

# *Study on Financial Risk of Real Estate Enterprises*

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**Abstract:** The real estate industry plays a very important role in economic development and social stability. It is also a high-risk business. At present, China's real estate enterprises are under the double pressure of market supply and demand and government policy. How to effectively control the financial risk of real estate enterprises, so as to make the industry efficient, sustainable and stable development has become a key problem to be urgently solved. Starting from the development status and trend of real estate enterprises, analyzes the forms and causes of financial risks of real estate enterprises in China in the paper, and puts forward targeted risk prevention measures according to the analysis results. The purpose is to improve the risk management level of enterprises and minimize the losses that risks may bring to enterprises.

## 1. Introduction

At present, domestic economic development has begun to enter the new normal of economic development. As an important pillar of domestic industry, the real estate industry is characterized by high investment cost, long investment payback period and weak liquidity ability. The real estate industry has extremely profound practical significance for the further development of China's economy and social stability. However, under the current environment of external economic instability and continuous changes in economic policies, domestic real estate enterprises are facing a more severe market environment. At the same time, the real estate industry has a weak awareness of prevention, low level of control and prediction of financial risks and a series of potential contradictions in this industry highlighted. Therefore, under such a background, how to improve the ability of enterprises to deal with financial risks should become the domestic real estate industry to maintain long-term healthy and stable development of the urgent problem to be solved. In the paper analyzing specific financial risks of real estate industry research, and put forward the corresponding control strategy.

## 2. Current Situation Analysis of Financial Risk of Real Estate Industry in China

In recent years, China's real estate industry has developed rapidly, but at the same time, there are many problems. For example, the housing price is growing rapidly, the demand for investment real estate is increasing greatly, and the number of vacant houses is high. The price bubble in the real estate market has been generated. The real estate industry needs to go through a long process from

investment and operation to profit. This is because the whole business activities of the real estate industry are supported by a huge amount of capital. At the same time, the complex market environment makes most enterprises face high risks in the process of production and operation. At present, the financial risks in the whole real estate industry are increasing year by year, and the main performance of the financial risks in the domestic real estate industry can be divided into the following types.

## **2.1 Abnormal Financial Indicators**

In order to judge the financial situation of an enterprise, financial indicators can be used to evaluate and analyze the financial situation. If the company's financial status is good, we can use the corresponding financial indicators to analyze the company's financial status is normal and the risk is small. These indicators include earnings per share, operating profit, asset-liability ratio and so on. On the contrary, if the financial situation of the real estate company is abnormal, the operating profit and asset-liability ratio of the company will also be abnormal due to the problems in the operation of the company. Therefore, investors can use these abnormal financial indicators to determine the risks that the company is currently facing and effectively control losses to reduce the risk of target losses. Asset-liability ratio is used to measure the capital utilization rate of creditors of enterprises, reflecting the degree of loan safety of creditors. Compared with other industries such as manufacturing, the index value of real estate enterprises is relatively large, usually above 60%.

## **2.2 Defaulting on Debt Payments**

Under normal circumstances, if the enterprise is in a high debt level and the project invested by the enterprise can not reap the expected benefits, then the company will be faced with the risk of being unable to pay the debts due. This will also lead to real estate enterprises facing the risk of tight capital chain or fracture.

Many real estate enterprises acquire land at high prices, and a large number of land enclosure further promote the rise of real estate prices. Therefore, the real estate industry has accumulated a large amount of development funds. After entering 2019, China's real estate market continued to decline, and the corresponding credit environment also continued the tight pattern in recent years, and the important background of this momentum is that the government adopted a series of economic stimulus plans and loose monetary policies.

In such a context, the Agricultural Bank of China introduced the details of the mortgage. After this, the Industrial and Commercial Bank of China also began to implement the detailed rules of discount on housing loan interest rates. After this, other banks have also introduced corresponding measures. The policies adopted by these banks also laid the foundation for further gains in the property market.

## **2.3 Financing Difficulties**

### **2.3.1 Single Financing Method, Big Credit Risk**

The single financing structure is obvious, and the proportion of indirect financing is large, which is the main characteristic of China's real estate industry at present. At present, the financing method of China's real estate industry is mainly through bank loans, which account for more than 90% of the capital source of China's real estate industry, and the proportion of direct financing is very small. A large number of bank loans have brought huge financing costs to the real estate industry. If the sales of the real estate industry are not smooth, it is difficult to recover the funds and return the bank loans as scheduled, making the banks face the credit risk that the loan funds can not be recovered in time.

