

Decoding China Local Government Financing Vehicles (LGFVs)

Risk, Opportunity and Outlook

Zerlina Zeng, CFA
Senior Analyst – Chinese Corporates

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What is an LGFV and Why Does it Exist?

Local government financing vehicles (LGFVs) are used by local governments to fund off-budget spending. It exists because of the imbalanced sharing of revenue and spending between the central and the local governments.

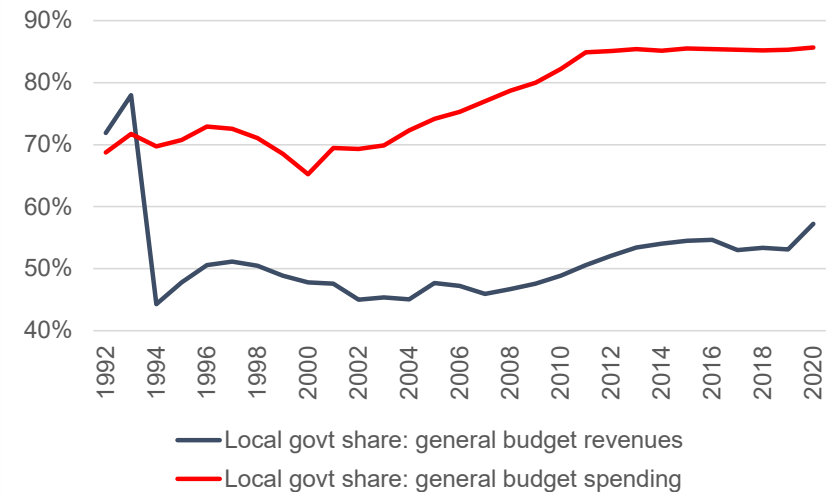
China's Administrative Hierarchy

Government tier	Types of government	Count
Tier 0: central government	Central government	1
Tier 1: provincial government	Provinces, autonomous regions, municipalities ⁽¹⁾	31
	Centrally-planned cities ⁽²⁾	5
Tier 2 ⁽³⁾ : prefecture city government	Provincial capitals (sub-provincial level)	27
	Prefecture cities	300+
Tier 3: district/county government	Districts and counties	2800+

How does Local Governments Fund Off-Budget Spending via LGFVs



Local Governments' Share in Revenues and Expenses



Differences Between LGFVs and Commercial SOEs

LGFVs perform public service roles and rely on their governments to repay debt. Commercial SOEs compete for profits and rely on their own cashflows to service debt. However, the difference is increasingly unclear.

The SOE Universe in China

Type	Controlling Government	Examples
Central SOEs (129)	Central SASAC & Organization	E.g., PetroChina, Sinopec, CNOOC, ChemChina, Chinalco, China Minmetals, CSSC, BaoWu Steel, SPIC, Huadian Group, Datang Group, Huaneng Group, China Resource Group, State Grid, COSCO, COFCO etc
	Department of CCP (102)	E.g., banks (ICBC, CCB, ABC, BOC etc.), AMCs (Harong AMC, Cinda etc.), Securities & brokers (Citic Group, Everbright Group), insurers (China Life, PICC Group etc)
Local SOEs	Ministry of Finance (27)	E.g., banks (ICBC, CCB, ABC, BOC etc.), AMCs (Harong AMC, Cinda etc.), Securities & brokers (Citic Group, Everbright Group), insurers (China Life, PICC Group etc)
	Provincial government, Provincial SASAC, Provincial Finance Bureau	<u>Commercial local SOEs</u> : Yunnan Energy, Chongqing Energy, Hebei Iron & Steel, Beijing Capital Group, Shougang Group, Shanghai Port Group, Hainan State Farm, Greenland, <u>LGFVs</u> : Gansu Provincial Highway, Henan Water, Qingdao Conson, Beijing Infrastructure Investment, Tianjin Rail Transit
	City government, City SASAC, City Finance Bureau	<u>Commercial local SOEs</u> : Sichuan Changhong, Yibin Wuliangye, Zhangzhou Jiulongjiang, <u>LGFVs</u> : Chongqing Nan'an Urban, Chengdu Communications, Zhengzhou Real Estate, Shaoxing City Investment, Kunming Railway
	District government, District SASAC, District Finance Bureau	<u>Commercial local SOEs</u> : Anji Qicai Lingfeng Rural Tourism Investment (Zhejiang Huzhou Anji District) <u>LGFVs</u> : Yiwu State-Owned Asset Operating Co, Shangyu State-Owned Asset Operating Co, Chengdu Eco & Tech Zone Investment (Chengdu Longquanyi District),

