

Low lending standards provide NPL opportunities in China

By Simon Osborne | 12 July 2010

Panellists at the *AsianInvestor* and *FinanceAsia* Asia-Pacific Debt Investor Forum mull over why demand for Chinese distressed assets is relatively low.

China has a cycle all of its own, commented panellists at the *AsianInvestor* and *FinanceAsia* Asia-Pacific Debt Investor Forum in Hong Kong last week.

Lending in China has increased in the past 12 months, as banks have deployed more money on macro government policy than on fundamental ratio-based lending. Assuming that splurge in lending will eventually result in a number of non-performing loans, they will in due course be transferred to distressed investors.

"It will take time to improve lending standards in banks, so there will be non-performing loans related to the expansion of credit, especially those to China's state-owned enterprises [SOEs]," says David Madden, managing partner at DAC Management in Hong Kong.

Madden still thinks there will be ugly-looking investments that will need to be discarded, but he says he has never been at a China debt auction involving more than three bidders compared to the usual show of five to 12 bidders elsewhere in Asia. This is proof that investment banks have reduced their exposure to China, with some having exited the market completely and others reluctant to deploy capital in the same way as in the past. In the 'golden age' of the mid-noughties, distressed asset buyers paid a lot for deals and servicing them proved expensive. Now, with a smaller number of buyers, it has become easier to bargain with debtors.

If China opens up the distressed market to make it easier for international investors, there will be more interest and a secondary wave of funds and investment banks will emerge.

But why buy distressed in Asia, particularly when there are more obvious deals in Europe and North America, which are both markets that are intrinsically simpler to transact in than Asia, and especially China?

You can still get 25% internal rates of return in Japan and Australia,

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sometimes secured by real estate, but there is no great appetite in general from Asian investors in capital raising for distressed. Asian family offices appear to be more interested in specific distressed opportunities, says Lee Soo Cheon, chief investment officer at [SC Lowy Financial Services](#) in Hong Kong.

Property has perhaps been the most highlighted boom in China in the past 12 months, and Zhang Xiaolin, co-founder and managing director of [Shoreline Capital Management](#) in China, highlights entry points around that theme.

"There may be opportunities for bridge-loan deals, as developers are finding it hard to get financing from banks or from pre-sales," says Zhang. "In provinces like Guangdong and Jiangsu, interest costs for bridge real-estate financing can be 4% per month or more. Also, SOEs that are not real-estate-focused may ultimately move towards spinning off their real-estate interests."