Financial Services Commission

Press Release

May 13, 2024

FSC AND FSS ANNOUNCE MEASURES TO SEEK AN ORDERLY SOFT-LANDING IN THE REAL ESTATE PROJECT FINANCE MARKET

- The announced measures will facilitate financial companies to more clearly distinguish viable projects from unviable ones to ensure seamless supply of funds to the former while encouraging market-driven restructuring or liquidation of the latter.
- Additional support measures prepared, such as additional guarantee support for increased construction costs, creation of a syndicated loan to support restructuring or liquidation, and the availability of various incentives through temporary easing of financial regulations.
- The measures will be implemented in a flexible manner so as to ensure that the market and financial and construction companies are sufficiently capable of coping with the effects of the measures, with the upgraded evaluation standards expected to take effect from June.

The Financial Services Commission and the Financial Supervisory Service announced measures to seek an orderly soft-landing in the real estate project finance market on May 13, expanding upon the series of previously introduced measures aimed at stabilizing the market.

BACKGROUND

Since the second half of 2022, the government has been working to facilitate an orderly soft-landing in the real estate project finance market through various market stabilization programs designed to stabilize financial markets, such as the PF-ABCP (project finance asset-backed commercial paper) market and bond market, and by providing funding support to the development projects that are considered to be financially viable, while encouraging restructuring or liquidation of projects that are deemed to be unviable.[1]

Corporate bond spreads, which stood at 109 bps at the end of September 2022, rose quickly to 177.2 bps on December 1, 2022 due to market anxieties about PF-ABCPs. However, as the government and the private sector actively took steps to respond in a timely manner, by introducing the corporate bond market stabilization fund and the PF-ABCP purchase program, bond market conditions began to stabilize since after January 2023, and corporate bond spreads as of the end of April 2024 stood at 46.6 bps. Spreads on commercial paper (CP) also spiked to 240 bps on November 23, 2022, but have come down to the recent level of 68 bps, showing signs that financial market conditions have returned to stability.

To facilitate funding of the development projects that are operating on solid financial grounds, the government introduced a project finance guarantee program worth

[1] The market stabilization programs were initially set up in the size of KRW50 trillion-plus in October 2022, but their size has been expanded to about KRW94 trillion currently with introduction of additional liquidity support programs designed to promote housing market and construction activities.

KRW30 trillion in October 2022, from which about KRW18 trillion has been implemented thus far in support for projects making a transition from bridge loans to project finance loans. Along this line, in September 2023, various lending support programs were also introduced to assist construction companies via policy financial institutions.

In addition, by making necessary updates to the consortium agreement of the project finance lending institutions' consortium in April 2023, the authorities have been promoting lenders to take more market-driven approaches for managing development projects that lack financial viability through selloff or auction. Debt restructuring is also being pursued using the project finance normalization fund created in September 2023.

Individual private financial institutions have also been making efforts in supplying funding support for the real estate project finance market and construction companies. The financial authorities have been closely checking the provisioning situation of financial companies to continue to enhance their provisioning to ensure that project finance related losses do not lead to their prudential or liquidity risks.

However, despite these efforts, amid concerns about interest rates and prices staying higher for longer for a prolonged period of time, there have been cases in which a restructuring or liquidation is being put off for seemingly unviable projects through maturity extension, with default rate also rising in the nonbank sector.

An accumulation of insolvency in project finance loans can cause a crunch in funding supply even for the development projects that are operating on solid financial grounds, raising alarms for a supply shortage in the property market. Moreover, without a soft-landing, an abrupt and wholesale liquidation of insolvent projects can lead to excessive tightening in the property market, spreading shocks throughout the construction and financial industries.

In order to remove market uncertainties and ensure a soft-landing in the real estate project finance market, the financial authorities have been seeking to improve the standards for assessing the viability of development projects in more objective and reasonable ways. At the same time, by having a series of meetings and discussions with the financial and construction sectors, the financial authorities have sufficiently taken into account the opinions and views presented by these industries.

Against this backdrop, based on the progress of various measures put in place thus far and the opinions collected from the industries, the government has prepared the following set of measures in seeking an orderly soft-landing in the real estate project finance market.