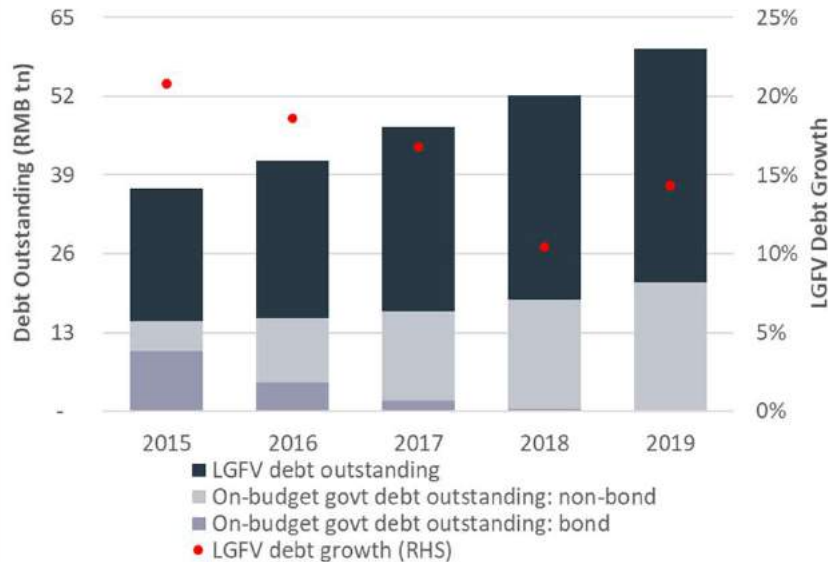
Types of Government Controlled Platforms

Platform type	Roles
Traditional LGFVs	Urban infra/transportation infra/primary land development, public utility, social housing, shanty-town reconstruction e.g. Gansu Provincial Highway, Yinchuan Tonglian Capital, Yangzhou Urban Construction, Shaoxing City Investment
Development zone platform	Integrated operator of national new districts, economic & technological development zones e.g. Chengdu Tianfu New Area, Dalian Deta, Chengdu Xingcheng, Hunan Xiangjiang New Area, Tianjin Binhai New Area
State-asset operating platform	Integrated state-asset operating platforming with various public service roles e.g. Yiwu State-owned Asset Mgmt., Beijing Haidian State-owned Asset Mgmt., Taizhou State-owned Capital
Investment holding platform	Provincial gov't controlled platforms with equity investment in strategically important industries and assets e.g. Yunnan Provincial Investment, Anhui Provincial Investment, Guangxi Investment
Financial holding platform	Investment holding co with stakes in various financial institutions e.g. regional banks, brokers, insurers, trust co e.g. Wuhan Financial Holdings, Hangzhou Finance & Investment, Zhongyuan Yuzi Investment
AMC platform	Asset management platforms used by local gov't to restructure non-performing assets e.g. Guangzhou AMC, Zhongyuan AMC

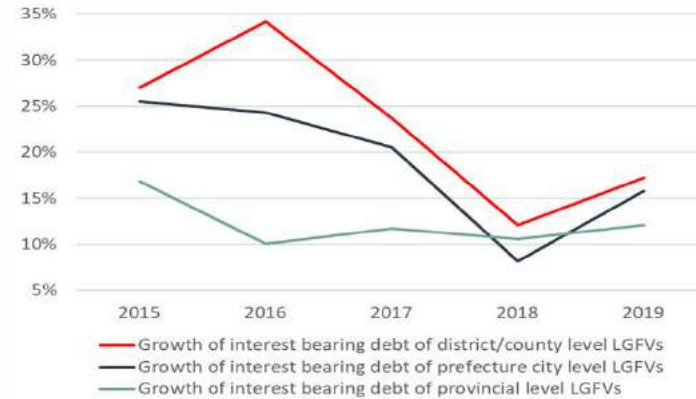
Will LGFVs Continue to Exist?

It is infeasible to remove the LGFVs' financing role as the intergovernmental fiscal regime in China remains imbalanced and the local governments do not have enough revenues to absorb the off-budget debt.

