



# FOREIGN INVESTMENT IN U.S. REAL ESTATE

## Current Trends and Historical Perspective

Prepared by the Research Division of  
THE NATIONAL ASSOCIATION OF REALTORS®

November 2008



NATIONAL ASSOCIATION OF REALTORS®

*The Voice for Real Estate®*



## Preface

Through the early years of the 21<sup>st</sup> century, the U.S. real estate market was the envy of most nations in the world. For the residential sector, housing activity posted record numbers in the first half of the decade. Homeownership in the U.S. rose from 65.4 percent in 1996 to peak at 69.0 percent in 2004 – a record. In 2007, as home sales declined home ownership slipped slightly but still registered 68.1 percent. Commercial real estate, after under-performing in the years after the 2001 recession, returned to health in the 2002-07 timeframe. There was significant investment in and absorption of commercial space. Vacancy rates declined, and rental rates increased in retail, office, industrial, and multifamily sectors.

Foreign investment has helped to support the U.S. real estate market: the globalization of the economy extends to real estate. Foreign governments, international financial institutions, foreign companies, foreign pension and equity funds, and foreign individuals have all observed the performance of U.S. real estate. In many cases foreign investors have entered the U.S. residential and commercial markets; U.S. real estate provides a safe haven and opportunity for many foreign investors.

There are few barriers to foreign investment in U.S. real estate. Foreign investment in U.S. real estate companies—either directly or through ownership of company stock -- allows the companies to expand, creating new jobs and expanding services for real estate consumers. In addition, foreign capital flowing into U.S. financial markets contributes to the health of our nation's economy by putting downward pressure on long-term interest rates.

This report examines the trends in and impacts of foreign investment in U.S. residential and commercial real estate markets. The report examines the level of foreign investment in real estate and real estate companies through 2007, along with a breakdown of the major countries with significant holdings in the U.S. The data in this report reflects conditions prior to the financial market dislocations and onset of recessionary conditions in 2008. Post 2007 foreign investment in U.S. real estate has been significantly curtailed pending resolution of liquidity, stability, and solvency issues for the overall financial system.

## **Executive Summary**

The U.S. real estate market has continued to attract investors from outside the United States. Foreign investors are attracted to the U.S. market for various reasons, not the least of which is that foreign participation in U.S. real estate is relatively free and open. Investment from other countries also helps to stabilize U.S. interest rates and, helping to keep mortgage interest rates low, helps to spur commercial investment, and assisting consumers in becoming homeowners.

### **Foreign Investment in the U.S.**

Foreign direct investment holdings in U.S. real estate companies totaled \$41.7 billion in 2007. In 2007, Latin America, Australia, Germany and Japan accounted for more than half – 52 percent -- of foreign direct investment in U.S. real estate. Foreign investment in *all* U.S. asset holdings increased from \$2.16 trillion in 2006 to a record \$2.42 trillion in 2007. The amount of private foreign market ownership of U.S. stocks and bonds also rose -- to over \$6.13 trillion in 2007, a 14 percent increase from 2006.

### **Impact of Foreign Funds on Interest Rates**

The flow of foreign funds into the U.S. securities market helps to put downward pressure on long-term interest rates. NAR estimates that in the absence of foreign capital, long-term interest rates would probably be higher than current levels.

### **Impact on the U.S. Economy**

Foreign investment helps to create jobs through direct and indirect investment as well as having a favorable impact on commercial real estate. There also appears to be a significant impact on the economies of a number of states from foreign purchases of residential properties.

### **Looking Ahead**

After a number of years of increased foreign investment, the prospects for continued increases in foreign direct investment in U.S. real estate are likely to be reduced in the short run. The U.S. economy, while posting GDP growth for 2007, in 2008 appears to be in a recession. There has also been a modest gain in the strength of the dollar, reducing foreigners' purchasing power for homes in this country.

