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HSBC's UNSECURED real estate lending: Q3 2023

HSBC booked a £400 million write-down on its commercial real estate lending into China in Q3 2023, but the damage is surely far higher.

There has been no write-down in the value of its 62% stake in Hang Seng Bank - Standard Chartered Bank took a £562million write-down on its 16% stake in China Bohai Bank, which is 28% of its value at the turn of the year. An equivalent write-down by HSBC on its Hang Seng stake would have been £3.3 billion. After all, Hang Seng Bank and China Bohai Bank operate substantially in the same market.

The £400 million write-down, solely on commercial property loans, also looks pretty light when one considers that Standard Chartered Bank took a £150 million hit on a portfolio of £2.2 billion which is 6.8%. HSBC has a portfolio of £11 billion (US$13.6 billion) with a write-down of £400 million being 3.6% of that. The difference of 3.2% would have caused HSBC a further £352 million write-down.

So we potentially have further write-downs for HSBC of £3.7 billion to bring it to the same place as Standard Chartered.

Even if its write-downs on commercial property lending had been £752 million rather than £400 million, that would only partially reflect the deep problems in its portfolio. HSBC's portfolio of Chinese commercial property lending contains £1.8 billion of loans rated as 'sub-standard' (the fourth category of credit quality out of five), and £2.8 billion rated as 'credit impaired', the fifth and lowest category. That is £4.6 billion, or 42% of the whole portfolio, that is 'sub-standard' or worse, with a particular concentration of bad business booked by HSBC itself in Hong Kong, where Hang Seng Bank is headquartered.

Hang Seng Bank has both a residential mortgage book and a portfolio of commercial property lending of its own, but here we are just looking at HSBC's own China commercial property lending.

£6.0 billion of its £11 billion portfolio is booked in Hong Kong, and out of this £6.0 billion £3.8 billion (or 63%) is rated either as 'sub-standard' (£1.2 billion) or as 'credit-impaired' (£2.6 billion).

And now we come to the most totally incredible thing:

- £0.9 billion out of the £1.2 billion 'sub-standard' is UNSECURED
- £2.1 billion of the £2.6 billion 'credit impaired' is UNSECURED
- This means that 79% of the portion of the Hong Kong loan book into commercial property (£3 billion out of £3.8 billion) that is of poor quality is also UNSECURED

Since when was any 'real estate lending' UNSECURED?

According to the Corporate Finance Institute, 'Commercial real estate (CRE) lending refers specifically to credit that is created to finance or refinance commercial property.'

It lists various types of finance but then states that 'The common thread among all forms of CRE lending is that physical property serves as collateral to secure the credit exposure'.[1]

If real estate lending is unsecured it should be entered into the bank's accounts as personal lending if the borrower is an individual, or as corporate lending if the borrower is a non-personal legal entity, like a company, trust or limited liability partnership.

Are HSBC's loans unsecured because of fraud – e.g. the loan has been drawn down to finance construction but the money has been siphoned off and no edifice has resulted?

Are HSBC's loans unsecured because of defective documentation – e.g. the loan has defaulted but the edifice cannot be repossessed by the bank because its legal paperwork does not permit it?

The problem extends to financial reporting: an investor, credit analyst or share analyst surely has the right to assume that any loan categorized as 'real estate lending' or 'residential/commercial property lending' is secured with a mortgage.

Not only that, the bank's financial regulators would assume that loans categorized under 'real estate lending' were secured, not least because they then qualify for a much-reduced allocation of capital to be held against them.

Why have the auditors signed off the accounts with loans booked into the account chart as 'real estate lending' when they are unsecured?

What has the Financial Reporting Council got to say about this?

Key source: HSBC Q3 investor presentation p. 8 – figures in US$ millions

3Q23 results Appendix

Mainland China commercial real estate update

Mainland China CRE exposures by booking location and credit quality

At 30 September 2023

	Memo: Hong Kong at 2Q23	Hong Kong	Mainland China	Rest of Group	Total
Total	*8,076*	**7,504**	**5,146**	**985**	**13,635**
Strong	*1,161*	1,197	1,748	111	3,056
Good	*747*	643	946	431	2,020
Satisfactory	*973*	925	1,689	233	2,847
Sub-standard	*1,891*	1,485	520	191	2,196
Credit impaired	*3,304*	3,254	243	19	3,516
Allowance for ECL*	*(1,981)*	**(2,031)**	**(221)**	**(18)**	**(2,270)**

Hong Kong booked sub-standard and credit impaired exposures

$m	Total exposure	Of which not secured	ECL allowance*
Sub-standard	1,485	1,075	(71)
Credit impaired	3,254	2,588	(1,893)‡
Total	**4,739**	**3,663**	**(1,964)**

c.73% coverage ratio against not secured, credit impaired exposures

- Total mainland China CRE exposure **$13.6bn, down $0.6bn** vs. 2Q23 mainly due to write-offs and down **$7.7bn vs. FY21**

Hong Kong booked exposures:

- **$7.5bn**, **down $0.5bn** vs. 2Q23; $7.2bn drawn loans & advances
- Our exposure classified as strong, good and satisfactory remained broadly stable vs. 2Q23:
  - c.50% is to state-owned enterprises; c.50% is primarily lending to privately-owned enterprises that are not residential property developers. This is reflected in the minimal ECL allowance in this part of the portfolio
- Given worsened market conditions, the management assessed plausible downside scenario of c.$1bn ECL now looks more realistic for FY23
  - YTD ECL charge of **$0.8bn**
- **FY23 Group ECL guidance of c.40bps unchanged**[10]

Exposure in previous periods is shown on a reported FX basis
* ECL allowance shown on not secured exposures only
‡ 3Q23 ECL allowance and credit impaired exposures were reduced by c.$0.4bn vs. 2Q23 due to write-offs

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[1] https://corporatefinanceinstitute.com/resources/commercial-real-estate/commercial-real-estate-lending/ accessed on 20 November 2023