KEY POLICY MEASURES

I. IMPROVING THE STANDARDS FOR EVALUATING VIABILITY OF DEVELOPMENT PROJECTS

The current evaluation standards observed in the financial sector do not sufficiently take into account the peculiar characteristics and risks associated with project finance, and that they are not specific enough to sort out unviable projects for an orderly liquidation. Therefore, by making improvements to the standards employed by the financial sector in evaluating the viability of development projects, the authorities will seek to facilitate financial companies to more clearly distinguish between the projects that are sound and viable and those that fail to meet standards through more objective and reasonable assessment on the viability test.

a) To this end, first, financial companies will be allowed to evaluate the viability of development projects by considering not only project finance loans and bridge loans but also land mortgage loans and debt guarantee contracts, which pose a similar level of risks, and funding from MG Community Credit Cooperatives.

b) The current evaluation criteria that are largely centered on main project finance loans will be broken down into bridge loans and main project finance loans, depending on the characteristics of individual projects, to strengthen the evaluation system, and for each stage of the project, the risk elements and the degree of risks will be made more specific and subdivided to ensure more effectiveness in viability testing.

c) In addition, the viability evaluation ratings will be further broken down into four grading categories (satisfactory, average, attention, and insolvency risk) from the currently available three grading types (satisfactory, average, and deterioration risk). This will help to facilitate a normalization of viable projects through provision of new funding support and a liquidation of those falling short of the viability test through restructuring, selloff, or auction to promote a more orderly soft-landing of the project finance market.

Viability evaluations performed by financial companies will not be operated in a uniform and rigid manner but rather flexibly while allowing financial companies to look at various evaluation criteria in a comprehensive manner. Moreover, if needed, financial companies may resort to a divergent evaluation process on exceptional cases, if the matter has been dealt with and considered by their internal risk management procedure.

d) In addition, the authorities will prepare standards for managing the development projects that are considered as unviable as well as a process for inspecting and managing them to ensure effective oversight and supervision over real estate development projects.

II. Ensuing Seamless Supply of Funds to Sound and Viable Projects

The vast majority of development projects that are deemed to be running on solid and viable financial conditions will be supplied with adequate funding support.

a) A seamless funding supply will be made available for funds needed to make a switch from bridge loans to project finance loans. In March 2024, the amount of support made available for project finance loan guarantees was expanded by KRW5 trillion for a total of KRW30 trillion, provided through Korea Housing & Urban Guarantee Corporation (HUG) and Korea Housing Finance Corporation (HF), and a new guarantee program was also created to provide KRW4 trillion in lending support for non-residential development projects.

b) Provision of support for the projects in the stage of main project finance loans and which require additional funding for construction costs will be expanded. There will be additional guarantee support for increased construction costs made available through HF and HUG for those deemed as viable projects but face challenges in moving forward with the builder entering a debt workout. Moreover, by utilizing the project finance normalization fund, the authorities will work to make sure that sound and viable development projects are able to receive additional supply of funds needed.

c) The authorities will also look into instances where excessive fee burdens are imposed on developers and construction firms in project finance to seek measures for improvement.

III. Encouraging Systematic Restructuring and Liquidation of Unviable Projects

For a pocket of development projects that fall short of being considered to be viable, the authorities will foster conditions where financial companies are able to restructure or liquidate them in a systematic way, while making available funds and incentives necessary to make that happen through concerted efforts by the private and public sectors.

a) First, the authorities will create conditions to facilitate financial companies to pursue restructuring or liquidation on their own in a systematic way.

Projects requesting for a maturity extension for the second time or more will be subject to a higher threshold in securing a consent from the real estate project finance lenders' consortium (consent from two-thirds needed previously will be changed to three-fourths). When a maturity extension is granted, from now on, overdue interest payments will have to be paid in principle. In addition, the authorities will work to draw up standards for auctioning off project finance bonds held by financial companies to help create conditions in which financial companies are able to actively seek restructuring or liquidation on their own.

b) Through concerted effort by the private and public sectors, funds and incentives needed to seek restructuring or liquidation will be provided.

The banking and insurance sectors will jointly contribute KRW1 trillion in setting up a syndicated loan first, and after considering the progress and market situation, the availability of syndicated loan will be expanded in stages to up to KRW5 trillion.

The syndicated loan will be used to provide financing for the auction, purchase of non-performing loans, and temporary liquidity supply for the development projects that are being auctioned off based on the evaluation of project viability screened by five banks and fiver insurance companies.

To facilitate restructuring and liquidation of unviable projects, the authorities will also work on seamless implementation regarding Korea Land and Housing Corporation (LH)'s land purchase program (up to KRW3 trillion), and allow Korea Asset Management Corporation (KAMCO) to acquire assets through auction as previously announced in March.