Composition of Local Government's Debt Outstanding



YoY Growth of LGFVs Debt of Different Tiers of Government



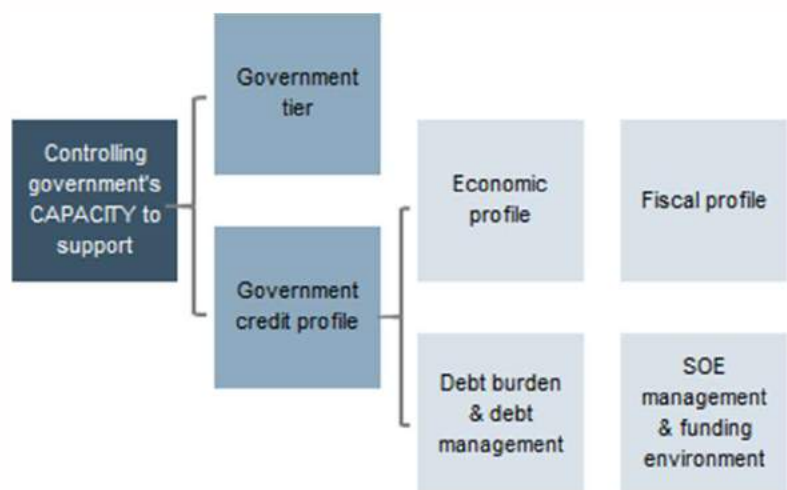
Measures to Reduce LGFVs Debt (2018 State Council Doc)

1. Repaying off-budget debt through budget revenues and fiscal deposits
2. Improving the LGFVs' debt servicing capacity through the injection of cashflow generating state assets (e.g., toll roads, commercial properties, and utility assets)
3. Coordinating with financial institutions to refinance and extend the LGFVs' debt outstanding
4. Restructuring the debt of insolvent LGFVs through market oriented mechanism

Local Government's Capacity to Support: Case Study

Three key determinants of government support: (1) the government's capacity to support (2) the LGFVs' role and linkage to the government

How We Assess a Local Government's Willingness to Support



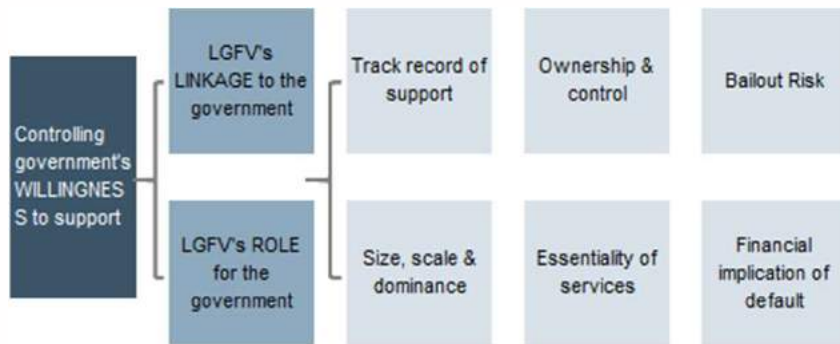
How Local Governments Support Distressed Entities

Supported entity	Controlling government	Resources mobilized	Details
Jiangsu HanRui Investment Holding	Zhenjiang City (in Jiangsu Province)	Local banks	In 2020, a local branch of Minsheng Bank refinanced Hanrui's high-cost trust loans with low-cost bank loans.
Guizhou Expressway	Guizhou Province	A listed SOE	- In 2020, the government's listed SOE Kweichow Moutai (SHA: 600519) issued a bond to acquire shares in the indebted Guizhou Expressway - Moutai transferred additional shares to the government, which were sold in the open-market. The proceeds were injected into the LGFVs.
Changde Urban Construction and Investment Group	Changde City (in Hunan Province)	Other LGFVs	In 2019, the government injected infrastructure related LGFV assets into the company, strengthen its status as the dominant LGFV, which helped to lower its funding costs
Gansu Provincial Highway Aviation Tourism Investment	Gansu Province	Upper-tier government: the central government	In 2020, the company obtained a syndicated loan led by China Development Bank to refinance high-cost project debt related to government toll roads

Local Governments' Willingness to Support: Link & Role

An LGFV with a very important role for the controlling government is typically a dominant and irreplaceable platform with strong public service role

How We Assess an LGFV's Link to Its Controlling Government



Rank of LGFVs' Functions Based on the Importance of the Service to the Local Governments

