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Analysis of Real Estate Investment Risks: A Case Study of Evergrande's Bankruptcy and Its Implications

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Abstract:
Real estate investment is characterized by high capital intensity and long cycles, making it inherently exposed to multiple risks such as policy supervision, market supply-demand fluctuations, and cash flow volatility. These risks not only cause asset depreciation for individual investors and business crises for enterprises but also pose severe threats to regional real estate market stability and even the overall financial system. Taking Evergrande Group's bankruptcy as a typical case, this paper systematically analyzes the internal causes of the crisis, including high-leverage debt risks, inefficient diversification, and governance failures. It also explores external factors such as the industry downturn cycle and the policy-market feedback loop. Furthermore, the paper examines the spillover effects, such as over 800 suspended projects affecting more than 3 million homebuyers and a 35% non-performing loan ratio for commercial banks related to Evergrande. Finally, it puts forward multi-dimensional implications for corporate governance, industry transformation, and financial supervision. This study aims to provide practical references for real estate investors to avoid risks, enterprises to optimize risk control systems, and regulatory authorities to maintain market stability, thereby promoting the industry's shift toward high-quality development.

Keywords: Real Estate Investment Risk; Evergrande Bankruptcy; Debt Risk; Industry Transformation; Financial Supervision.

1. Introduction

Real estate investment is not a low-risk choice. Its capital-intensive and long-cycle nature means it is always accompanied by risks such as policy regulation, market supply-demand imbalances, and cash flow fluctuations—ranging from asset depreciation and loan defaults for individual investors to business crises for enterprises due to project stagnation, and even impacts on regional real estate market stability[1]. Therefore, proactive and systematic analysis of real estate investment risks is not only a „firewall“ to pre-empt potential losses but also a core prerequisite for scientific investment decision-making and long-term asset preservation and appreciation. This paper takes Evergrande Group's bankruptcy as a typical case to conduct in-depth analysis and extract investment-related insights.

2. In-depth Analysis of the Causes of Evergrande's Bankruptcy

2.1 Internal Causes: Specific Manifestations of Risk Accumulation in Operations

2.1.1 Debt Structure Risks Under the High-Leverage Model

Evergrande's total debt of 2.4 trillion yuan, short-term debt accounts for over 40% (approximately 960 billion yuan), and the company relies heavily on non-standard financing methods such as trusts and asset management plans (accounting for about 35% of its total financing). Such financing typically incurs costs of 8%-15%, significantly higher than those of bank loans. In the first half of 2021, Evergrande's interest expenses alone amounted to 53.7 billion yuan, while its operating cash flow in the same period was only 31.4 billion yuan—resulting in an interest coverage ratio of less than 0.6 and creating an unsustainable risk of „borrowing new debt to repay old debt“[2].

Additionally, Evergrande faced prominent off-balance sheet debt issues: the scale of off-balance sheet real estate bond products issued by its shell companies exceeded 200 billion yuan. These hidden debts were exposed during the 2021 audit and verification process, further exacerbating market concerns about the company's actual debt burden[2].

2.1.2 Chaos in Diversification Implementation and Resource Mismatch

Since Evergrande announced its entry into the automotive industry in 2019, it has invested over 50 billion yuan. However, as of 2023, fewer than 10,000 mass-produced vehicles have been delivered. Meanwhile, the two major production bases in Tianjin and Guangzhou (planned during the same period) have a total designed production capacity of 1 million vehicles, leading to a capacity utilization rate of less than 1%. More critically, Evergrande's automotive business failed to establish technological barriers, relying on external procurement for core components. In 2022, the R&D cost per vehicle reached 600,000 yuan, far exceeding the industry average[3].

In addition, due to insufficient distribution channels and brand recognition, Evergrande's cross-border ventures into fields such as mineral water, grain, oil, and other fast-moving consumer goods (FMCG) accumulated losses of over 7 billion yuan between 2014 and 2020. These businesses had extremely weak synergy with the core real estate business and consumed approximately 15% of the core business's liquidity[3].

2.1.3 Governance Failures: Cases and Chain Reactions

In 2020, Evergrande engaged in a series of related-party transactions with „Weiwei Regional Capital“ (controlled by company executives), acquiring equity in a cultural tourism project at a price more than 30% higher than the market price— involving over 8 billion yuan. The project was later suspended due to capital chain rupture, resulting in significant asset impairment[4].

