble, Japan's economy grew well, and the demand for land in metropolitan areas was strong. During the bubble economy, the leverage ratio of Japanese residents and households continued to rise. From 1985 to 1990, it rose from 48.9% to 68.8%.[18] The consumers, both from China and Japan, have indirectly contributed to the real estate bubble, both for speculation and needs. Additionally, the above analysis also clarified that both China and Japan face issues with inadequate review processes by financial institutions when granting mortgages, coupled with a lack of risk assessment.

Unlike Japan, China's "three red lines" policy represents a proactive measure by the central government in response to issues within the real estate market. Therefore, it can be argued that the outbreak of China's real estate crisis is not the result of a vicious cycle of accumulating bubbles, as seen under Japan's main bank system, but rather a product of the Chinese government's deliberate efforts to guide sound asset allocation. Furthermore, the policy tension between China's central and local governments is another distinguishing feature from Japan. Moving forward, this paper will establish an analytical framework encompassing five key actors, including the central government, local governments, real estate companies, financial institutions, and consumers, to analyze the unfolding of China's real estate bubble burst through the lens of their interplay.

Central Government: Balancing Growth and Stability in the Real Estate Game

The central government is the highest administrative body representing China and is the statutory administrator of the entire national economy, with the constitutionally mandated functions of managing economic work and urban and rural construction. The identity positioning of the central government determines that it has the management scope of covering the whole country and the management function of having an overall view of the whole situation, which is complemented by higher management authority.[19] Therefore, the central government has the responsibility of macro-control of the national economy, reducing all kinds of risks in economic development, and maintaining stable macroeconomic development. Over the past 40 years, the central government's interventions in the real estate market have included monetary, credit, land, housing, and tax policies.

Since the 1998 housing reform, China's real estate market has become a key pillar of the national economy, contributing 7% to 10% of GDP.[20] It has stimulated industries such as steel, cement, and home appliances, driving overall growth. Increased homeownership has boosted wealth, supporting consumption and investment. Additionally, property-related loans form a large part of bank credit, linking housing price stability to economic security. Thus, the sector's health is vital for national economic stability.

Estimated Impact of Real Estate Investment Activities on GDP (2007–2020)

Year	Growth Rate of Real Estate Equipment Investment (%)	Nominal GDP Growth Rate (Expenditure Approach) (%)	Real estate investment value-added to GDP ratio (%)	Contribution of Real Estate Investment to Nominal GDP Growth (%)	Pull Effect of Real Estate Investment on Nominal GDP Growth (pct)
2007	28.80%	23.20%	6.70%	–	–
2010	18.90%	17.50%	8.90%	–	–
2012	17.10%	11.40%	11.60%	–	–
2015	0.80%	7.00%	10.90%	–	–
2016	7.40%	7.80%	11.50%	18.40%	1.43
2017	3.00%	11.10%	11.20%	8.50%	0.95
2018	-3.30%	10.50%	9.80%	-3.00%	-0.32
2019	8.00%	8.20%	9.90%	10.00%	0.82
2020	6.60%	3.50%	10.20%	19.20%	0.67
2021	7.20%	11.20%	9.80%	6.50%	0.73

Data Source: National Bureau of Statistics, WIND, Tianfeng Securities Research Institute

Table 2: Estimated Impact of Real Estate Investment Activities on GDP (2007–2020)[21]

However, while contributing to economic growth, China's real estate market has also generated adverse effects, leading to numerous irrational phenomena. One prominent example is Evergrande Group, a leading real estate developer that adopted a "rapid expansion, debt-driven, and high-leverage" model.[22] The company aggressively accumulated land reserves and quickly developed housing projects nationwide, positioning itself as one of China's largest real estate companies. Financially, Evergrande relied heavily on bank loans and capital market financing, operating with high leverage by using debt and pre-sale funds to sustain cash flow. While this model delivered short-term growth, it also led to mounting financial risks. In the event of market downturns or liquidity issues, excessive debt levels pose systemic financial risks.