In the meantime, there will be other measures aimed at facilitating liquidation of non-performing debts, such as introducing the right of first refusal at KAMCO funds to foster speedier execution by funds and having KAMCO to provide additional KRW400 billion worth of support to MG Community Credit Cooperatives (KRW200 billion) and savings banks (KRW200 billion).

IV. Working to Minimize Impact on Market, Financial and Construction Companies

In the process of working to soft-land the real estate project finance market in an orderly manner, the authorities will also seek measures to minimize the impact this can have on the market, construction firms, and financial companies.

a) Through temporary easing of regulations on financial companies, the authorities will propel supply of private capital into the project finance market and promote seamless restructuring or liquidation. To ease liquidity and prudential management burdens of savings banks and specialized credit finance companies, the availability of the temporarily eased regulations, which became available in the nonbank sector (eased levels of savings banks' loan-to-deposit ratio and specialized credit finance companies' KRW liquidity ratio) from the second half of 2022, will be extended until the end of this year. Along this line, the authorities will seek to provide incentives for the employees of financial companies in the form of liability immunity even when losses are accrued in the process of their handling of a selloff of an unviable development project or when providing support through syndicated loan.

b) In addition, the authorities will regularly inspect the situation regarding financial companies' provisioning for the restructuring or liquidation of unviable development projects, while continuing to encourage the nonbank sector to bolster capital to manage prudential risks.

c) The market stabilization programs worth a total of KRW94 trillion-plus will be effectively implemented, while the authorities keep close monitoring of situations in financial markets, construction companies, and the nonbank sector to make sure that the government is ready to immediately respond with related organizations if necessary.

   In particular, for construction firms, the authorities will work to ensure seamless availability of lending programs through Korea Credit Guarantee Fund (KODIT), Korea Development Bank (KDB), and Industrial Bank of Korea (IBK), as well as KODIT's P-CBO (primary collateralized bond obligation) support, construction industry's own guarantee program, and PF-ABCP (project finance asset-backed commercial paper) purchase program. The authorities will also closely supervise the specialized credit finance, savings banks, and mutual finance sectors to make sure that there are no soundness or liquidity issues arising from these financial companies.

   The government will continue to work on the measures announced earlier that are intended to boost housing supply and make efforts to closely engage with the construction sector to seek solutions to recent challenges surrounding construction costs and so on.

Further Plan

In response to potential risks in the real estate project finance market, the government has so far taken steps to support financial companies to bolster their provisioning and boost demand and provide liquidity for construction companies. Moving forward, the government plans to implement the measures in a flexible manner so as to ensure that the market, financial companies, and construction firms are adequately able to cope with the effects of the measures.

The upgraded evaluation standards for evaluating the viability of construction projects are expected to take effect from June this year, after gathering sufficient comments from related stakeholders. The types of construction projects that will be subject to the upgraded evaluation standards will be expanded in stages to ease concerns in the market, and the authorities will work to ensure thoroughness in management and close monitoring over the entire evaluation process to seek a soft-landing in the project finance market. The authorities also plan to finish up revising relevant rules by the end of June this year for the provision of incentives and so on.

In particular, to prevent market anxiety and regularly check and seek improvements in the process of implementing the measures on a continuing basis, the FSC, the FSS, and the Ministry of Land, Infrastructure and Transport will operate a joint taskforce with the financial and construction sectors to ensure close communication and promptly seek additional remedies if needed.

Moreover, the authorities plan to seek improvements to address some of the more structure-based problems in the project finance market, such as the completion guarantee agreement for construction companies, the nature of low-capital-and-high-leverage funding structure in property development projects, and the generally inadequate level of consideration given to the viability of development projects among stakeholders. The government will look into these structural issues to help prevent uncertainties in the real estate project finance market.

Despite significant uncertainties in the project finance market causing abrupt liquidity crunch and stirring uneasiness about the soundness of certain financial and construction companies, the concerted efforts taken by the private and public sectors have thus far paved the way for a soft-landing of the current situation, equipped with appropriate conditions, capacity, and policy tools.

A successful soft-landing requires a clear, thorough, and transparent communication of policy tools to boost predictability, alongside the self-help efforts of market participants.

As a responsible stakeholder in an orderly soft-landing process, the financial sector will be encouraged to faithfully carry out its role as best as possible, and if needed, the authorities will seek to quickly take steps to do what more can be done by the public sector through KAMCO.

To make sure that there is a sufficient level of predictability and work toward a successful soft-landing in the project finance market, the authorities will continue to closely engage with stakeholders and communicate relevant timeline and details of the measures.

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