### **2.3.2 Too Many Restrictions on Real Estate Financing**

The real estate industry is a capital-intensive industry, so in the development, more funds need to be realized through external financing channels. Therefore, real estate funds mainly for external financing, and the main way of financing are mainly bank loans, enterprise pre-sales, enterprises financing and bond of trust of housing, but dominated by the credit financing of real estate industry in our country, and bank loan term is shorter, usually with a long cycle of real estate development, In addition, the application of other financing methods limit factors too much, the financing process is difficult, many enterprises can not reach the expected amount of financing target, resulting in the limitation of financing channels.

### **2.3.3 Lack of Innovation in the Way of Bank Credit**

The capital-intensive characteristics of the real estate industry mainly include high degree of modern technology and equipment, large amount of capital occupation and high labor productivity. Therefore, a large amount of capital is the basic guarantee for the normal operation of the real estate industry. At present, the capital of China's real estate industry development mainly comes from bank loans. Although this method is the most convenient, it is not innovative. Therefore, it is necessary to pay attention to the innovation of bank financial mode and credit mode.

## **2.4 Poor Liquidity**

Because there is no way to repay debts on schedule to raise funds, the proportion of capital flowing into and out of China's real estate enterprises has been seriously unbalanced, so it has shown the status quo of capital turnover. The main reason for this is the capital dispatch and arrangement of real estate enterprises. In this context, real estate enterprises are also faced with a long cycle of capital turnover and other problems. In addition, enterprises are faced with a more volatile macro environment, which further increases the financial risk of enterprises <sup>[1]</sup>.

If analyzed from the Angle of capital operation, the source of capital of China's real estate enterprises is also multi-channel. Specifically, it includes traditional bank loans, equity financing and bond investment. There are other ways. Including rental income, sales income, pre-sale of real estate, real estate financing lease and so on. In the face of so many ways of capital operation, the financial management of real estate enterprises, as well as the allocation of funds has brought extremely high difficulty.

## **3. Causes of Financial Risks in Real Estate Industry**

### **3.1 External Cause Analysis**

#### **3.1.1 Economic Environment**

To a certain extent, the real estate industry and China's macroeconomic development are mutually promoting and restricting. Therefore, the further development of the real estate industry will affect the growth of the domestic economy, and the growth of the domestic economy will also affect or restrict the development of the real estate industry. In such a macro context, how the domestic economic situation affects the amount of capital entering the real estate market depends on the effective demand of enterprises. In addition, it also determines the solvency of real estate companies. At the same time, the above factors also affect market judgment and wait-and-see sentiment, the sales of the Company's various products, and the availability of timely recovery of credit and financial market financing and financing costs.

### 3.1.2 Macro Policy

The development of the real estate market is greatly affected by the national macro-control, and the impact of macro-policies on the financial risks of real estate enterprises is mainly reflected in the following aspects:

#### (1) Monetary Policy

The real estate industry is a capital-intensive industry, which determines that the amount of money in a country's market will affect the capital demand of real estate enterprises. In this way, the capital pressure of China's real estate enterprises has been further eased. However, at the beginning of 2017, speculation demand increased in China's market, overheating economic growth and excessive bubbles in the real estate market. Accordingly, the domestic government adopted an increase in deposit reserve ratio, and domestic monetary policy began to change. As a result, the government adopted a series of tightening macro-control policies, which reduced the stock of capital in the market and aggravated the financial pressure of real estate enterprises.

#### (2) Credit Policy

The impact of the housing loan policy on the real estate market is obvious. Before 2019, due to strong investment demand, real estate prices continued to rise, in particular, the first and second tier cities increased sharply. In this case, the state has put forward the concept of "housing without speculation", and has adopted a tightening policy for real estate loans, raising the down payment and loan interest rates, which has played a role in curbing the demand for real estate investment to a certain extent. However, in 2020, due to the impact of the epidemic, the overall economic level of our country declined, the uncertainty of investment in real estate increased, the sales volume of real estate decreased significantly, and the real estate industry encountered winter. From 2020 to 2021, many real estate enterprises have reached an unsustainable level, and the full outbreak of Evergrande real estate's financial crisis is a typical case. Therefore, since 2022, the central bank has issued some loan policies to promote housing purchase. The down payment ratio of the first home loan has been reduced to 20%, and the loan interest rate has also been reduced to a minimum of 4.25%. These policies have greatly stimulated the enthusiasm of home buyers, and the real estate market has ushered in opportunities.

#### (3) Tax Policy

The important means of regulating industrial development in China also includes tax policy. Recent years, the Chinese government issued unified reduction of deed tax temporary exemption of stamp tax on individual housing purchases, aiming to coordinate with the policy of promoting domestic demand. In this context, it also promotes the development of enterprises. Since the beginning of 2017, in order to control the domestic housing price and restrain the speculative purchase of houses, the Chinese government has issued a series of policies, such as imposing full business tax on the real estate sold for more than five years. A series of tax regulation policies mentioned above will have an important impact not only on the sales of real estate enterprises, but also on the production of real estate enterprises.