Since 2016, the central government has increasingly recognized the problems stemming from irrational real estate market development. It introduced the principle that "houses are for living in, not for speculation," emphasizing the residential nature of housing as a cornerstone of its policy approach. Following this shift, a series of policies have been implemented, including land market reforms, stricter financing regulations for real estate developers, initiatives to develop the rental housing market, and measures to mitigate financial risks within the sector.

Year	**Policy Area**	**Specific Measures**	**Purpose or Impact**
2017	Rental Housing Develop-ment	"Notice on Accelerating the Development of the Housing Rental Market in Large and Medium-Sized Cities with Net Population Inflows" proposes the establishment of a government housing rental transaction service platform to foster the housing rental market.[23]	Reduce purchasing by encouraging renting.
2017		"Pilot Program for the Construction of Rental Housing on Collective Building Land"[24]	Pilot projects for special rental housing in 13 cities.
2018		"Notice on Matters Relating to the Participation of Insurance Funds in the Long-Term Rental Market"[25]	Support the entry of specialized, large-scale businesses into the rental market.

2019	Land Management	"Promoting the Formation of a Regional Economic Layout with Complementary Advantages and High-Quality Development" emphasizes land management reform and the tilting of construction land resources towards key urban agglomerations.[26]	Scientific planning of land space.
2020	Land Management	"Decision on Authorization and Delegation of Land Use Approval Authority"[27]	Controlling the price of land.
2019	Real Estate Market Financing Management	"Notice on Conducting the Work of Consolidating Achievements in Curbing Disorder and Promoting Compliance Development"[28]	Prohibited the use of domestic and foreign funds for land sale financing; strengthened loan management and curbed improper practices, such as misappropriating funds for real estate development.
2019	Real Estate Market Financing Management	"Notice of the Requirements for Filing and Registering Applications for Real Estate Enterprises to Issue Foreign Debt"[29]	Requiring real estate enterprises to issue foreign debt to strengthen information disclosure and clarify the use of funds, to prevent possible risks in the issuance of foreign debt by real estate enterprises.

Table 3: Central government's macro-control policies

on the real estate industry

The policies implemented by the central government had a clear effect in curbing irrational home-buying behaviors among consumers. For the sales area of commercial housing in China, in 2017, the sales area was 169.4 million square meters, a 7.7% increase compared to 2016.[30] In 2018, the sales area rose to 171.7 million square meters, growing by 1.3%.[31] In 2019, the sales area was slightly down at 171.6 million square meters, a decrease of 0.1%.[32]

However, it is worth noting that despite the slowdown in the growth rate of housing sales, the growth rate of housing prices in China remained relatively high from 2017 to 2019. In 2017, the average price was 7,892 yuan, a 5.6% increase from 2016. In 2018, the price increased to 8,724 yuan, a 10.5% rise, and by 2019, the average price had reached 9,310 yuan, marking a 6.6% increase, with the average price surpassing 9,000 yuan. Another notable trend is the increase in real estate development investment. In 2017, the total investment in real estate development was 10.98 trillion yuan, a nominal increase of 7.0% from 2016.[33] This rose to 12.03 trillion yuan in 2018, a 9.5% increase, and continued to grow in 2019, reaching 13.22 trillion yuan, up 9.9%.[34]

The slowdown in sales area growth contrasts with the continued rise in housing prices and real estate investment. The demand from investors and speculators created a price bubble and led developers to believe in strong demand, resulting in excessive supply without real demand support. Due to worries about the aforementioned factors, the central government started to control the debt ratios of large real estate companies in August 2020, and Evergrande Real Estate declared bankruptcy due to the restriction of financing from high debt ratios.

Local Governments: Balancing Central Directives with Self-Interest

The organizational structure of local governments in China usually consists of four levels: provinces, cities, districts, and villages (townships), and the lower levels of government are required to follow the orders of the higher levels of government.[35] These local governments implement central government policies within their own areas and adjust them according to local situations.