The current recessionary environment is also making U.S. real estate somewhat less attractive to foreigners in the short run. Consumer spending in the U.S. has slowed. As of November 2008, significant job losses in the U.S. economy – particularly in office space-using sectors such as financial services and real estate, accompanied by losses of jobs manufacturing and construction – suggest that the demand for office and industrial space will decrease. The one positive portent for the future is that U.S. exports are up, thus generating a modest need for increased warehouse space. In addition, the demand for multifamily properties should remain fairly solid, as potential first-time home buyers continue to rent while waiting for the credit crunch to abate.

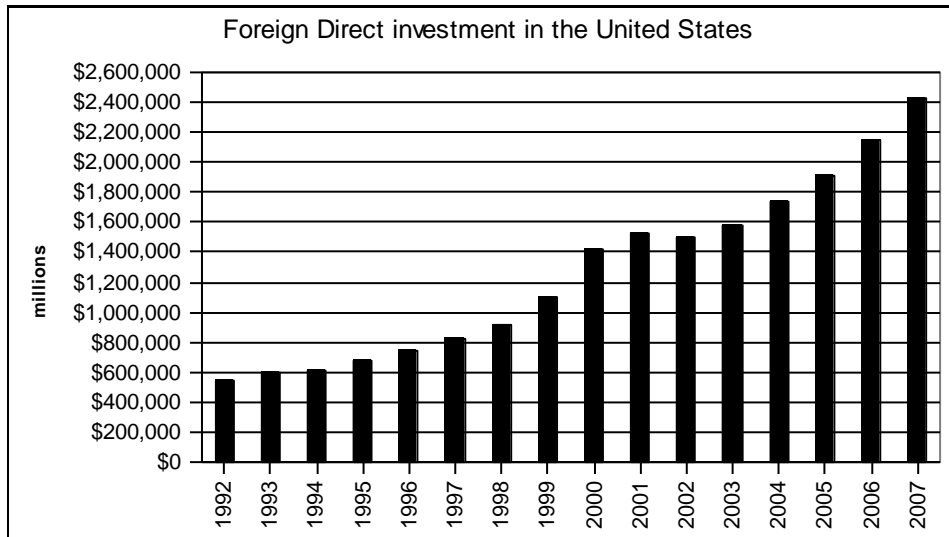
## **Foreign Direct Investment in the U.S. and in U.S. Real Estate**

The expanding globalization of the world economy has spurred increased investment across international borders. This report discusses the impacts of foreign investment in U.S. assets and real estate and analyzes the resulting effects on the overall U.S. economy. In the case of the commercial sector, there has been substantial foreign investment in U.S., including office buildings, multi-family housing, retail, and industrial space. With the advent of the current recession, foreign investment has slowed, and a number of emerging markets—particularly China, Brazil, and India—have attracted increasing international investor interest in lieu of U.S. opportunities. The U.S. commercial market is temporarily depressed: vacancy rates have been rising along with increased pressures on rental rates. However, this is expected to change as economic conditions improve in mid 2009. In the case of the residential sector, in 2007, the U.S. housing market continued a period of slower activity with a 13 percent decline in total yearly sales for existing homes from the previous year. New home sales dropped more than 35% from their level in 2006. Home prices declined as well. These sales and price declines followed a sequence of four record years of sales and the highest increases in inflation-adjusted home price appreciation in over 40 years. Recently the decline in residential sales has stabilized in the neighborhood of 5 million sales per year in 2008.

### **Commercial Properties**

In recent years there has been increased demand for foreign ownership of U.S. commercial properties. One way to determine the extent of international engagement in U.S. real estate is to examine trends in foreign direct investment in the U.S. Figures from the U.S. Department of Commerce—focused on commercial and multi-family properties--show a continuing rise in investment by foreigners from 2002 to 2007. By the end of 2007, the level of foreign direct investment (FDI) in the U.S. reached an all-time high of almost \$2.42 trillion, a 12.6 percent increase from the level in 2006 and a 27 percent increase over the level in 2005.

