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China's Fall?

Do homefront woes signal the end to U.S. investment?

by Mike Margolis

China's slowing economy, devalued currency, roller-coaster-like stock market, government focus on domestic growth, rumored delays in further financial liberalization — surely all this spells the end of the Chinese investment boom in U.S. real estate? Isn't this Japan 1991 all over again?

Absolutely not. The year 2016 is likely to be the strongest yet for Chinese investment in U.S. real estate, and growth will continue for years to come.

IMF Vote

To forecast the future, we should look not to Tokyo 25 years ago, but instead to Washington, D.C., where, in November, the International Monetary Fund voted to include China's yuan in the IMF's basket of currencies with "special drawing rights." The yuan becomes the fifth global reserve currency, joining the dollar, euro, yen, and pound — probably in September 2016, when the existing basket allocations expire.

In 2010, the IMF rejected the yuan because China's foreign exchange controls were too tight. Over the last five years, China has demonstrated a commitment to steadily loosening constraints, including those on the outbound flow of capital.

Essentially the IMF's decision gives China's currency the seal of approval for use in international transactions. It is a watershed moment in a now-inexorable process of making the yuan freely convertible, and hence facilitating outbound investment from China.

Certainly there will be occasional countersignals, but these will reflect at most a temporary slowing of the pace of liberalization, not a reversal. Nothing fundamental has changed in China's underlying strategic and policy reasons for encouraging Chinese companies to "go global," such as the Chinese State Council's December 2014 promise to increase financing support.

True, China's economy is slowing, but that's relative. The IMF predicts China's growth will slow from 6.8 percent in 2015 to 6.3 percent this year; however that's still more than double the U.S.'s 2.8 percent predicted economic growth rate for 2016. Taken altogether, these events mean more Chinese money will be available to invest, and that money will continue to flow outward more freely.

Why U.S. Real Estate?

Of course, Chinese capital is seeking quality investments all across the world, in virtually all business sectors. But the flow into U.S. real estate will be particularly strong.

Besides the fact that the intrinsic value of the U.S. real estate market looks good for investors anywhere, U.S. real estate has a special appeal for Chinese investors. Real estate has been a treasured asset class in China for centuries, and the golden era of Chinese domestic real estate market is over and done. The U.S. represents badly needed geographical diversification.

Pricing is high in the favored cities of New York, San Francisco, and Los Angeles, but risk is viewed as low, and interest is increasing in other cities with growing Chinese populations, such as Houston, Seattle, Miami, Chicago, and Boston. The investment patterns are too new to draw sweeping conclusions — little happened before 2012 — but anecdotal evidence suggests that returns will be solid.

Large Chinese development companies have projects in several large U.S. markets and presales on new large condo developments, for example, appear to be fast and strong, in part because of demand from emigrating Chinese buyers. Smaller Chinese developers, who are still substantial and experienced, are eager to follow the large trailblazers' lead.

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Moreover, many Chinese have a personal stake in the U.S. A rapidly growing number of wealthy Chinese entrepreneurs, executives, and professionals send their children to U.S. colleges and increasingly to U.S. high schools. Over 300,000 Chinese students were enrolled at U.S. universities in the 2014-15 academic year, according to the Institute of International Education, the highest number from any country, representing 31 percent of all international U.S. college students.

Chinese nationals often buy condos for their college-age children to live in while studying in the U.S., or homes in suburbs with excellent high schools, sometimes sending a parent or grandparent to the U.S. to live with school-age children. In fact, the Chinese comprise the largest group of foreign investors buying U.S. homes and condos, according to the National Association of Realtors, and they pay the highest prices, recently averaging $831,000.

Chinese investors are also the biggest users of the EB-5 investment immigration program. Of the 10,692 EB-5 visas issued in 2014, 85 percent went to Chinese investors who invest in U.S, job-creating projects — often hotel and other commercial real estate developments — in exchange for permanent visas for their families.

Beyond Real Estate

Many expect the Chinese currency will continue to depreciate against the U.S. dollar. Interest rates in the U.S. are expected to rise, while China continues to lower rates as an economic stimulus measure — multiple times in 2015. That means investing in the U.S. may be a promising currency play.

For Chinese investors, U.S. assets also represent an important hedge against political risk, such as fallout from President Xi Jinping's well-known anti-corruption drive or unexpected events such as China's recent, forceful government intervention in domestic stock markets. The stability of the U.S. political and economic system allows a good match between real estate assets that can safely be held for the long term and the long-term liabilities of certain sectors of Chinese business, for example cash-rich insurance companies.

Finally, on the U.S. side, investing from China is getting easier. Geopolitical tension rarely affects local decision-making. Most cities and states are fully aware that jobs and other benefits will be created by each significant Chinese investment into commercial real estate, and are eager to help clear away red tape and get it done in their community.

These factors will boost Chinese investment into U.S. real estate for years to come. Bet on it.

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