The mechanism for examining the performance of local officials is one of the core dynamics of the operation of local governments in China and directly influences the direction of local government policy.[36] The promotion and performance evaluation of local officials is usually closely related to the economic growth, fiscal revenues, employment rate, and social stability of the areas under their administration. This assessment mechanism has created a “GDP tournament” in which local governments tend to prioritize economic growth in order to achieve better evaluation results. This “GDP-only” orientation encourages local officials to actively promote the local economy during their term of office.[37]

Considering the existence of land finance, land transfer, and construction have become one of the main means to promote local economic growth. In order to increase revenue from land sales, local governments often raise land prices in the real estate market. In order to guarantee revenue, local governments usually control the supply and demand relationship in the real estate market through land supply. When demand in the real estate market is strong, local governments increase land supply to curb the rapid rise in housing prices and increase fiscal revenue. When demand is weak, local governments control land supply to stabilize market prices and ensure the continued growth of fiscal revenues.

Thus, the role of local governments in the real estate market is both as policy-makers and as major players in the market. This results in the need for local governments to balance the policy directives of the central government with their own development interests, which gives real estate companies the space and confidence to grow.

In Guangdong Province, where Evergrande Group is located, as an example, under the policy tone of "housing without speculation" demanded by the central government, the local government of Guangdong Province has also gradually strengthened the regulation of the real estate market. Since 2016, the Guangdong government has strictly controlled housing demand through policies such as purchase and loan restrictions. For example, Guangzhou requires non-local residents to provide at least two years of social security payment records for house purchases,[38] while Shenzhen has increased the down payment ratio for home purchases, raising the down payment ratio for second suites to 70% or even higher.[39]

However, out of self-interest, the Guangdong Government has also shown some flexibility in the implementation of regulatory policies. In adjusting the strength of policy implementation, local governments still allow some cities to maintain market activity by increasing land supply and developer financing. First-tier cities such as Guangzhou and Shenzhen have gradually increased land supply in the face of the central government's policy of restricting purchases and loans in order to safeguard fiscal revenue while curbing housing prices. Evergrande Group has actually received policy support from local governments for quite a long time, which is why it still expanded its business territory with large-scale high debts after the central government put forward "housing without speculation", explaining how the seeds were sowed for the crisis.

Real estate companies represented by Evergrande: high debt, high leverage and high turnover

Evergrande Group was founded in Guangzhou City, Guangdong Province in 1996. The Asian financial crisis broke out in the following year, and Evergrande leveraged the opportunity with its real estate marketing strategy of "small space, low price and low cost", and expanded rapidly with its high-turnover and high-leverage business model.[40] The existence of land finance played a key role in promoting Evergrande's expansion in the early stage. During the acceleration of China's urbanization, the local government realized financial revenues by selling land, and the demand in the real estate market was huge.

Evergrande took advantage of this policy window to rapidly expand its land reserves and realized efficient operation of funds and asset expansion through low-cost land purchases and rapid construction and sales.[41]

Although China's central government put forward the 2016 "housing without speculation" policy and increased macro-control efforts to stabilize housing prices, Evergrande did not recognize the situation. Its managers' overconfidence, coupled with the flexibility of the local governments' adjustments, driving the company to continuously expand from 2016 to 2018, Evergrande's land reserve area doubled from the initial 0.051 billion square meters to 312 million square meters in 2018. As its debt scale climbed rapidly and its debt structure tended to be unstable, it was completely contrary to the central government's policy of debt reduction.[42]

Evergrande's Debt Situation Over the Years

Unit: 100 million RMB

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021(Mid)
Total Assets	3841	4745	7570	13509	17618	18800	22066	23011	23776
Actual Total Liabilities	2938	4149	6906	13013	16495	12014	19780	19507	19665
Reported (Nominal) Total Liabilities	2688	3621	6149	11583	15195	15714	18480	19507	19665
Nominal Debt-to-Asset Ratio (%)	77.22	76.31	81.23	85.74	86.25	83.59	83.75	85.77	82.71
Actual Debt-to-Asset Ratio (%)	84.4	87.44	91.23	96.33	93.63	90.5	89.64	84.77	82.71

Note: Data are sourced from Evergrande's annual reports. "Nominal total liabilities" refer to the total liabilities disclosed in the financial statements, while "actual total liabilities" are adjusted based on the substance-over-form principle, taking into account perpetual bonds and investments from strategic investors.

