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JLL Research Report

Assessing the impact of foreign ownership on residential markets

This paper seeks to determine the scale of non-resident foreign purchase of residential properties in key global cities and the impact on housing shortage and affordability.

Our conclusion: Markets with high foreign purchases are not necessarily the most unaffordable or have the highest vacancy rates. Instead, housing supply is key to maintaining affordability. Targeted taxes and use of home-sharing platforms can encourage optimal use of cities' residential stock.

Foreigners' focus on global cities

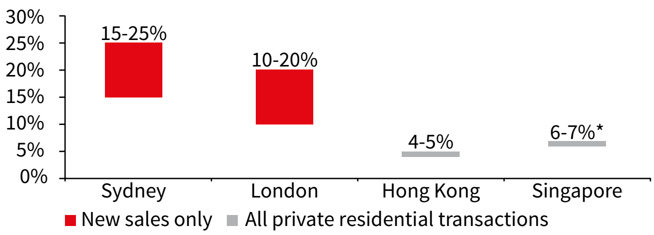
Foreign purchase of residential properties has come under the limelight in many global cities. Since the recovery from the global financial crisis in 2008-2009, home prices in many major cities around the world have risen sharply on the back of low interest rates, high liquidity and the increasing presence of foreign investors. Fears of potential housing bubbles and housing affordability crisis have led many governments worldwide to introduce property cooling measures. Foreign purchase of residential property in global cities can become a sensitive issue for local residents, affecting affordability, the sense of ownership and identity and even nationalism. As a result, in some cities, foreign investment in the housing market has also become a prickly political issue.

In recent years, Singapore, Hong Kong, London, Melbourne, Sydney, and Vancouver have, one by one, imposed or revised taxes to tame foreign purchase of residential properties and moderate housing prices.

Based on our research, foreign non-residents make up 2-12% of overall transactions in global cities:

- **Sydney**: Foreign buyers are restricted to purchasing only new-built housing in Australia. Foreign purchases in Sydney are the highest at about 15-25% of new residential sales in 2016.
- **London**: A study by LSE and GLA[1] estimated that foreign buyers make up less than 20% of new-build market transactions while a study by the University of York based on Land Registry data estimated about 13% of new-build units sold to overseas buyers in 2014-16.
- **Singapore**: Foreign buyers make up 6-7% of sales volume in the private residential market, which makes up 25% of total residential stock and 30% of yearly residential transactions in Singapore.
- **Hong Kong**: Foreign buyers make up 4-5% of total residential transactions.

Figure 1: Non-resident foreign purchases in global cities in 2016



*6-7% of sales volume in the private residential market, which makes up about 25% of Singapore's total stock

Source: JLL Research

[1] London School of Economics and Political Science and Greater London Authority
https://www.london.gov.uk/moderngovmb/documents/s58640/08b2b%20LSE%20Overseas%20Investment%20report.pdf

Driving factors for foreign purchasing residential properties in global cities

1 - For occupation, as foreigners enter the workforce as expatriates

According to the United Nation's Migration Report 2015, the number of people living outside their home country surged to 244 million or 3.3% of the world's population in 2015, up from 173 million in 2000. The growth in expatriates is likely to continue with the advancement of technology and more affordable air transport. In Singapore, for example, employment pass holders make up 5.2% of total employment in 2016, an increase from 4.6% in 2010.

2 - For children's education

JLL's International Residential Property team finds that children's education is another popular reason for foreign investors to purchase residential properties in global cities. In 2015-16, 19.2% of students attending publicly funded universities and other higher education in the UK were international students, based on the UK Higher Education Statistics Agency. The number of Chinese students in the UK, at more than 91,000, far exceeded other nationalities. In Singapore, international students made up 30% of students attending National University of Singapore and Nanyang Technological Technology in 2017, according to Times Higher Education. Ownership helps to eliminate the hassle of house hunting in every school term and reduces the risk of rising living costs due to potential rent increases.

3 - Buy to let

Rental income could be another reason for foreigners to invest in overseas properties. However, this seems to make sense only in Singapore and Hong Kong currently, where net rental yields provide a positive spread over mortgage rates. In Sydney and Melbourne, yields are now lower than mortgage rates, similar to Shanghai and Beijing, where non-resident foreigners are not allowed to purchase residential property. The UK average two-year fixed mortgage rate has dropped to less than 2.0% since 2015 while the NOI of residential properties in central London remained flat at around 2.0% in the past five years.

