

Box B

Chinese Demand for Australian Property

Chinese investment in Australian residential and commercial property has increased significantly in recent years. This interest in property from Chinese households, institutional investors and developers is not unique to Australia; they are also active in the property markets of other countries, such as the United States, the United Kingdom, Canada and New Zealand.

The Australian banking system's direct exposure to Chinese property investors and developers appears to be small. However, if Chinese demand were to decline significantly, that could weigh on domestic property prices and so lead to losses on the banks' broader property-related exposures. This box explores these issues further.

Housing

Non-resident Chinese buyers own only a small portion of the Australian housing stock, but industry contacts suggest that they account for a significant and increasing share of purchases. These purchases are largely concentrated in off-the-plan apartments (especially in Sydney and Melbourne), in part because all foreign buyers, other than temporary residents, are generally restricted to purchasing newly constructed dwellings. Consistent with observations by industry contacts, the limited and partial data available from the Foreign Investment Review Board (FIRB) suggest that approvals for all non-residents applying to purchase residential property have increased substantially of late

(Graph B1).¹ The majority of these approvals are for new dwellings in New South Wales and Victoria. China is the largest source of approved investment in (residential and commercial) real estate and its share of total approvals is growing, but it still only accounts for a small fraction of overall market activity.

Graph B1
FIRB Residential Real Estate Approvals



Sources: CoreLogic RP Data; FIRB; RBA

Nonetheless, if a significant subset of buyers reduce their demand sharply, this can weigh on housing prices, and Chinese buyers are no exception to this given their growing importance in segments of the Australian market. Such a reduction in housing

¹ Setting aside any misreporting to FIRB, these data overstate the share of foreign purchases of Australian residential property for several reasons: not all of the FIRB approvals translate into actual purchases; for some proposed developments, developers can receive pre-approval from FIRB to sell up to 100 per cent of the dwellings to foreign buyers, but the data are not subsequently updated to reflect the actual share of these dwellings sold to foreign buyers; the data are gross approvals to foreign buyers and do not subtract any subsequent sales of these properties; and given that foreign purchases are skewed towards more expensive housing, the importance of these purchases in overall dwelling turnover will be overstated in value terms. For a detailed discussion of these data limitations, see Gauder M, C Houssard and D Orsmond (2014), 'Foreign Investment in Residential Real Estate', RBA *Bulletin*, June, pp 11–18.

demand could result from a number of sources, including:

- A sharp economic slowdown in China that lowers Chinese households' income and wealth. Any accompanying depreciation of the renminbi against the Australian dollar could further reduce their capacity to invest in Australian housing. In the extreme, Chinese investors may need to sell some of their existing holdings of Australian property to cover a deteriorating financial position at home. A macroeconomic downturn in China could also be expected to have knock-on effects on other countries in the region, which could also affect those countries' residents' capacity and appetite to invest in Australian property. On the other hand, if economic prospects in China deteriorate this could make investment abroad, including in Australia, more attractive and result in an increase in demand for Australian property.
- A further tightening of capital controls by the Chinese authorities that restricts the ability of Chinese households to invest abroad.
- A domestic policy action or other event that lessens Australia's appeal or accessibility as a migration destination, including for study purposes. Industry contacts suggest that in addition to wealth diversification, many Chinese purchases are dwellings for possible future migration, housing for children studying in Australia or rental accommodation targeted at foreign students. If so, this demand could be expected to be fairly resilient to shorter-term fluctuations in conditions in China or developments in the domestic property market, but more sensitive to changes in migration or education policy.