Table 4: Evergrande's Debt Situation Over the Years

In 2021, the "three red lines" policy was formally implemented. Evergrande touched all the lines and was categorized as a red-tier real estate enterprise, therefore, Evergrande was unable to increase any interest-bearing liabilities, its financing ability was greatly reduced, and its cash flow crisis became more and more serious. Evergrande's large-scale defaults have been reported repeatedly, and the crisis has rapidly developed and produced a series of subsequent impacts.[43]

The development history of Evergrande Group, which is highly indebted, highly leveraged and highly turnover, is a microcosm of Chinese real estate companies. High turnover is the most typical business model. In order to accelerate the return of capital and improve the efficiency of capital use, real estate companies usually start projects quickly after acquiring land and bring them to market in a short period of time by streamlining the approval process, compressing the construction cycle, and utilizing the pre-sale system. The core of this model lies in the use of rapid capital turnover to realize reinvestment, enabling them to complete more projects with limited time and capital investment, further expanding land reserves and asset size. Evergrande and other enterprises use this precise model to achieve high-speed expansion.[44]

However, the high-turnover business model also brings problems of quality and risk. Due to the excessive speed, many companies have problems with project quality and property management. In addition, this model is highly sensitive to market cycles, and companies will face serious liquidity problems once market demand or sales speed declines.

The high-leverage model is an important means for real estate companies to achieve rapid expansion. In order to obtain land and development capital, they rely heavily on highly leveraged means such as bank loans, trust financing, and overseas bonds. Through highly leveraged financing, companies can achieve rapid expansion with limited capital.

However, the use of high leverage increases financial risk, making their debt ratio high, and due to the long real estate construction cycle and short debt maturity time, real estate companies must continue to repay the old debt through new debt. Once the market demand declines or financing constraints arise, real estate enterprises will face the risk of capital chain breakage.[45]

Highly indebted, highly leveraged, high-turnover real estate companies engage in interest-driven high-speed expansion, but neglect risk management and financial health, therefore market storms and policy-oriented tightening problems continue.

Complex Financial Institutions

In the rapid development and cyclical fluctuations of China's real estate market, banks, financial regulators and auditors, as key financial actors, have not only contributed to market expansion, but also played an important role in risk prevention and control. However, these financial institutions have always had an interest game between profit-driven and market regulation, forming a more complex financial network.[46]

Commercial Banks

Commercial banks are the main suppliers of capital to China's real estate market, supporting the expansion of real estate companies and demand for housing purchases through loans and mortgages for home purchases. During the upswing cycle, the credit support provided by banks laid the capital foundation for the high-speed expansion of real estate companies. In particular, large real estate companies, such as Evergrande, obtained a large number of loans from banks because of their huge project scale and market influence. Such loans not only supported Evergrande's expansion but also increased the bank's revenue. However, the highly leveraged debt model has created potential financial risks for banks, and real estate loans have become one of the main sources of banks' non-performing assets during the downward market trend. As a result, when Evergrande faced liquidity problems, the bank not only had difficulty in recovering its loans but also had its overall asset quality affected, due to a large number of non-performing real estate loans.[47]

Shadow Banking and Informal Financial Institutions

With traditional bank credit struggling to meet the demand of the real estate market, shadow banking and trust financing have become one of the sources of funding for real estate companies. These informal financial channels are more flexible and often bypass credit policy restrictions to provide additional financial support to real estate companies. Evergrande and other real estate companies raised funds through shadow banking tools such as trusts and wealth management products when bank financing was restricted, further pushing up the leverage ratio. As shadow banking is not subject to strict financial regulation, its risk exposure is not fully assessed. The invisibility of such financial instruments made it difficult for regulators to monitor them in real-time, further obscuring the overall risk of the financial system during the period of real estate expansion.[48]

Financial Regulators

Financial regulators, such as the PBOC and CBIRC, act as policy regulators in the real estate market, exercising macro-control through a range of policy tools. In 2021, the "three red lines" policy was implemented to limit the indebtedness of real estate companies, forcing them to adjust. Regulators also have limited speculation in the real estate market by controlling loan ratios and imposing loan limits for house purchases. However, due to the diverse financing channels of real estate companies, the lag in regulation makes it difficult to comprehensively cover all financing behaviors. In the Evergrande incident, although the policy regulation by financial regulators played a role in preventing and controlling the situation, they failed to identify potential risk exposures in shadow banking and other instruments promptly, which led to the accumulation of systemic risks.[49]