Interest rates have declined since 2011. If and when rates rise, the spread of rental yield above mortgage rate will worsen further. This may weaken the desire for investors to purchase residential properties for leasing and rental yield.

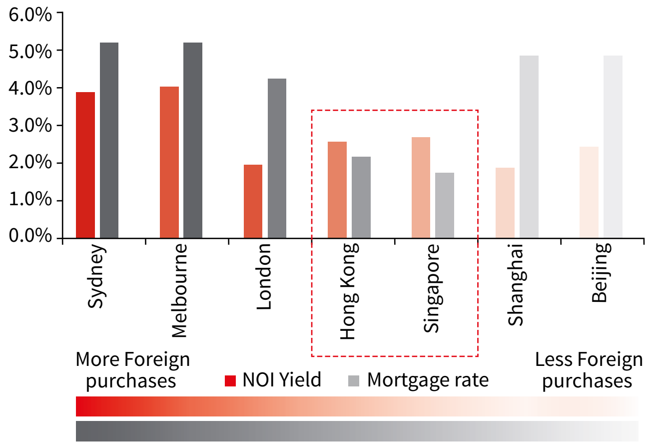
4 - Wealth preservation and diversification

Wealth preservation and capital appreciation are often the main appeals for investors when it comes to residential property investment.

Global cities are often considered safe havens with sustainable economic growth, a trusted government and a conducive business environment. Residential properties in global cities with a high potential for long-term capital appreciation are, therefore, popular destinations for investors to preserve their wealth and diversify their investment portfolio.

The price of prime residential properties in London, New York and Hong Kong increased 20%, 60% and 66%, respectively, on average between 4Q07 and 4Q16. Singapore prime residential prices, however, declined about 1% during the same period due to a series of cooling measures implemented between 2010 and 2013. Before this downturn, the prices in Singapore surged 60-70% from the global financial crisis trough in 2009.

Figure 2: Estimated residential net property income yield and mortgage rate for global cities



Source: CoreLogic RP Data Australia, Reserve Bank of Australia, IPD, Bank of England, Hong Kong Rating and Valuation Department, REALIS, PBOC, JLL Research

Debunking the myths of foreign ownership of residential properties

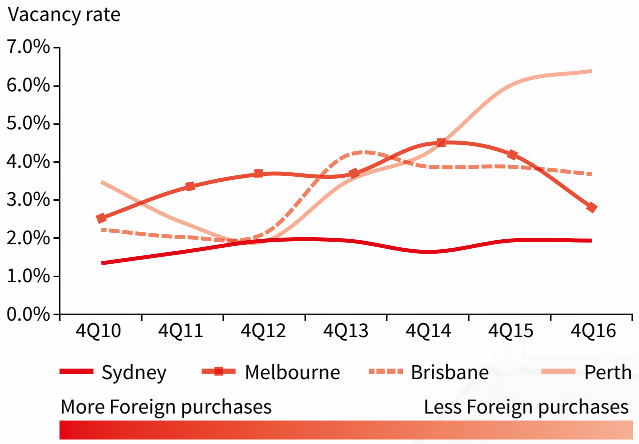
We examine a few common myths regarding the impact of foreign ownership on housing shortage and affordability.

Myth #1: Foreign purchase results in higher vacancy rates - DEBUNKED

Some people believe that foreign purchases are the cause for high vacancy rates in many cities, as properties purchased by foreigners are likely to be left vacant. However, in cities such as Sydney and Melbourne, where foreign purchases are higher than in Perth and Brisbane, the vacancy rates were lower at 1.8% and 2.7%, respectively, compared with 6.4% in Perth and 3.6% in Brisbane at end-2016. There is little evidence that foreign owners are more likely to leave their houses/apartments vacant compared with local owners.

JLL transaction survey of Asian buyers in London showed that 85% intend to rent out their investment properties. In fact, rental yield is one of the two components used to calculate investors' return. If the rents could cover agent fees and maintenance costs to result in positive net rent, both foreign and local investors would be likely to put their properties on the leasing market for the additional return. The vacancy rate, at the end of the day, is still the result of fundamental demand and supply. The volume of foreign purchases does not seem to be the determining factor that drives the vacancy rate.