A substantial reduction in Chinese demand would likely weigh most heavily on the apartment markets of inner-city Melbourne and parts of Sydney, not only because Chinese buyers are particularly

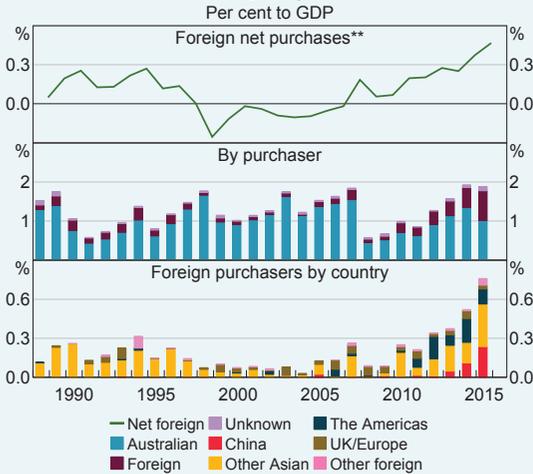
prevalent in these segments but also because other factors would reinforce any initial fall in prices. These include the large recent expansion in supply in these areas as well as the practice of buying off-the-plan, which increases the risk of price declines should a large volume of apartments return to the market if the original purchases fail to settle.

The Australian banking system has little direct exposure to Chinese investors. Australian-owned banks engage in some lending to foreign households to purchase Australian property, but the amounts are small relative to their mortgage books. Australian-owned banks also have tighter lending standards for non-residents than domestic borrowers, such as lower maximum loan-to-valuation ratios, because it is harder to verify these borrowers' income and other details, and because the banks have less recourse to these borrowers' other assets should they default on the mortgage. Australian branches of Chinese-owned banks appear to be more willing to lend to Chinese investors because they are often in a better position to assess these borrowers' creditworthiness, particularly where they have an existing relationship. Nonetheless, although the direct exposures are small, if a reduction in Chinese demand did weigh on housing prices this could affect banks' broader mortgage books to some extent.

Commercial Property

Chinese institutional investors and residential property developers have also become increasingly active in Australian commercial property markets. In the past two years, they accounted for 9 per cent of purchases (greater than \$5 million) compared with 1 per cent on average during the prior decade (Graph B2). These figures may understate the involvement of Chinese investors to the extent that they invest through trusts or managed funds domiciled in other Asian countries, which, in turn, invest in Australian commercial property. Another

Graph B2
Commercial Property Transactions*



* Only includes transactions greater than \$5 million

** Foreign purchases minus foreign sales

Sources: ABS; JLL Research; RBA; Savills

avenue for foreign investment is indirectly through portfolio inflows into domestically listed investors and developers.

The growing involvement by Chinese buyers is occurring in a broader context of increasing foreign investment in Australian commercial property. In 2015, foreign investment accounted for around 40 per cent of purchases, the highest proportion since such data were first collected in the late 1980s. This compares with earlier increases in foreign investment in commercial property, such as the early 1990s, when such investment reached around one quarter of all purchases for a number of years, mainly driven by Japanese investors. Unlike in that episode, though, most recent Chinese investment is thought to be equity funded rather than debt funded.

Over recent years, around half of Chinese purchases have been high-grade office property, largely in Sydney and Melbourne, and almost half have been lower-grade office or industrial buildings in Sydney, primarily for conversion or development into apartments. This reflects Chinese developers' intentions to develop several high-rise apartment

projects in Sydney and, to a lesser extent, Melbourne and Brisbane. Chinese developers have also become increasingly active in greenfield land markets, particularly in Melbourne.

Along with demand from elsewhere in Asia, Chinese demand has been an important factor behind the marked compression in Australian commercial property yields, by contributing to the rapid price growth in Sydney and Melbourne and supporting prices in other cities. However, it is unclear whether demand will be sustained at these lower yields, particularly if yields elsewhere and on other assets increase over time.

Liaison with banks suggests that Chinese institutional investors and developers fund much of their activity with equity from their own balance sheets and loans from Chinese banks, including their Australian branches. While Australian-owned banks do lend to foreign developers, this is generally to long-standing customers or, occasionally, by taking the lead on syndicated deals in which foreign banks provide a large portion of the funding or take the first exposure to credit losses. As with housing lending, the main risk to the Australian banking system is therefore indirect; were Chinese or other investors and developers to sell down their portfolios or were inflows of investment to fall, prices of commercial property and development sites could decline, weighing on the banking system's broader commercial property exposures. ❖