Essentiality of service	LGFV Functions
Critical	Critical infrastructure such as key segments of national railways and metro in key cities e.g., Gansu Provincial Highway, Kunming Rail Transit, Wuhan Metro
Important	Local urban infrastructure, urban water and gas services, affordable housing, shanty town reconstruction e.g., Chongqing Nan'an Urban Construction, Chengdu Communications, Shaoxing City Investment
Moderately important	Market-oriented property projects, tourism/culture related public facilities, investment and financial holding platforms e.g., Yunnan Cultural & Tourism, Qujiang Cultural and Tourism

Identify Weak LGFVs

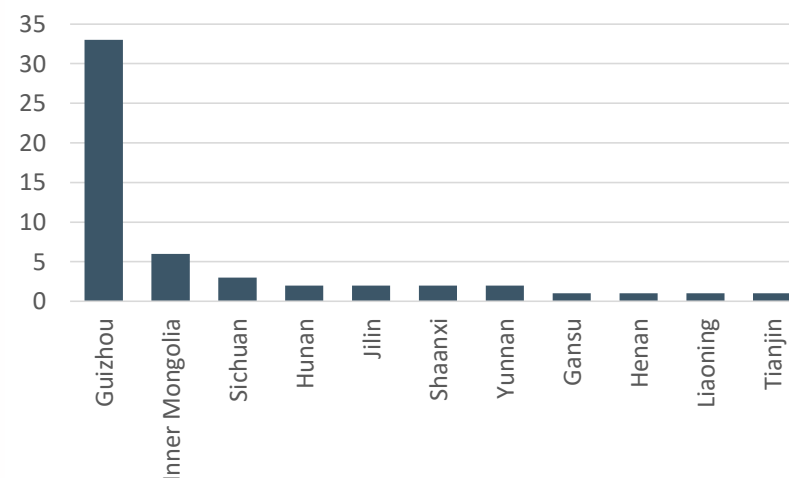
Characteristics of Weak LGFVs Include: Weak Capacity to Support, Weak Policy Role and Weak Liquidity

I. Default Case Study: Hohhot Chunhua Water (weak capacity to support & weak liquidity)

Hohhot Chunhua Water's Weak Liquidity Was Due to Delayed Payments From the Hohhot City Government

As of	31-Dec
Accounts and other receivables	7,360
Accounts and other receivables as % of total assets	24%
Of which: \geq 1-year overdue	3,422
> 1-year overdue receivables as % of total receivables	47%
Accounts and other receivables due from the Hohhot city government and other government related agencies	6,125
Receivables due from the Hohhot government and government agencies as % of total receivables	83%

Number of Trust Product Default Since 2018 by Province

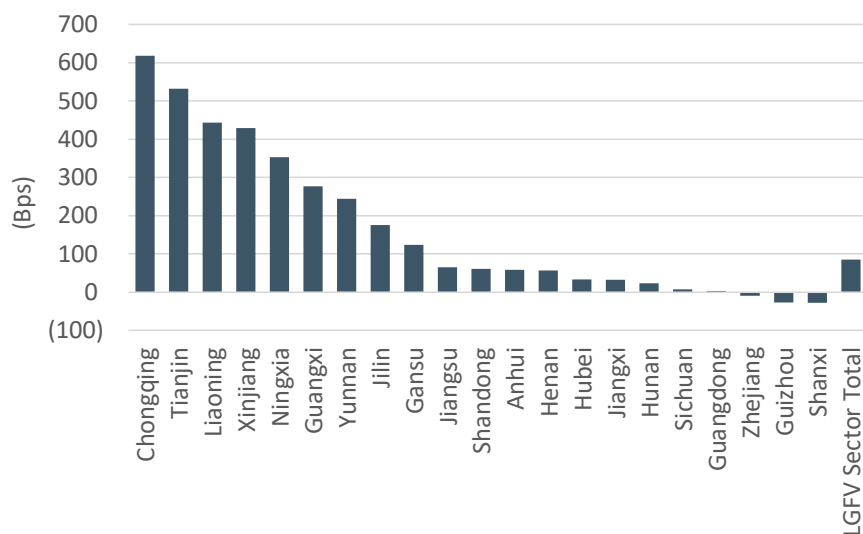


II. Default Case Study: Chongqing Energy (weak policy role & weak liquidity)

Which Ones to Chase Post the Sell-Off

The Chinese LGFV Sector's \$ Bonds Sold Off In the Past Three Months. We believe some LGFVs were over sold, which has created investment opportunities