## 3.2 Internal Cause Analysis

### 3.2.1 Managers Weak Awareness of Financial Risk

The quality of senior managers in China's real estate enterprises needs to be further improved, and the formulation of enterprise management and development strategy does not meet the corresponding requirements. At the same time, there is not enough awareness of risk. In this context, most of our country's enterprise managers in the enterprise's business decisions, only pay attention to the construction process and the quality of construction, but pay little attention to the enterprise's internal

financial capital management, cost management, risk control management <sup>[2]</sup>. As a result of the widespread existence of these problems, resulting in the enterprise internal containment relationship confusion, internal financial control information transmission is not smooth, and also led to the financial cost accounting of these enterprises is very simple and rough major problems.

At present, the managers of real estate enterprises have a weak awareness of risk management. The reasons are as follows: First, China's real estate industry is closely related to China's economy; Second, the industry initially had the advantage of favorable policies and high profits. Therefore, when the managers of these real estate enterprises make decisions and manage the enterprises, they will deliberately downplay the risks of the enterprises or just turn the risk management of the enterprises into formalism. In addition, China's real estate industry from the initial stage to the stage of development, only experienced a short period of more than ten years. This also makes most senior managers of real estate enterprises do not have a comprehensive and specific awareness of what financial risks are and how an enterprise should prevent and control the financial risks faced by the enterprise. However, with the further development of the domestic real estate market, the internal norms of the industry are also constantly perfect. In addition, China's support policies for the real estate industry continue to decrease, for the industry's regulation and control policies are also increasing. In this context, the overheated investment in the domestic real estate market has been greatly suppressed. The Chinese government has also driven a number of small real estate companies with weak risk awareness out of the industry through a series of sudden housing control policies and a series of combination of policies.

### 3.2.2 Capital Structure Imbalance

For the real estate industry, both in the development stage and in the operation process, a large amount of capital is needed to support the operation of enterprises, and the period occupied by this part of capital is also long, which is determined by the capital-intensive characteristics of the real estate industry. If the real estate enterprises only rely on the enterprise's own capital is not able to meet the needs of enterprise operation. Therefore, in the real estate enterprise debt management is very common. At present, most of the real estate enterprises in China rely on bank loans for project development and operation. The other part will come from the advance payment paid by the owner, as well as the debts of the enterprise in the construction of the project, the capital invested by the enterprise itself only accounts for a small part. This also reflects the weak financial strength of most real estate enterprises. Therefore, the high debt capital of enterprises leads to the serious high internal asset-liability ratio, and the corresponding financial leverage of enterprises also has a negative effect. According to the investment scale, project duration, market expectation and other factors of the enterprise, the rational arrangement of the enterprise's capital structure, financing method and loan term. If the enterprise does not consider its capital structure rationally and borrows blindly, it will bring heavy financial pressure to the enterprise itself. At the same time, enterprises will not be able to repay debts when they are due, leading to insolvency crisis and even bankruptcy of enterprises <sup>[3]</sup>.

At the same time, the vast majority of real estate enterprises will also appear budget management is not strict, cost control lax problems. Because the enterprise's cost management project is numerous, it involves the main body is also more, so this requires the enterprise's financial personnel must be familiar with the financial and business of the enterprise. On the other hand. The managers of some real estate enterprises ignore the management of enterprise costs. Because its managers pay more attention to the quality and progress of the project, which also leads to a large deviation between the enterprise's financial budget and the actual cost in the process of operation, thus increasing the financial risk of the enterprise.

### **3.2.3 Financing Method Is Relatively Simple**

Since China's reform and opening-up, the marketization of the economy has been gradually deepened. At the same time, China's financial market has also been further established and developed. In this context, China's real estate enterprises can also obtain funds through a variety of channels. At present, the main ways of financing for China's real estate companies are as follows: bank loan, financial leasing, bond issuance, housing presale and so on. In these ways of financing enterprises to obtain the degree of difficulty is not the same, at the same time to obtain conditions of capital cost, the impact of corporate earnings are also different. At present, the capital of China's real estate enterprises mainly comes from financial institutions, which is caused by the characteristics of the industry in which China's real estate enterprises are located, the large amount of capital demand, and the small amount of enterprises' own capital. In recent years, the Chinese government has made it clear that it will no longer carry out large-scale stimulus policies, and China's monetary policy has gradually changed from a loose environment to a neutral one. However, the financing mode of China's real estate enterprises still hasn't changed. At present, the real estate industry is still dominated by bank loans<sup>[4]</sup>. If the internal cash flow of enterprises with maturing debts is insufficient to repay the maturing debts in time, the enterprises will fall into financial difficulties.