Meanwhile, between 2019 and 2021, many core executives cashed out over 12 billion yuan through equity pledges and the transfer of assets from affiliated companies. Among them, Xia Haijun (then Vice Chairman of the Board of Directors) made a profit of 4 billion yuan in 2020 alone through dividends and equity reductions. This created a phenomenon of „insider hollowing out“ at the onset of the crisis, further undermining the confidence of external investors and creditors[4].

2.2 External Causes: Specific Impact Paths of Environmental Changes

2.2.1 Precise Impacts of the Industry Downturn Cycle

Among Evergrande's land reserves, 62% (approximately 230 million square meters) are located in third- and fourth-tier cities. From 2021 to 2024, the average price of new houses in these cities dropped by 18%, and land transfer fees decreased by 45% year-on-year—leading to a reduction of over 300 billion yuan in the valuation of Evergrande's reserved land[5].

More importantly, the destocking cycle in these cities extended from 12 months in 2020 to 28 months in 2023. Among the over 300 projects in third- and fourth-tier cities sold by Evergrande in 2023, more than 190 had a destocking rate of less than 20%. Due to delayed sales, some projects were forced to offer discounts of up to 30% below cost, further eroding profits[5].

Additionally, the industry's financing environment tightened comprehensively. In 2021, the bond issuance scale of real estate enterprises decreased by 56% year-on-year. As an enterprise that violated the „Three Red Lines“ policy, Evergrande not only failed to secure new financing but also faced concentrated selling of its existing bonds by institutional investors. In the second half of 2021, the price of Evergrande's bonds plummeted by over 80%, triggering cross-defaults and accelerating the outbreak of its debt crisis[5].

2.2.2 Vicious Cycle of Policy Supervision and Market Confidence

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After the implementation of the „Three Red Lines“ policy in 2021, Evergrande was included in the „key supervision list,“ and banks completely suspended its development loans. Consequently, the balance of Evergrande's development loans in 2021 decreased by 62% compared with 2020[6].

Meanwhile, supervision over pre-sale funds was tightened: third- and fourth-tier cities require 100% of pre-sale funds to be deposited into regulatory accounts, with priority given to engineering construction. This completely invalidated Evergrande's previous model of „misappropriating pre-sale funds to supplement cash flow.“ In 2021, Evergrande's supervised pre-sale funds amounted to 120 billion yuan, accounting for 40% of its sales revenue in the same period—leading to a sharp reduction in its discretionary funds[7].

This was further compounded by the 2021 Evergrande Wealth Product Suspension Incident (involving 40 billion yuan worth of financial products), which triggered a „mortgage suspension wave“ among homebuyers. In 2022, owners of over 200 Evergrande projects across the country collectively suspended their mortgage repayments, involving a total mortgage balance of over 50 billion yuan. This further led to banks suspending the approval of mortgage loans for Evergrande projects, forming a vicious cycle: „declining sales → tight capital chain → project suspension → homebuyers suspend mortgages → further declining sales”[6].

2.3 Associated Impacts: Spillover Effects of the Crisis

The Evergrande crisis was not limited to the company itself but also triggered chain reactions across the upstream and downstream of the industry.

Upstream impacts: As of 2023, Evergrande owed over 200 billion yuan to construction companies, leading to more than 15 billion yuan in non-performing loans for leading enterprises such as China State Construction Engineering Corporation (CSCEC) and China Railway Construction Corporation Limited (CRCC). Additionally, Evergrande had arrears of over 80 billion yuan to material suppliers, 70% of which were owed to small and medium-sized building materials enterprises—some of which were forced to shut down due to capital chain rupture[8].

Downstream impacts: Between 2021 and 2023, Evergrande had a cumulative total of over 800 suspended projects, involving more than 1.2 million undelivered housing units and affecting over 3 million homebuyers. Many local governments were forced to establish special funds for „ensuring project completion“ (baojianlou). In 2023 alone, governments at all levels invested 150 billion yuan in such funds, squeezing out local financial resources allocated to other people's livelihood areas[8].

Financial system impacts: In 2023, the non-performing loan (NPL) ratio of commercial banks‘ Evergrande-related loans rose to 35%. In response, some joint-stock banks reduced their credit limits for the real estate industry, further exacerbating financing difficulties for the entire industry[8].