Auditors

PwC, as Evergrande Group's long-term auditor, is responsible for Evergrande's financial statements. However, PwC failed to expose the hidden risks of Evergrande's financial health on time when it was exposed to high-leverage risks.[50]

Its behavior reveals the lack of independence of audit firms driven by complex interests. Influenced by revenue dependence, PwC may have chosen to avoid certain financial issues in Evergrande's audit in order to secure client relationships and long-term business. As a result, the audit report failed to reveal Evergrande's financial pitfalls, which led banks and investors to mistakenly believe that Evergrande was financially healthy and continued to provide financing support during the period of market expansion, thus indirectly exacerbating systemic financial risks. This incident highlights the conflicting roles of audit firms between profit motive and market norms.

Consumers: Drivers and Victims of the Real Estate Bubble

Based on the above, it can be seen that the two major demands in China's real estate market, investment and residence, divide consumers into two categories: housing investors and housing demanders.

As housing prices continue to rise, many investors have turned to real estate for higher returns. According to the China Household Finance Survey, the vacancy rate in urban areas increased from 18.4% to 21.4% between 2011 and 2015 and remained at 21.4% in 2017. First-tier cities had a vacancy rate of 16.8%, while second and third-tier cities had rates of 22.2% and 21.8%, respectively.[51] The "China Urban Housing Vacancy Analysis" reported that 65 million homes were vacant in 2017, indicating a serious issue of unsold properties.[52] For investors, rising prices lead to expectations of further increases, encouraging speculation and greater profit potential. Many properties are left vacant, awaiting price hikes for resale.

Additionally, with expectations of rising housing prices, homebuyers often adopt a "buy now, or prices will only go higher" mentality, while investors share the belief that "prices rise, so buy now." These further fuel demand in the market, driving prices up again.[53]

Since 2016, China's GDP and urban per capita income growth rates have slowed, falling behind housing price growth. The national average housing price-to-income ratio has been rising, reaching 8.19 in 2018, surpassing 9 briefly, and dropping to 8.71 in 2022.[54] This means that for lower-middle income households, incomes are insufficient to pay for house prices, and purchasing a home through a bank loan has become the choice of most home buyers, and those who demand housing are forced to incur large amounts of debt by taking on huge amounts of debt to purchase housing, resulting in the expenditure on housing purchase to account for too high a proportion of household income and creating a high debt ratio for households.

Along with the continuous rise in housing prices, the deviation of housing prices from their basic level and their continued rise have led to the need for housing demanders to accumulate more down payments and apply for more home mortgages to purchase housing, which has raised the risk of China's financial system, while household indebtedness has risen. Some homebuyers are even obtaining down payments through credit facilities such as "down payment loans", "down payment installment loans" and "consumer loans." By the end of 2020, personal housing loan balances reached 34.44 trillion yuan, making up 69.46% of real estate loans.[55] As a result, many families use most of their savings for down payments and mortgages, limiting other spending and investments. The average family needs to spend most of its savings to realize "a place to live" in the face of high housing prices.

Therefore, housing speculators have become the enablers of the housing price bubble while ordinary consumers have become the victims of high housing prices.

Policy Recommendations

Since the implementation of the "three red lines" policy, large real estate enterprises represented by Evergrande have successively defaulted on their debts. The central government's policy of restricting the financing of large real estate companies out of concern for systemic financial risks and social instability caused by high housing prices and corporate indebtedness is consistent with the central government's function. However, with the outbreak of COVID-19 in early 2020, the already-cold real estate market erupted into a debt crisis one after another under the policy of restricted financing, the price of commercial properties in China plummeted, and many real estate projects under construction were forced to stop due to the broken capital chain, resulting in consumers not being able to get possession of their properties on schedule, and severely affecting the upstream and downstream industry chains, which in fact adversely affected China's economic restructuring.