Average YTW Change of LGFVs \$ Bonds Over the Past 3-Month



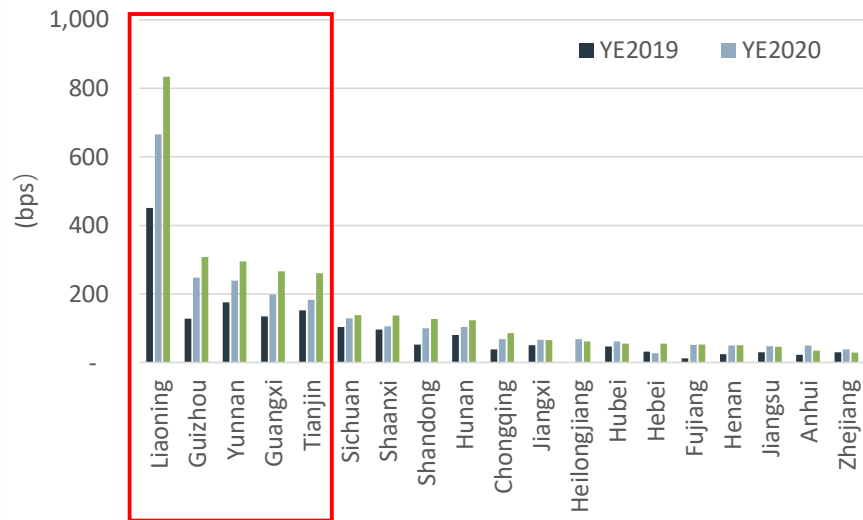
Relative Value View: Attractive LGFV \$ Bonds Post Sell-Off

Company Name	Credit Rating	Issues	Coupon (%)	Maturity	Mid Price	YTW (%)
Investment Grade LGFVs						
Weifang Urban Construction	NR/NR/BBB-	WFURCD 6.5% Oct-21	6.50	Oct-21	101.4	3.22
Chongqing Nan'an Urban	BBB/NR/BBB+	CQNANA 5.88% Jun-22	5.88	Jun-22	102.8	3.26
Kunming Traffic Investment	NR/NR/BBB-	KMCMIN 6.2% Jun-22	6.20	Jun-22	99.8	6.38
Gansu Provincial Highway	BBB/NR/BBB+	GSHIAV 3.875% Jul-22	3.88	Jul-22	99.2	4.58
Kunming Rail Transit Group	NR/Baa1/BBB+	KMRLGP 3.5% Dec-22	3.50	Dec-22	99.1	4.11
Chengdu Xingcheng	NR/NR/BBB+	CHDXCH 2.95 Mar-23	2.95	Mar-23	97.8	4.23
High Yield and Non-Rated LGFVs						
Yuyao Shuncai Investment	NR/NR/NR	YYECOD 7% Dec-21	7.00	Dec-21	101.8	3.89
		YYECOD 6% Apr-22	6.00	Apr-22	101.7	4.17
Yangzhou Eco & Tech Zone	BB+/Ba1/NR	YANGZH 5.5% Jun-22	5.50	Jun-22	101.8	3.83
Chengdu Airport Xingcheng	NR/NR/BB+	SLSCCI 6.5 Jul-22	6.50	Jul-22	102.9	3.92
Huai An Traffic	NR/NR/BB	HACOMM 6% Sep-22	6.00	Sep-22	99.8	6.16
Mianyang Investment	NR/NR/BB	MIANYA 5.95% Oct-22	5.95	Oct-22	100.1	5.87
Hangzhou Linjiang Inv	NR/NR/NR	HZLJDV 5.3% Dec-22	5.30	Dec-22	102.0	4.61

LGfV Sector Outlook

Credit Differentiation is key

Spread of AA+ Rated Onshore LGfV Bonds Over China Government Bond by Province (bps)



