How foreign purchases of U.S. homes impact prices and supply

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Housing markets are preferred destinations for foreign investors looking for yields, vacation homes or safe havens, or for those dodging tax restraints and corruption crackdowns in their home countries. But demand for U.S. homes from foreign investors, especially Chinese, pushes up home prices, exacerbating concerns over housing affordability, according to new research from Wharton.

House prices grew 8 percentage points more in U.S. zip codes with high foreign-born Chinese populations from 2012 to 2018, according to a paper titled "Global Capital and Local Assets: House Prices, Quantities, and Elasticities," authored by Wharton doctoral student Caitlin Gorback and Wharton real estate professor Benjamin Keys.

"The big picture is we have an affordability crisis for housing in the cities where the jobs are," Keys said. "One of the real tensions in the U.S. housing market is that the places that are seeing sharp job growth are not creating new housing quickly enough to accommodate that job growth."

The starkest example of disconnects between job growth and housing is the San Francisco Bay Area and specifically San Mateo County, said Keys. Since 2012, that region has had about a 30% increase in employment, but less than a 10% increase in housing units, he added.

Keys blamed those housing shortages on zoning restrictions that deter new homebuilding, and rising construction costs. "There are about six times as many new jobs as there are new housing permits," he said. "There are a lot of hoops to jump through to get anything built in these places, especially to build in a way that is dense."

Foreigners buying U.S. homes potentially exacerbate that problem of affordability, Keys continued. Chinese buyers have led foreign investments in U.S. homes for the past seven years. In 2019-2020, they bought U.S. home properties worth $11.5 billion, or little more than a sixth of the total, according to a report from the National Association of Realtors (NAR). Other investors in the top five came from Canada, Mexico, India and Colombia, in that order. (Colombia last year replaced the U.K. as the fifth-largest country of origin of foreign buyers). Foreign buyer purchases made up 4% of the $1.7 trillion existing-home sales last year, the NAR report noted.

The research by Gorback and Keys also shows that house prices and rents have risen in places that have seen large doses of foreign investment. "That is in large part because the places where you see foreign buyers are those same places that have more dynamic economies and have more jobs."

About half of the homes that foreigners buy are used as primary residences; the others serve as vacation homes, second homes or a pied-a-terre they visit occasionally, said Keys. "For example, a lot of the Canadian investment in U.S. homes is from snowbirds buying Florida houses."

The Reach of a 'Demand Shock'

Using foreign investment as a "demand shock," the paper also looks at how responsive housing development is to changes in price. "If prices rise in a market, does that spur construction? Does that lead to shovels in the ground?" asked Keys. Different markets respond differently to those triggers, and much depends on the availability of alternative locations nearby, he noted.

The study found that housing markets are relatively inelastic to price changes in the short run of about 10 years. "Housing prices can move around much more rapidly than housing construction can," said Keys. He added that "coastal markets and markets that have had historically tighter zoning requirements appear to be more inelastic over this period," adding that this finding is consistent with prior research.

Keys noted that their research provides "a new empirical estimate of these elasticities that hasn't been estimated using this approach or over this time period." It makes it possible "to compare and contrast and hopefully to calibrate urban economics models related to how responsive we would expect housing markets to be to different types of shocks," he added.

The "demand shock" of foreign investment also triggers ripple effects in housing markets, the study found, citing Seattle as a case example. "In the case of Seattle, when you drill down geographically, you see this pattern of differential house price growth, not just in the high foreign-born neighborhoods, but in the neighborhoods that border those neighborhoods," said Keys.

The Seattle example is part of the study's computation of the impact foreign capital flows have on house prices and supply for the largest 100 markets in the U.S. It found that local housing markets are price inelastic in the short run, but that is heterogeneous (or varies) across markets. Seattle displayed "a spillover effect" where investment in foreign-born Chinese neighborhoods pushes up housing prices in the nearby neighborhoods as well, Keys continued. Seattle also absorbs some of the demand redirected from Canada, where cities like Vancouver deter foreign ownership of homes through taxes, including on ownership of vacant homes, he added.

Redirected Foreign Demand, Volatility

The U.S. housing market is also particularly sensitive to tax restraints many countries impose on foreigners buying residential properties in their jurisdictions, the paper found. Some of the investors turned away from those countries head to the U.S., which does not have those tax restraints.

Chinese investments in U.S. housing reflect in part a flight of capital from China in recent years, said Keys. "A big part of that was about wealthier Chinese citizens moving their money abroad to avoid taxes and to avoid scrutiny," he added. In fact, China in 2016 experienced "the greatest episode of capital flight in history," according to a Wall Street Journal report at the time.

