

# Evaluation of the Impact of Recent Recession on Real Estate Funding Mechanisms



## Finance

**KEYWORDS :** funding mechanisms , market, impact , recent recession, real estate

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### ABSTRACT

*Being a basic and leading industry, the development of real estate sector is fluctuated. As the ups and downs showed in macroeconomics, the real estate industry is in a state of consistently waving.*

*This paper mainly talks about the impact of recent recession on real estate funding mechanisms compared with two countries which are China and UK, the result shows that some major concerns like mortgage rate, the scale of households are the initiative reasons for the recession of real estate market.*

### INTRODUCTION

The real estate sector is a dominated industry in the development of economy through both countries. Securing the healthy development of real estate industry can prevent nations from suffering global financial crisis and inflation.

During recent years, in China, the real estate sector does take a huge positive impact on the macroeconomic development. However, due to the over-expanding, it twist the funding structure and lead to recession nowadays.

As for the UK, after recovering from global financial crisis, there were fluctuations showed in the real estate market. At the beginning of 2014, there are negative signs showed near London that property prices fell.

### I. RECENT RECESSION

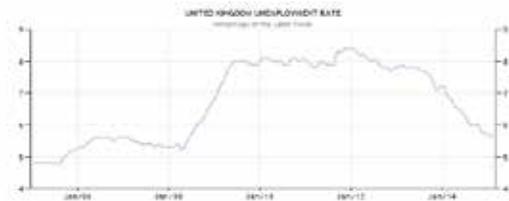
From the financial crisis and subprime crisis development, real estate sector has an extremely closeness with financial industry. In some developing countries like China, the vicissitude of real estate industry can directly influence national finance. The same situation in developed countries like UK, with the global financial crisis, the real estate suffered a lot from it.

With globalisation, the global financial crisis inevitably swayed to China. The entire real estate industry faced a severe situation. Both the ability and willingness of consumption of consumers declined due to the crisis.

The reasons and consequences in real estate and finance are mutual. Firstly, for example, in the booming period of time, the capitals in people's hands would increase in value. This means that people with strong purchasing power can push the house prices and selling upward and maintain in a high state. However, when macroeconomic increase stagnated, the power of consuming will drop, shrinking fortunes and finally influence the selling of properties, which is the major concern in real estate industry.

Secondly, withdraw of foreign investment affect the real estate sector. Due to the subprime crisis in America, the investment banks in the Wall Street was closed or deposited. For example, some high-grade properties were sold out in September 2008 thanks to the global crisis. This can be explained by the modification of Chinese real estate market, the selling showed a significant decrease, some certain area's property prices were higher than other places due to the unbalance house prices from north to south of China.

Thirdly, pay cuts showed with the slow-down of macroeconomics affected by global financial crisis.



**Table: United Kingdom Unemployment Rate**

Source: trading economics.

This is the unemployment rate of the UK from 2005-15, during the global financial recession in 2008 the unemployment rate risen dramatically. This definitely led to the high unemployment rate and shortened the willingness of people to buy a house.

### II. IMPACT OF RECENT RECESSION ON REAL ESTATE SECTOR

The real estate industry, as the basic and dominant industry, develops in the continuous adjustment and fluctuation process like macroeconomic business cycle. But the violent and frequent fluctuation will not only do harm to the real estate industry but also lead to the disequilibrium of resources allocation, capital waste, maladjustment of industry structure, adding difficulty of the investors and even influence national economy.

From the macroeconomic side, frequent fluctuation and the recession will lead to unbalance of industry chains and capital waste thus influence the development of national economy.

It is true that in China, the last 10 years there are ups and downs in the change of house prices. The tendency of house prices from 2005-09 is in a state of rising, after which it showed fluctuation. Especially in recent years, the recession comes, and the house prices decreased to average 5000 yuan per square.

There are several factors that can explain the influence of recession on real estate industry.

#### 2.1 Mortgage Debt

The mortgage rate has become a major concern in both China and UK real estate industry. In China, the way real estate companies raise money is depending on bank loans normally, this means that the mortgage debt rate will determine how much they need to raise money and the financial cost changes. In the UK, the main problem is that a major proportion of mortgage debt is either at a variable or fixed for less than two years mortgage rate, this is important because although the basic macroeconomic implication will increase the influences to economy, the existence of household indebtedness is likely to be a positive impact on the economy.