## **4. Financial Risk Prevention and Control Countermeasures**

### **4.1 Raise the Risk Awareness of Management and Finance Personnel**

First, real estate enterprises should improve the training and quality of their internal management and financial personnel, and strengthen the vigilance of their employees in the face of risks. Enterprises should also pay attention to improve the internal financial management system, and formulate corresponding rules and regulations. This requires the enterprise to actively manage the financial department and its employees, and at the same time, it should fully play the leading role in internal control and financial risk management<sup>[5]</sup>.

Second, enterprises should improve the comprehensive quality level of relevant management personnel. If real estate investment enterprises want to keep their potential risks in a stable and controllable range, so that enterprises can have strong risk avoidance and defense capabilities<sup>[6]</sup>, it is necessary to further improve the level of enterprise risk management in development, construction, management and operation.

Third, in order to lay a good foundation for risk management, real estate enterprises should also enhance the training of risk identification ability of enterprise managers in the face of risks, and enterprises should organize and establish risk prevention plans.

### **4.2 Optimize the Capital Structure and Effectively Avoid Risks**

For enterprises, different capital structures may bring different financial leverage effects, which may increase the financial risks of enterprises<sup>[7]</sup>. In a narrow sense, capital structure refers to the proportion of long-term liabilities and own capital. If the enterprise adopts the proper debt management in the operation, it can not only provide the enterprise with huge leverage, but also make the investor's return increase day by day, and even lead to the bankruptcy of the enterprise. It is precisely because of this relative result that the debt management will bring economic benefits to the enterprise at the same time corresponding to the enterprise will produce different degrees of risk. Therefore, when an enterprise is operating in debt, it should fully consider its internal financing ability, anti-risk ability, future development and other actual needs, and rationally consider the capital

structure of the enterprise. Through a reasonable analysis of the internal situation of the enterprise, the capital structure of the enterprise is optimized to achieve the purpose of reducing the financial risk of the enterprise <sup>[8]</sup>.

On this basis, the real estate industry can innovate financing channels to achieve complementary advantages. Under the current financial policy environment in China, real estate listed companies can use the real estate bond market to finance. In addition to innovative financing methods and financing channels, listed real estate companies can use joint restructuring to enhance their strength and consolidate the capital chain. Powerful large real estate enterprises merge small and medium-sized enterprises, and integrate the resources of the annexed enterprises through mergers and acquisitions or mergers between small and medium-sized enterprises.

#### **4.3 Broaden Financing Channels and Strengthen Financing Capacity**

The source of funds has become the biggest bottleneck for the real estate industry to expand its scale and improve its benefits <sup>[9]</sup>. This is because the investment scale of the real estate industry is huge, and the capital payback period of such enterprises is long, which also makes the capital demand of real estate investment enterprises huge, which requires enterprises to choose the financing mode from multiple angles, and continue to expand the channels of financing. On the other hand, real estate investment enterprises should also choose the financing mode according to the different financing period, so as to achieve the best combination mode. Enterprises should measure the benefits and risks according to their own operation and development needs, and decide the combination of short-term and long-term financing on this basis. Generally speaking, China's real estate investment enterprises adopt a combination of financing, mainly long-term debt, supplemented by a small amount of short-term debt <sup>[10]</sup>. This is based on the real estate investment enterprises themselves have a long development cycle characteristics decided. In addition, in order to reduce the pressure of financing and reduce the risk of financing, enterprises should also speed up the withdrawal of pre-sale funds. In the above process, enterprises should always pay attention to the relevant policies and measures timely issued by the state and the range of bank interest rates, and then adjust and improve the internal financing structure of enterprises, so as to enhance the ability of enterprises to deal with incoming financial risks.

#### **5. Conclusion**

The real estate industry is an important industry closely related to the economy and people's livelihood as well as a capital-intensive high-risk industry. On the basis of reading a large number of literature, combined with the characteristics and development status of China's real estate enterprises, this paper analyzes the financial risks of China's real estate industry with abnormal financial indicators, unable to repay debts on schedule, financing difficulties, capital turnover and other forms of expression. Combined with these forms of expression to analyze the internal and external causes of financial risks in China's real estate industry, external including economic environment and political environment, and internal including managers' weak awareness of financial risks, capital structure imbalance, financing is relatively single and other reasons, find the key to the problem. Began to implement the real estate enterprise financial risk prevention and control aspects of the analysis, this article will raise awareness of the risk of management and financial personnel, capital structure, establish a scientific and effective risk aversion, broaden the financing channels, strengthen the financing ability three aspects in detail elaborated how to carry out real estate financial risk prevention and control, so as to promote the development of national economy to grow.

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