As those investors turned their attention to the U.S., its housing markets turned out to be more sensitive than previously thought, said Keys. "One surprising finding in our study is how responsive foreign investment is to tax policies imposed abroad," he added. "The takeaway for us is that these policies that are being imposed in countries like Singapore, Australia, Canada and New Zealand have a direct effect on the U.S. housing market."

Several countries consciously regulate foreign investments in residential properties, recognizing the undesirable effects some of that could have, especially with speculation. The paper documents 10 policy events in five countries between 2011 and 2018 that made the U.S. housing market "relatively cheaper to invest in." The governments in those countries used tax policy to deter foreigners from buying housing properties and to curb speculation.

Singapore was the first to introduce a foreign buyer tax in 2011 in the form of a stamp duty; it progressively increased that to 20% by July 2018. Hong Kong levies stamp duties of 30% on nonresident home buyers, which includes a duty on those who are not first-time buyers, including residents.

Others that levy taxes on foreign buyers of residential properties include the governments of British Columbia and Ontario in Canada; Victoria in Australia; and New Zealand. British Columbia also levied a speculation and vacancy tax in certain communities. Many countries impose such "foreign real estate buyer taxes" in order to deter foreign capital inflows and stabilize housing prices in their markets, the paper's authors noted.

While foreign investments have lifted home prices in select U.S. markets, they have declined in the last three years. Foreign inflows had been steadily increasing from $66 billion in 2009-2010 to $153 billion in 2016-2017, but have since dropped to $74 billion last year (2019-2020), according to the NAR report cited earlier.

Chinese investments in U.S. housing have followed that pattern, falling from nearly $32 billion in 2016-2017 to $11.5 billion last year. Keys attributed that to China's capital controls in recent years and pressure on its citizens to unwind their investments abroad in order to shore up its domestic economy, as the Wall Street Journal reported. The U.S.-China trade war, U.S. controls on immigration and unfavorable exchange rates have also dampened Chinese investments in U.S. housing, he noted.

What's Next for U.S. Housing?

Keys said his study is timely now because "there's a big question about how the housing market will come back after COVID-19." He noted that several housing submarkets in the U.S. have seen "huge inflows of foreign investment" over the last 10 years. "If that dries up, it would represent an opportunity for domestic buyers and put downward pressure on prices, but that may be a bad thing for existing home owners."

If the pandemic persists, foreign investments in U.S. homes would continue their decline, and cause home prices to fall, Keys predicted. In that setting, "clearly, there would be an advantage for domestic homebuyers," said Keys. "[Also], a decline in foreign investment may relax some of the affordability constraints to a modest degree in cities where the jobs are more plentiful than the housing in them."

Some of the space vacated by Chinese and Canadian investors could be filled by those from Mexico, India and Colombia, which have shown rising appetites for U.S. homes. But such demand is "highly dependent" on U.S. federal policies, said Keys. U.S. policies on combating COVID-19 is the first factor, he added. "Relative to the alternative markets where foreign buyers may be considering, we as a country have done the worst job managing the COVID crisis. Investors who are deliberating between the other megacities of the world and are concerned about public health will steer their investments away from the U.S. at the moment."

The outcome of the forthcoming U.S. presidential election could change some of those stakes. "At the moment, it feels like a difficult time for immigrants to feel welcome in this country, given the set of federal policies in place and the barriers to immigrate," said Keys. "So, a change in administration that is attached to a change in those policies could certainly reinvigorate investment in the U.S. housing market."

Policy Prescriptions

Could the U.S. do something to protect its housing markets from unfavorable foreign investment? Policy makers could weigh the speed and magnitude at which foreign capital flows would decline, if the U.S. were to impose "a large foreign buyer tax" to deter foreign investments in housing, said Keys. Such investments "appear to be quite elastic" to the imposition of a foreign-buyer tax, he added.

"My concern is largely one of unused housing units, especially in expensive areas," said Keys. A vacancy tax similar to that in Vancouver is "worth considering," he added. "One of the things that rapid flows of investment could do is they can distort construction efforts and put additional resources towards building properties that foreign investors may want only in the short term, but then that housing stock will last a very long time."

Keys also urged state and local governments to re-examine zoning and height restrictions, and the time delays that permitting for new construction entails. "The number of hurdles to jump through makes it so challenging to develop affordable housing in the U.S.," he added. Some states like California have already begun taking legislative action to push local communities to change their zoning rules, he noted.

More information: Caitlin Gorback et al. Global Capital and Local Assets: House Prices, Quantities, and Elasticities, (2020). DOI: 10.3386/w27370

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