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Evergrande Group and China's Debt Challenges

Since 2021, some Members of Congress have raised concerns about the People's Republic of China (PRC or China)'s debt levels and the solvency of PRC property developers. The inability of Evergrande Group, China's second largest property developer, to repay its domestic and foreign debt highlights issues related to the structure and operations of PRC firms in China and offshore, and the role of the state in PRC firms, generally and in times of crisis. While U.S. firms' direct exposure to Evergrande is about $348.4 million, according to Bloomberg, the case raises broader issues for Congress, including: (1) foreign creditor rights in PRC corporate restructurings; (2) potential opacity and risks in how PRC firms are structured, operate, and report; and (3) potential risks in China's economy. Congress directed U.S. audit oversight of and reporting requirements for PRC firms in P.L. 116-222, and is considering other U.S. investor protections, reporting requirements for PRC firms, and restrictions on certain U.S.-China trade and investment activity. For related issues before Congress, see CRS In Focus IF11667, *China's Economy: Current Trends and Issues*, CRS In Focus IF11803, *U.S. Capital Markets and China: Issues for Congress*, CRS In Focus IF12212, *U.S.-China Auditing Agreement and Issues for Congress*, and CRS In Focus IF11284, *U.S.-China Trade Relations*.

Evergrande Group

Evergrande is a state-tied property conglomerate based in Shenzhen that also operates energy, entertainment, health, insurance, and technology businesses. It was founded in 1996 when the government was liberalizing property sector investment. Tax reforms in 1994 had shifted a large amount of local revenue flows to the central government, prompting local governments to turn to sales of land-use rights and bond issuances for revenue. This shift raised the importance of property transactions and values to local governments.

The Shenzhen government is a major shareholder in Evergrande. In 2017, Evergrande moved its real estate assets into Hengda Real Estate Group Co., Ltd., with plans (later deferred) to list Hengda on the Shenzhen Stock Exchange through a reverse takeover of Shenzhen Real Estate, a government firm. Hengda sold 25% of its shares to the Shenzhen government and state investors. Evergrande is also tied to the PRC central government. The Ministry of Finance's CITIC Group is a shareholder. In 2018, Evergrande signed a $16 billion agreement with the China Academy of Science to invest in foreign technologies on its behalf; it acquired electric vehicle firms in the United States, the United Kingdom, and Sweden, and invested in biotechnology research at Harvard University.

Evergrande's overseas presence allows it to raise and transfer funds in and out of China. Evergrande and three of its subsidiaries—China New Energy Vehicle, HengTen Networks, and Evergrande Property—are listed in Hong Kong. It trades corporate bonds in Singapore and operates a wealth management business through a life insurance firm. Evergrande's CEO controls two firms registered in the British Virgin Islands (BVI)—Xin Xin (BVI) Ltd. and CEG Holdings (BVI) Ltd.—to facilitate offshore investments. Of its more than 500 subsidiaries, Evergrande named 170 "principal" subsidiaries in its 2022 annual report.

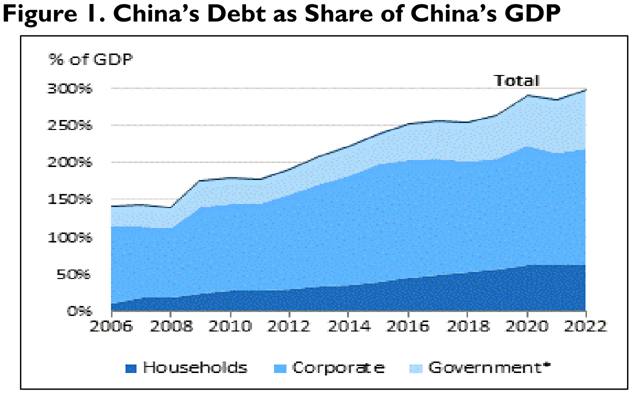
Evergrande's Debt and Restructuring

In 2021 Evergrande was unable to repay $305 billion (2% of China's GDP) it owed to PRC and foreign creditors. That figure did not include off-book liabilities. In January 2024, a Hong Kong court ordered Evergrande to liquidate assets tied to its Hong Kong unit after a failed restructuring deal among PRC banks and foreign creditors. Hong Kong's court ruling does not govern the firm's PRC subsidiaries, which constitute 90% of its business. Since 2021, the firm's PRC assets have been mostly redistributed to domestic creditors, particularly local governments. In 2021, Hong Kong and PRC authorities agreed to mutually recognize liquidation orders in a trial that is not in Shenzhen where Evergrande is based. In March 2024, PRC securities regulators fined the firm over $500 million and banned its founder from financial markets for fraudulent accounting and reporting. According to Bloomberg, as of 2024 the firm owed $300 billion in debt (including $20 billion in offshore debt) and held about $240 billion in assets. U.S. firms hold about $348.4 million (1.5%) of the firm's $23.2 billion in foreign corporate debt.

PRC Debt and Deleveraging Efforts

PRC total debt—household, corporate, and government—reached 297% of GDP in 2022 (**Figure 1**), with the majority of debt held by companies. (PRC firms owe an estimated $945.5 billion in bond payments in 2024). Local governments had $7.6 trillion in interest-bearing debt raised through finance vehicles as of 2022, according to a Peking University study. In January 2024, the PRC government restricted the issuance of 364-day offshore bonds to close a gap that local governments had been using to raise funds.