**Graph 1: Foreign Direct investment in the United States<sup>1</sup>**



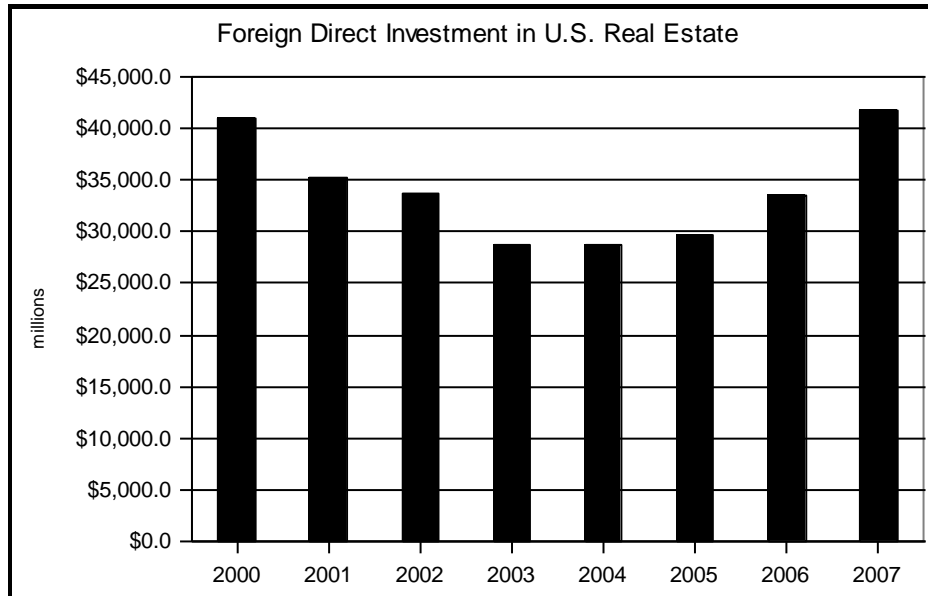
The amount of foreign investment in the U.S. real estate sector (excluding rental and leasing) sector rose in 2007 to \$41.7 billion, continuing the uptrend that began in 2003. That is an encouraging sign in light of the downturn in the U.S. real estate market that began in 2006. These figures on foreign direct investment in American real estate companies, as measured by the Commerce Department, include only the purchases of stock in U.S. real estate (and related) companies. They do not reflect, for example, a vacation home purchase by foreigners.<sup>2</sup> However, they do include transactions related to commercial real estate as well as supporting stock prices of residential real estate companies such as Reology, previously known as Cendant.

---

<sup>1</sup> Source: Bureau of Economic Analysis, Department of Commerce.

<sup>2</sup> This home sale would, however, show up in the existing-home sales figures produced by the National Association of REALTORS®, or the new home sales statistics released by the U.S. Census Bureau.

