



Maximizing Returns on Distressed Assets: China's Real Estate Industry

As major Chinese real estate companies head toward default, offshore bondholders often find themselves lacking leverage in restructuring negotiations over assets mostly located in China. However, our global Claim Monetization & Dilution team details below some non-traditional strategies activist investors can take to bolster their position and hasten the monetization of distressed assets.

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Offshore bondholders, lacking leverage against companies whose assets are mostly in China, often see themselves in a disadvantaged position in restructuring negotiations when facing distressed Chinese real estate companies teetering on the edge of default. However, by utilizing a creative activist approach, investors may be able to maximize the return on their investment.

One of the most pressing examples is China Evergrande Group, among the largest real estate developers in the People's Republic of China ("PRC"), which has faced liquidity issues since the fall of 2020. The July 2021 freezing of RMB 132 million (US \$20.8 million) of Evergrande's bank deposits created a panic sell of its stocks and bonds, and its overall indebtedness stands at around US \$90 billion.

Evergrande is not alone. Since the announcement of the "three red lines" policy by the People's Bank of China in August 2020, controls over debt financing have tightened and Chinese banks have squeezed credit lines. In 2020, the average asset-liability ratio of TOP500 Chinese real estate companies reached 78% with over RMB 30 trillion in total debt. China Fortune Land Development Co. Ltd., Languang Development Co. Ltd. and Tahoe Group Limited have each successively defaulted on their bonds in the past year.

Investors should consider the below key strategies when plotting out an activist approach to monetizing distressed assets.

1. Search for offshore assets and structures.

Using investigative tools, investors may uncover assets outside the PRC that are owned or controlled by the company, opening up a more easily accessible treasure trove to ratchet up the pressure and create short term return on investment.

For example, Evergrande's holding and top-level companies are vastly incorporated in offshore jurisdictions. This corporate structure allows offshore investors to deploy a liquidation strategy to enforce on the group's assets from the top down. As for China Fortune Land, the group owns 38 entities in Singapore and several development projects in Indonesia. Because every company has a different business structure, identifying unique pressure points becomes an important first step to drive effective negotiations.

2. Target decision makers.

Activist investors should look for ways to influence the ultimate decision maker. Oftentimes, these real estate giants are controlled primarily by a family, or an individual chairperson. That key decision maker can steer the restructuring negotiation single-handedly, so the ability to influence their decision through legitimate means can effectively change the dynamics of any restructuring negotiation.

For instance, the cessation of Tahoe Group's efforts in creating liquidity for the chairman by acquiring Tahoe Life Insurance, the insurance business in Hong Kong and Macau operated by its majority shareholder Tahoe Investment Group Co., Ltd, created a bigger problem for the chairman, but could be helpful in Tahoe Group's negotiation. Additional pressure can be exerted through the inclusion of the chairman in the PRC Supreme Court's "Dishonest Debtors List" or to apply for an order restraining high value spending.

3. Take aim at potential business plans.

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Investors can apply legitimate forms of near-term pressure by frustrating potential business plans by exercising creditor rights. Through strategies devised to block a prospective sale, or even to unwind a completed sale, the distressed company may face unresolvable liquidity issues and its decision maker may feel enormous pressure to negotiate under better terms. There may also be opportunities for investors to seize assets “in transit” if a transaction was not properly conducted, allowing investors to obtain a quasi-security over the distressed company. Activist investors may look at potential opportunities, such as Evergrande’s potential listing of its tourism and drinking water business.

These strategies (1) drive up the market price of the securities as it facilitates negotiation for a more favorable restructuring plan, which may in turn help bring capital injections from white knights and other potential co-investors; and, (2) build on foundational enforcement procedures, which encourage favorable settlement or even provide quasi-security to unsecured creditors.

Owing to the size and complexity of these PRC real estate giants, the most direct path to monetization almost always requires navigating complex competing institutional relationships, taking adverse positions to competing creditors, financial institutions or other stakeholders.

To create the most favorable environment for negotiation, it is vital for investors to keep a lookout for creative strategies in situations where traditional restructuring has proven ineffective.

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Our global Claim Monetization team helps clients realize value from their claims, developing investigative, enforcement and asset tracing/recovery plans in the pre-dispute stage, to maximize future monetization. Our integrated team, of former U.S. government lawyers, Hong Kong solicitors, UK solicitors and barristers (including King’s Counsel) and offshore lawyers, uniquely positions us to drive cross-border proceedings — advocating directly for our clients or closely leading local counsel in jurisdictions around the world.

With lawyers admitted across the U.S., UK, Asia, the Middle East, Latin America and key offshore financial centers, our team offers deep experience coordinating investment monetization and judgment enforcement strategies across multiple jurisdictions.