Figure 3: Vacancy rates



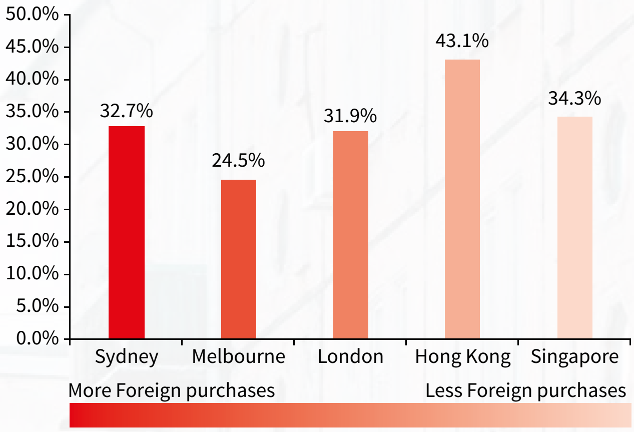
Source: Real Estate Institute of Australia

Myth 2: Foreign purchases create a shortage and erode rental affordability - DEBUNKED

In comparing affordability among some key global cities, the median rent to income ratios in Singapore, London, Sydney and Melbourne ranged between 25% to 35%. Hong Kong had the highest ratio of about 43%, which means that 43% of the household income was spent on rent. Housing stress status is normally flagged if rental costs or housing costs, in general, exceed 30% of household income. Rental affordability appeared to be the most severe in Hong Kong while the proportion of foreign purchases in Hong Kong was on the low side when compared with other global cities such as London and Sydney.

Should foreign purchases be the leading factor in the rental affordability, the ranking of rent to income ratios would have been different among the above cities. In fact, rental affordability is associated with bigger issues in the city, such as wealth distribution management and affordable housing supply for low-income households. Housing policy interventions, therefore, need to take into account various aspects instead of focusing on only one area to alleviate the affordability issue.

Figure 4: Rent to income ratio in selected global cities in 2016



Source: REALIS, SingStat, Annual Survey of Hours and Earnings, Census and Statistics Department, CoreLogic RP Data Australia, Australian Bureau of Statistics, JLL Research

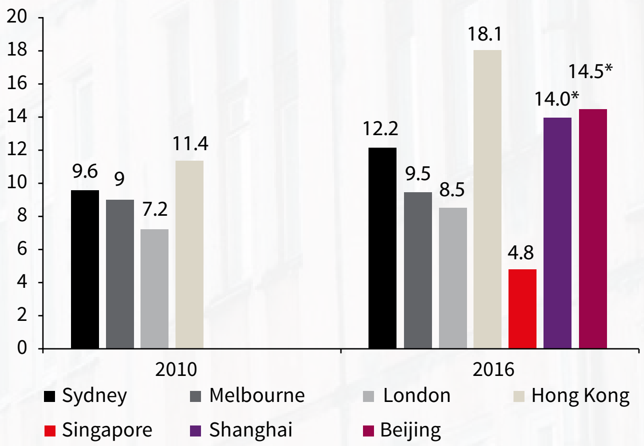
Myth 3: Foreign purchase contributes to eroding price affordability - TRUE

Most housing markets are considered affordable if the median house price to income ratio is 5 years or less. Most global cities examined in Figure 5 have severely unaffordable housing with the exception of Singapore, perhaps due to its comprehensive public housing program. Other global cities such as London, Hong Kong, Sydney and Melbourne seem to suffer from the demand-supply imbalance, in which the demand level was pushed up by foreign investors. Thus we agree that foreign purchases do contribute to the erosion of housing affordability in many global cities.

Besides, we also compare home price to income ratios in global cities such as London, and Singapore, where foreign buying is prevalent, versus the ratios in Shanghai and Beijing, where non-resident foreigners are not allowed to buy residential properties.

We find that Shanghai and Beijing residential properties are highly unaffordable with a home price to income ratio from 14-15, while the ratios in London and Singapore were lower at 8.5 and 4.8, respectively, in 2016. Comparing across continents between Sydney, Melbourne and London versus Hong Kong, the latter is extremely unaffordable with a ratio of 18.1 compared with 12.2 in Sydney, 9.5 in Melbourne and 8.5 in London, even though the estimated proportion of foreign buyers in Sydney, Melbourne and London's residential market is higher than in Hong Kong. Foreign purchases do add to the demand for housing, but local investors are still the major players in the residential market. The issue of affordability in Shanghai and Beijing, for example, is mainly contributed by local Chinese buyers who love to store their wealth in properties and speculate on the rise of home prices in the biggest cities of China.