**Graph 2: Foreign Direct Investment in U.S. Real Estate<sup>3</sup>**



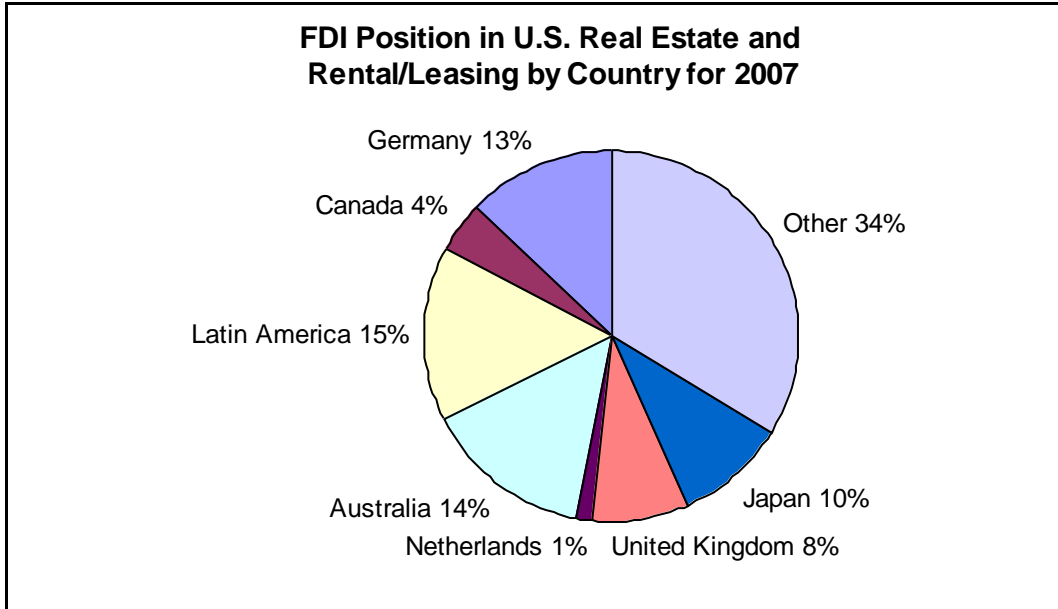
Foreign investment in U.S. real estate companies comes from many different countries, but several dominate. The primary players, in order of their level of U.S. investment in 2007 were:

- Latin America
- Australia
- Germany
- Japan
- United Kingdom
- Canada
- Netherlands
- Other Countries

<sup>3</sup>

Source: Bureau of Economic Analysis, Department of Commerce.

**Graph 3: FDI Position in U.S. Real Estate<sup>4</sup>**



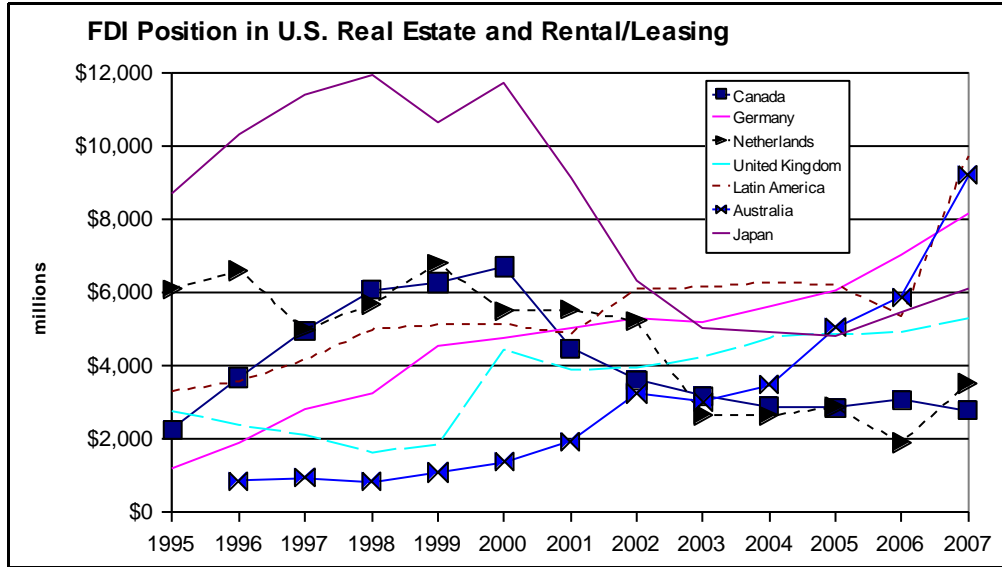
The increase in Latin American investment is significant. Real estate investment from Latin America, after being relatively flat from 1998 to 2001, began a steady ascent from 2002. In 2006, Latin America ranked fourth in terms of their foreign investment position and accounted for just over 12 percent of foreign investment in U.S. real estate. In 2007, Latin America ranked first, investing \$9.7 billion in the U.S. real estate market. Japan, which until 2004 had consistently accounted for the highest investment share, dropped to third place in 2006 and in 2007 was in fourth. Investment from Australia took the opposite path, rising from \$1.3 billion in 2000 to \$5.8 billion in 2006 and \$9.2 billion in 2007. Investment by Germans has also been steadily rising since 2000 to exceed \$8 billion in 2007.