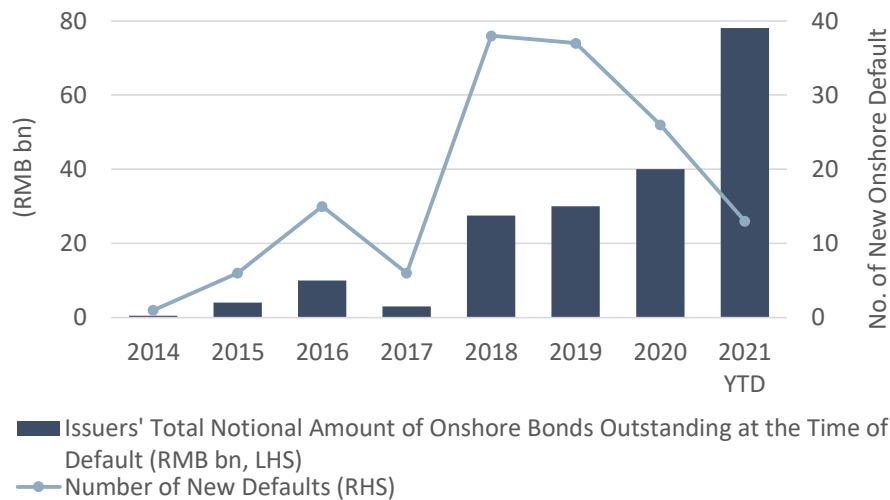
Spread of 5-year Onshore LGfV Bonds Over China Government Bond by Ratings (bps)



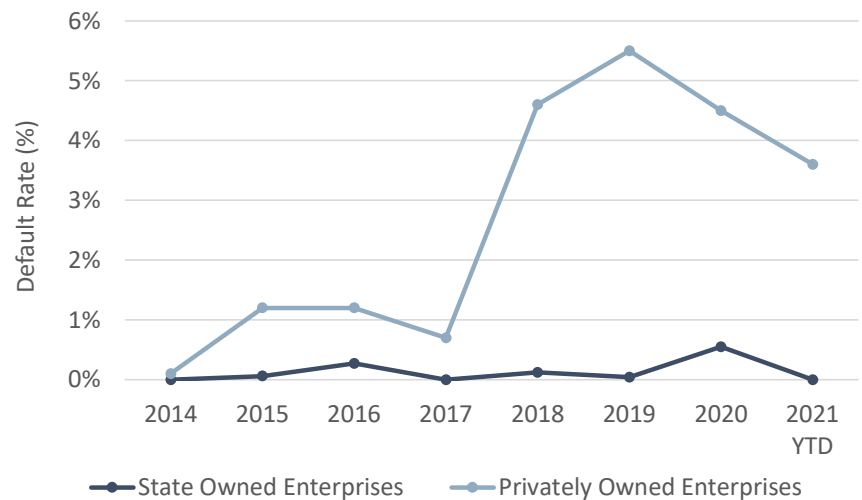
SOE Default and the Contagion Risk

SOE default rate went up in 2020 but is still much lower than private enterprises. We expect more commercial SOEs would be allowed to default.

China Onshore Bond New Default Since 2014



Total Notional Amount of Onshore Bonds Outstanding at the Time of Default as % of Total Corporate Bonds Outstanding



Listed of Defaulted Local SOEs

Defaulted Regional SOE	Province	Date of 1st Default	Total Amount Of Offshore Bonds Outstanding at Time of Default (USD mn)
Tianjin Real Estate Group	Tianjin	29-Sep-20	100
Qinghai Provincial Investment Group	Qinghai	10-Jan-20	850
Tewoo Group	Tianjin	25-Nov-19	2,050
Defaulted Regional SOE	Province	Date of 1st Default	Total Amount Of Onshore Bonds Outstanding at Time of Default (RMB mn)
Yongcheng Coal & Electricity Holding	Henan	10-Nov-20	24,410
Huachen Automotive Group	Liaoning	23-Oct-20	17,200
Tianjin Real Estate Group	Tianjin	8-Sep-20	9,832
Tianjin Real Estate Trust Group	Tianjin	24-Aug-20	3,859
Jilin Forest Industry Group	Jilin	18-May-20	1,000
Qinghai Salt Lake Industry	Qinghai	30-Sep-19	6,174
Xinjiang Production and Construction Corp's 6th State-Owned AMC	Xinjiang	12-Aug-18	2,500
Liuzhou Chemical Industry	Guangxi	31-Jan-18	6
Sichuan Coal Industry Group	Sichuan	26-Dec-16	4,750
China City Construction	Beijing	9-Dec-16	16,150
Hebei Logistics Industry	Hebei	17-Nov-16	450
Sichuan Coal Industry Group	Sichuan	15-Jun-16	1,000
Dongbei Special Steel Group	Liaoning	27-Mar-16	7,170
Zibo Hongda	Shandong	8-Mar-16	400
Guangxi Non-ferrous Metal	Guangxi	27-Feb-16	1,000

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Q&A

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