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Chinese investors in the Tier 2 cities look abroad

Over the past several years, within China there has been an increased interest in overseas property markets. According to National Realtors Associates, Chinese investment into USA property reached $28.6 billion in 2015, up from $4.1 billion in 2009. At first, the phenomena focused on the Chinese super-rich investing in overseas trophy properties, and then it spread to a broader group of Chinese investors, most often those in the Tier 1 cities of Beijing and Shanghai. More recently, however, we have seen an increase in this foreign property investment activity in Tier 1.5 and Tier 2 cities. In this piece, we explore the reasons Chinese individual investors are purchasing property abroad now and which markets they are investing in.

Why are they buying now?

Market volatility in the past several years has given Chinese investors more reservations about the domestic stock market and available wealth products, so it should not come as a surprise that investors who are already heavily invested in property may want to stick with that asset class, but diversify their portfolio by adding in foreign property.

And without even looking at domestic and international economic situation or future outlook, one could conclude the Chinese government has been a major driver for Chinese individuals to invest real estate abroad. In recent years in order to cool the housing market, the government put rules in place that made down payments larger for each successive property an individual purchased and also made getting additional mortgages progressively harder. Therefore, a first time home buyer might be required to make a 30 percent down payment, which is already high by international standards, and the down payment for the purchase of an additional property might increase to 50 or even 60 percent. These rules are now being relaxed, but not before investors started looking abroad.

Though the People's Bank of China claimed the RMB devaluation in August 2015 was a "one-off" move, it served wake-up call for affluent Chinese people to seek a safer place to store their wealth. Chinese foreign exchange reserves have fallen around 20% from their summer 2014 level, inciting fear that the RMB will continue its trend downwards. The stock market correction since mid-2015 and the recent turmoil in wealth management products have reinforced the idea that Chinese investors are unlikely to achieve stable returns domestically.

Additionally, after decades of extremely high growth, China's property sector has entered an adjustment phase and individual investors are finding it difficult to achieve the capital gains they had become accustomed to five or ten years ago.

The government's "Going Global Strategy" encouraged Chinese enterprises to play stronger roles internationally and has publicized some of these investment successes. Chinese outbound investment has increased significantly from $68 billion in 2010 to $116 billion in 2014, according to Ministry of Commerce.
The Chinese government intends to further encourage foreign investment in commercial real estate and the appetite of enterprises is growing. This has made some Chinese consumers more comfortable with the concept of investing abroad. Then the effect snowballs, as Chinese individuals investing abroad share their experiences and success stories, and more individuals are encouraged to consider a similar investment.

A few years ago there was broad media coverage of property tourism, where Chinese investors would travel in groups to look at existing property in the USA that was available, in some cases because of the fallout from the global financial crisis and excessive lending. In those cases, Chinese speaking agents guided Chinese buyers around markets with large amounts of available units.

As this trend has developed, it has become easier for Chinese individual investors to access the overseas residential market. Nowadays, a diverse group of service firms including banks, lawyers, accountants and real estate brokerages have created specialist teams and suites of services to catering to this growing investor type. Increasingly Chinese investors can now work with Chinese agents, banks and lawyers in China to successful make these investments abroad without ever having to leave China. And notably, some developers from Britain even opened their own sales offices in China.

The purchase of overseas real estate caters to different needs of a growing number of Chinese families wanting to obtain foreign residency, diversify their investment portfolio or invest in a market where their children may be studying abroad, potentially laying the ground work for a life abroad.

There are also other factors in the economic sense. First, some Chinese investors have accumulated wealth due to decades of a fast-growing domestic housing market. Especially for those who have owned multiple properties in the Tier 1 cities, investing in overseas property are just "cheap" when compared with house prices in the Tier 1 cities. Secondly, the flexible payment process helps to lower a buyer's financing burden compared with the process in China. If for example, a buyer purchased a property “off-plan” meaning in the pre-sale phase, the buyer might only need to make a minimal deposit and then several down payments over a year or two totaling less than 30% of the total house price. Then upon completion, the investor may have the option to pay off the property, obtain a mortgage or even sell the property, realizing a capital gain having only invested a fraction of the purchase price. Compared with investing in China properties, this process might make the actual payment for the overseas investment much lower than buying a property in China. Last, some investors are expected to lease their property to achieve a rental returns as well as capital gains. And rental returns overseas are currently often higher than in Chinese Tier 1 cities.

Which markets are they interested in?

Australia, the USA, Britain and Canada are four popular destinations for Chinese wealth looking for capital gains in overseas properties. One key reason is that gateway cities in these countries are seen as good places to invest with stable political environments and robust economies. At this point, there are no legal restrictions on property ownership by overseas parties. In addition, these cities have a history of price growth in the long term; relatively higher yields (rent over purchase price), and greater liquidity and transparent markets with clarity of rules and regulations. Some countries (the USA is a notable exception) allow property purchases to count towards investment totals that might allow an investor to qualify for a “green card” or permanent residency.

And while some countries are now increasing investment minimums to acquire an investment visa, some smaller European countries such as Portugal, Cyprus and Greece are still trying to attract Chinese investors and are seen as more welcoming.

In conclusion, Chinese individual investors purchasing overseas property have followed the footsteps of rational institutional investors. This group is not only limited to the super-wealthy but also investors from secondary cities looking to diversify their assets. Australia, the USA, Britain, Canada and small countries in Europe are some of the most popular destinations for Chinese investing overseas. Different types of products whether they be luxury or mid-market, ready to use or off-plan pre-sales have started to appeal to a wide variety of Chinese investors. As more business and educational exchanges take place, international tourism increases and local service provides develop to help Chinese investors access these markets, we expect this international property investment trend to only accelerate. Expect to see more international property promotions in a market near you soon and expect your Chinese friends to not only discuss the foreign fashions they have recently purchased, but potentially their overseas property too.

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