Figure 1. China's Debt as Share of China's GDP



Source: CRS with data from the Bank for International Settlements.

Notes: *Nominal value. Data does not include financial sector debt. U.S. debt as a share of U.S. GDP was 255.6% in 2022.

China relies on debt-financed fixed asset investment (including property) and exports for growth. The property market accounts for about 30% of China's GDP, a higher percentage than in most countries, according to the International Monetary Fund (IMF). Reliance on the property sector for growth constrains PRC efforts to reduce debt without broader economic effects. Property is a main source of local government revenue and factors into household net worth and corporate valuations. Declining land revenue affects local governments' ability to repay debt. In 2022, local government debt reached about $12.6 trillion (76% of GDP), according to the IMF.

In 2016, the PRC government initiated a campaign to rein in corporate and local government debt and unauthorized lending. This included scrutiny of overseas real estate, entertainment, and sports investments. In July 2017, *People's Daily*, the Communist Party of China's paper of record, published an article about financial risks caused by *gray rhino* firms, a term Michele Wucker coined to describe risks that are ignored because they are so large and visible. The article signaled a government push to rein in certain firms (e.g., Anbang Insurance, Dalian Wanda Group, Fosun International, and HNA Group). The government realigned these firms' investments with state goals, transferred assets to state investors and established related state trusteeship.

In 2018, the PRC government pledged to tackle financial risk as one of "three tough battles," and in 2019 bailed out several banks. In 2020, it launched a "three red lines" policy for property developers that sets: (1) a 70% ceiling on liability to asset ratios; (2) a 100% cap on net debt to equity ratio; and (3) a cash requirement to cover short-term liabilities. In 2021, the government became a shareholder, reined in the lending operations of Ant Financial and Tencent, and later in 2023 issued rules to regulate digital platforms' nonbank lending more generally.

Local governments funded pandemic efforts, placing further stress on their balance sheets. In response, Beijing has eased restrictions on the ability of firms and local governments to raise debt financing. In 2020 it issued $142.9 billion of special treasury bonds, the first issue since 2007, and fast-tracked corporate bond issuances. In 2023, an increased quota for special bonds allowed local governments to raise over $21 billion, proceeds they mostly used to stabilize local banks.

PRC Approaches to Corporate Risk

The PRC government has sought to rein in PRC firms and avoid broader market effects. PRC restrictions on capital flows have contained some risks, but property firms' large market exposure complicates these approaches:

PRC government actions can trigger firms' bankruptcy. Evergrande's debt crisis followed government restrictions in 2021 that constrained its ability to raise new funds to pay its extensive debt obligations. Tightening domestic housing policies arguably also weakened Evergrande's position.

Restructuring assets and shareholding avoid direct bailouts. The PRC government is a shareholder in Evergrande and other firms it investigates or restructures. It often directs state investors to acquire assets and become shareholders to cover liabilities and reposition troubled firms, at times realigning winners and losers within China's system. In 1999 and 2003, the government created large asset management companies to offload pervasive non-performing loans in the state banking sector. In 2023 and 2024, the PRC government directed a "national team" of state firms to purchase stocks to boost PRC capital markets, as it did in 2012 and 2015. The Shenzhen government and other state investors had previously supported Evergrande through investment and assumption of its liabilities.

Creditors may not be repaid equally. The PRC government typically prioritizes repayment for domestic retail investors, suppliers, contractors, and banks and may not require repayment of unregistered investments and internal corporate transactions (among business units and executives). In 1999, after the collapse of the Guangdong Investment Trust Corporation, the government prioritized domestic creditors. HNA Group repaid $25 billion of its $60 billion in obligations during restructuring.

Investment and Accounting Practices

Investment practices commonly used by PRC firms contributed to Evergrande's highly leveraged situation.

Counting unbuilt and unsold properties and interest payments as assets. About 60% of the firm's $240 billion in assets are unbuilt and unsold properties, and the firm counts loan interest payments as assets. This inflates the firm's position and increases risks if property values fall.

Using previously-financed deals as collateral for new loans. This practice allowed the firm to accumulate debt and become leveraged. In the case of HNA, the People's High Court of Hainan Province determined that its affiliates provided mutual guarantees for repayments. In 2019, the Swiss government charged HNA with using this practice to fund in its global acquisitions and operations.

Investing beyond the core business. Some PRC firms use insurance and wealth management firms to invest offshore.

Use of complex offshore structures tied to the CEO. To facilitate financial flows offshore, PRC firms often use overlapping contracts and shareholding that can make it difficult to assess liabilities. Evergrande's CEO and his family reportedly hold a large share of the firm's offshore debt. In March 2021 a Hainan court merged 320 of HNA's affiliates because: (1) it could not disaggregate complex relationships and shareholding; (2) internal controls were fictitious; (3) internal credit and debit deals were impossible to align; and (4) shell companies were used extensively.

Options for Congress

Congress has options to further explore Evergrande's situation and broader issues such as U.S. investment exposure to China, PRC firms' complex structures, state ties to PRC firms, and related risks. Congress might require a study to ascertain 1) the extent to which PRC firms use Evergrande's investment practices, accounting methods, and corporate structures, and 2) how such approaches affect the use of U.S. authorities regarding PRC firms. Congress also could ask the Securities and Exchange Commission and the Treasury Department to regularly report on U.S. aggregate exposure to China's economy and PRC firms (including PRC firms registered offshore), and any risks.

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