These specific details fully demonstrate the complexity of the Evergrande crisis: it is not only an inevitable outcome of the company's own strategic errors and governance flaws but also a product of the superimposition of multiple external factors (industry cycles, policy supervision, and market confidence). Meanwhile, the crisis's impact has transcended the individual enterprise, evolving into a systemic risk event affecting the industrial chain, financial system, and social livelihoods.

3. Multi-dimensional Insights and Industry Lessons

3.1 Corporate Governance: Restructuring Financial Discipline and Risk Control

3.1.1 Dynamic Risk Early Warning Mechanisms

Enterprises should abandon the „scale-first“ expansion mindset and establish a financial health index system centered on the net debt ratio and cash-to-short-term-debt ratio. For instance, Vanke reserves cash flow in advance through its „survival-oriented“ strategy to maintain liquidity security during industry downturns[1].

3.1.2 Synergistic Diversification with Core Business

Diversification strategies should adhere to the „capability circle“ principle, prioritizing areas with stable cash flow and synergy with core business resources. Country Garden's „real estate + agriculture/robotics“ ecosystem has achieved synergistic effects, whereas Evergrande's automotive business became a capital black hole due to insufficient technological accumulation[3].

3.1.3 Balanced Governance Structures

In response to the drawbacks of high equity concentration, enterprises are advised to introduce strategic investors, establish an independent director system, and strengthen audit supervision. For example, R&F Properties has restored market confidence through market-oriented debt restructuring and management incentive mechanisms[4].

3.2 Industry Transformation: From High Leverage to High-Quality Development

3.2.1 Dual-Track Risk Mitigation via Policy and Market

The „Three Red Lines“ policy has accelerated risk mitigation in the industry, which requires support from market-oriented mechanisms. The Hong Kong court's liquidation process for Evergrande provides a model for cross-border debt resolution. Local governments can take over the settlement of problematic projects through state-owned enterprises (e.g., the takeover of Hefei Evergrande Center)[5].

3.2.2 Business Model Upgrading

The transition from the „development and sales" model to the „development and operation services" model is crucial. Longhu Group has improved its return on assets (ROA) through its Tianjie commercial IP and smart services, while Poly Developments focuses on indemnificatory housing and urban renewal projects to reduce risks associated with market fluctuations[1].

3.2.3 Supply Chain Financial Risk Control

Industry participants should establish a supply chain credit evaluation system and promote the securitization of accounts receivable assets (e.g., Country Garden's Supply Chain Asset-Backed Securities (ABS)). Financial institutions need to strengthen supervision over related-party transactions to prevent illegal fund flows into high-risk areas[9].

3.3 Financial Supervision: Building a Full-Cycle Risk Prevention and Control System

3.3.1 Offshore Capital Flow Monitoring

For red-chip enterprises, it is necessary to strengthen requirements for offshore capital flow early warning and information disclosure. The China Securities Regulatory Commission (CSRC) has provided a law enforcement example of cross-border accountability for Evergrande's financial fraud, where the company was found to have overstated revenue by 564.1 billion yuan and was fined 4.175 billion yuan[10].

3.3.2 Investor Protection Mechanisms

A class action system and a special compensation fund should be established to address the inadequacies of the Hong Kong Investor Compensation Centre (ICC), which has limited coverage. Evergrande's delisting has caused losses to small and medium-sized shareholders, highlighting the need to strengthen investor rights protection through institutional design[10].

3.3.3 Risk Isolation for Financial Institutions

Financial institutions should set industry concentration limits and diversify risks through syndicated loans and asset securitization. Regulatory authorities need to strengthen penetrating supervision over shadow banking and off-balance sheet businesses to prevent cross-market risk transmission[9].

4. Conclusion

The Evergrande crisis serves as a critical warning for the real estate industry: high-leverage expansion, blind diversification, and flawed corporate governance will eventually lead to risk outbreaks under the superimposition of industry downturns and policy tightening. For real estate enterprises, the key to sustainable development lies in optimizing debt structures, focusing on core businesses, and improving governance efficiency. For the industry, transforming from a „scale-driven" model to a „quality-driven" model and strengthening supply chain risk management is essential. For regulatory authorities, building a full-cycle risk prevention system—covering corporate supervision, market mechanisms, and investor protection—will be crucial to maintaining the stability of the real estate market and the broader financial system. Only through joint efforts from enterprises, the industry, and regulators can real estate investment risks be effectively controlled, and the industry can achieve healthy and long-term development.

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