Based on the analysis of the five main key actors, combined with the need for future development, there are some possible policy recommendations:

> 1. Central Government as the architect and leader of national development strategies and should focus on three areas: First, prioritize stabilizing housing demand by completing unfinished projects, including establishing special funds, guiding financial institutions and state-owned enterprises to take over projects, and converting them into affordable or rental housing. Second, maintain stable real estate market operations by strengthening management and information disclosure, especially

the transparency in land and housing supply, and preventing systemic risks from sharp fluctuations in the market. Third, focus on institutional development by optimizing the fiscal allocation between central and local governments, strengthening central government oversight of local government debt issuance, financing platforms, and land transfer revenue usage, gradually reducing local governments' overreliance on "land finance," and guiding the new economic growth drivers.

2. Local Government as the practical implementer of national policies, must both follow the decisions of the central government and safeguard the development of its local economies. Therefore, local governments must first align closely with the central government's initiatives, establish systematic thinking, and better serve national strategic development. Then, they should move beyond the traditional land finance model, support the national strategic industry development with local advantages, and explore new engines for local economic growth. Furthermore, amid the current economic depression, it should intensify efforts to stimulate local consumption to drive economic recovery.

3. Real Estate Companies as market suppliers, under the "three red line" policy, should break away from traditional models. Instead they should enhance financial management and risk control capabilities, improve housing and service quality, address consumer's essential housing needs and issues like unfinished buildings, jointly promote the healthy development of the real estate market and align their adjustments with national strategic planning.

4. Financial institutions as capital providers and external regulators, should strengthen oversight of corporate compliance and supervision, enhance transparency in corporate evaluations, and improve risk assessment capabilities. Drawing on Japan's experience, financial institutions, especially the banking system, should establish accountability mechanisms and bankruptcy procedures and non-performing asset resolution frameworks, to prevent systemic risks and capital standardization issues.

5. Consumers, as the demand side of the housing market, should cultivate a rational consumption mindset and stick to the principle of "housing for living, not speculation." When making home-buying decisions, they should fully consider their income levels and long-term repayment capacity, to avoid blindly chasing price hikes, cluelessly following the crowd to purchase properties, as well as engaging in high-leverage operations aimed at short-term speculative gains, which will reduce the irrational demand that fuels the real estate bubble.

Conclusion

The collapse of the Evergrande Group can be seen as a focused burst of system risks that were built on the model of "high-leverage, high-turnover, high-debt" development of the Chinese real estate industry. It highlights the internal vulnerability between the financialization of real estate and the stability of macrofinance. This case also emphasizes the problem that in a complicated political-economic system, incompatible incentives between different stakeholders are a fundamental mechanism that contributes to distortions in the market. The risk prevention goal of the central government, the growth goals of the local governments, the expansion ambitions of the corporations, profit-making incentive of the financial institutions, and speculative incentives of the consumers themselves constitute a vicious cycle of misalignment of the incentives, which is difficult to fix. This paper discussed this chain of risks dissemination through central policy design and local implementation, to corporate strategy, financial multiplication and eventual end-user behaviors based on a multi-stakeholder model.

It should be noted that, the analysis presented in this research is largely premised on case study and qualitative analysis of mechanisms and does not offer a solid quantitative foundation through large-scale datasets. If future analysis could use more detailed information, like corporate financial reports, local land transaction data, and disaggregated household credit data, it would enable a more rigorous quantification of the relation between the behaviors of these actors. This would also help the creation of more accurate early-warning indicators of systemic risk.

In conclusion, according to the above analysis, redefining the real estate industry over the long term, as well as pursuing structural reforms, is the key to future solutions. It requires that policies should go beyond the cyclical adjustments, concerns of the optimization of central-local fiscal relations, a wider range of sources of local government revenue, enhanced financial supervision, and enhance the housing supply system. The experience of the Evergrande crisis teaches us that any supplement to individual parts of policy cannot solve the underlying systemic problems. Therefore, research and policy implementation in the future should be focused on addressing systemic issues. Although possible risk points need to be discussed, it should also be focused on channeling the resources of the over-dependent real estate market into the real economy and innovation sectors. Only such comprehensive actions and creative changes can eliminate the tension between stakeholders and finally, through doing so, the high quality development and better resiliency of the Chinese economy could be achieved.

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