Figure 5: Home price to income ratio in selected global cities



Note: *2015 data of Shanghai and Beijing affordability ratio from E-House reports

Source: Demographia, E-house report, JLL Research

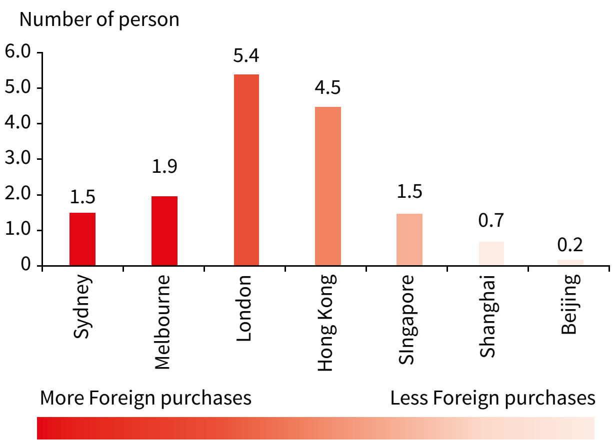
Foreign participation in residential pre-sales help expedite supply into the market

In our view, the key driver behind shortage and affordability is supply, rather than foreign investment. Affordability in Singapore has been maintained as the increase in residential stock was sufficient to support its population growth. In 2016, one housing unit was built for every 1.5 additional person in Singapore. In contrast, London and Hong Kong are facing a shortage with 5.4 and 4.5 extra persons, respectively, per new dwelling unit in the same year. The ratios of population growth to dwelling completion in Shanghai and Beijing were low in 2016 due to the government measures to cap their population at 25 and 23 million, respectively, by 2020.

Discussions with developers indicate that almost all developers need pre-sales to help reduce development risks and lumpiness of revenue. The LSE-GLA study pointed out that foreign investments in pre-sales helped to capitalise the increase in the build-to-rent market in the last two years.

85% of Asian buyers in London tend to rent out their purchased apartments after completion. Without foreigner buying, housing stock could arguably be even lower in London.

Figure 6: Number of additional persons (change in population) per an additional housing unit in 2016



Source: Australian Bureau of Statistics, UK Office for National Statistics, DCLG Departments for Communities and Local Government, Hong Kong Census and Statistics Department, HK Building Department, Singapore Department of Statistics, HDB, REALIS, National Bureau of Statistics of the People's Republic of China, Shanghai Housing Trading Center, Beijing Statistics Bureau, JLL Research

Government measures to encourage optimal use of housing resources

Targeted Taxes

Some governments have put in place higher buyer and seller stamp duties in the last few years to tame foreign purchases of property. Notably, foreigners buying a second property in Hong Kong now pay a 30% stamp duty on the purchase price.

We believe transaction taxes are inefficient and distortionary. Taxes could be more targeted and used to address specific issues. For instance, to ensure buyers do not keep properties vacant, Australia has in March 2017 introduced a new tax on properties which are vacant for six months or more in a year. At the same time, capital gains tax withholding threshold for foreign tax residents will be reduced from AUD2m to AUD0.75m and the withholding rate raised from 10% to 12.5%.

Allowing and effectively regulating home-sharing platforms, e.g. Airbnb and HomeAway

As technology and mobile internet penetration continues to improve, we expect the sharing economy to expand further. Governments that allow and proactively regulate home-sharing platforms could help to harness more of its housing stock for occupation.

Home sharing platforms such as Airbnb and Homeaway now account for around 25% of total available hotel room nights in global gateway cities in US and Europe. However, in the top international tourist cities in Asia, adoption is still low, with listings making up 6% of total available room nights. Some analysts have estimated airbnb average occupancy rate in the top four markets at 25-30%, compared to the average hotel occupancy rate of 80%. This implies that home sharing accommodations may make up 9-11% of total occupied room nights in these cities. This has created some pressure on hotel room rates as hotels experience fewer compression nights.

Home sharing platforms are working with city planning authorities to regulate and contain social side effects. Depending on the city, restrictions and taxes are being put in place to minimize the impact of these short-term accommodations on availability of affordable housing and disamenities.

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