#### 2.2 Environmental Factors

Some environmental factors will affect the change of house prices. For example, the atmospheric environment, which is the most important aspect for people's living, if there are severe air pollution, the house price must be affected. In china, today's air quality is in a state of decreasing sharply, according to the figure below, the different colours present how worse the air pollution is and the deeper of colour, the worse air quality the city has. Most parts of china are facing an "unhealthy" situation to live, people will consider the air quality as well because it will take an impact on their daily life and that is why the house price fall.



**Fig.1: the level of areas being polluted.**

Source: aqicn.org

### 2.3 Population

There are some connections between the property prices with population. Basically, when population rise, the demand for houses to live will increase and so will the house prices. Otherwise, if the population fall, the demand for living will decrease as well as the house prices.

Besides, the population quality and households can impact the real estate industry, too. In financial terms, a household's selection of a mortgage contract cannot be entirely separated from the mortgage finance systems, as they directly influence the volumes of residential mortgage debt and household's leverage position.

On the other hand, the scale of households can also play a role in determining the house prices. If the scale of a household changes and the total number of people don't change, then it will change the number of houses. According to China's one-child policy, a household normally has 3 person instead of 4 or 5, this may lead to the unbalance house prices. Some flats' selling may encounter a huge fall when compared with smaller ones. This is why the scale of households can take an impact on this industry.

## III. FUNDING MECHANISMS

### 3.1 Background

As a capital intensive industry, the real estate industry relies heavily on capital. This is why how to select a financing tool and optimise funding structure is the major concern for these companies.

### 3.2 Present Situation Of Funding Structures.

In a long period of time, the real estate followed by a rule called "cash is king". That is why keeping the capital chain healthy is the major strategy for real estate industry. However, if the house prices show a tendency of rising consistently, the real estate company must get more land, which will increase expected profit and continue next round of funding. This is why the storage of land become the only principle for companies to expand. This is the start of real estate funding structure getting worse.

As for developed countries, the funding environment is quite different from developing ones. Some developed countries, like the Great Britain, already form a funding mode which cored by REITs and based on traditional funding ways. Nowadays, there are

several prevailing funding methods like bank financing, enterprise financing, trust project financing, REITs.

### 3.3 Classification of Funding Structures.

According to the source of capital, there are internal and external financing. It can also be classified by the mutual relationship to direct and indirect funding.

### 3.4 Analysing the Ways of Funding

The methods of funding for real estate are various, such as internal financing, bank loans, listing and financing, government bonds, trust project funding and so on.

Internal financing is a way that real estate industry using the capital they already have to support projects, or enlarge fund foundation.

Bank loans usually consist of credit and mortgage loans. Credit loans depend on the achievement of developers and credit report. The advantage of bank loans is that developers can use other mortgage materials as mortgage or guaranteed by the credits of enterprise instead of real estate.

With the development of capital market, issuing shares is the most important way to fund, for those companies that are share-holding systems.

Government bonds are the measures to gather idle funding, which can provide funds consistently for real estate industry.

Trust project funding is based on using real estate industry as trust estate financing products. Trust funding companies can join the operation by providing developers with trust funds or participating in the investment with them.

### 3.5. Problems about the Real Estate Funding Mechanisms

Compared with the funding mechanisms from China and UK, they are facing different situations. For China, the real estate funding performance is still not as good as it in UK, or there is a huge gap. In some western countries like UK, real estate industry is part of the finance industry, while they are two isolated industries in China.

There are some disadvantages about the funding mechanisms of China. Firstly, the ways real estate industry raising money is distinct, especially rely on bank loans. Secondly, the real estate industry is lack of funds in the hands, this means that some companies would not have enough money to maintain it while they are in the process of pursuing more lands.

### 3.6 Correspondence with Macroeconomic.

The raising money process is playing an important role in running companies daily basis. Although it can change the current situation of some companies, rely heavily on the bank loans instead of improving the way of raising money will store huge financial risks for future.

## CONCLUSION

This paper mainly talks about the factors like mortgage rate and household scale that will influence the economy through recession. Besides, there are certain kinds of problems in the funding mechanisms of the real estate industry, the alteration of funding mechanisms can play an important role in responding with macroeconomic.

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