Other countries have curtailed their level of investment in U.S. real estate. Investment from the United Kingdom, after rebounding in 2006 to surpass the previous peak investment level set in 2000, made up 8 percent of foreign investment in 2007 – totaling \$5.3 billion, compared to 11 percent in 2006. Foreign investment from Canada has been steadily declining from a high of about \$6.7 billion in 2000 to \$2.7 billion in 2007.

<sup>4</sup>

Source: Bureau of Economic Analysis, Department of Commerce.

**Graph 4: FDI Position in U.S. Real Estate<sup>5</sup>**



In addition to purchasing stock in U.S. real estate companies, foreign companies may choose to buy U.S. real properties. The reasons include the desire to expand operations in the U.S. and thereby avoid tariff restrictions, to lower transport costs, or to take advantage of America’s skilled workforce. In 2007, eight percent of all U.S. commercial property was purchased directly by foreign entities.

**Table 1: Foreign Purchases of Commercial Properties<sup>6</sup>**

**Foreign purchases of Commercial Properties, 2006 and 2007**

Main Type	2006	2007
Apartment total	\$2,911,283,305	\$3,760,095,387
Industrial total	\$1,401,602,728	\$3,082,367,297
Office total	\$12,924,926,170	\$18,846,622,943
Retail total	\$7,045,754,969	\$14,567,735,537
Grand total	\$25,926,694,637	\$51,459,775,135

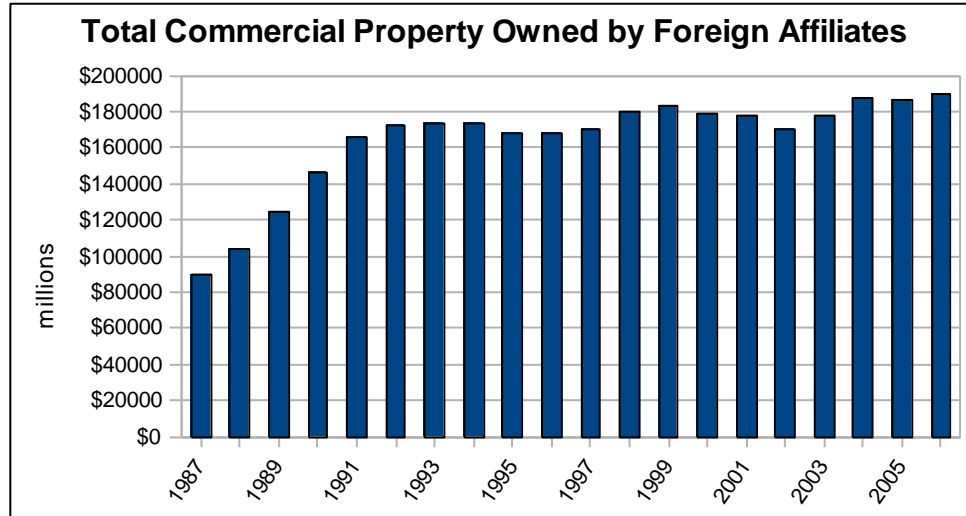
Foreign holdings through U.S. affiliates of U.S. commercial properties totaled nearly \$190 billion in 2006 – the latest year for which data are data available – rising slightly from the level in 2005 and the highest level on record. Over a longer time frame, total holdings of U.S. commercial properties more than doubled from 1987.<sup>7</sup>

<sup>5</sup> Source: Bureau of Economic Analysis, Department of Commerce.

<sup>6</sup> Source: Real Capital Analytics.

<sup>7</sup> According to the BEA, this data is calculated by combining BEA's annual surveys of Foreign Direct Investment and BEA estimates for firms not in the sample. A U.S. affiliate is defined as any firm in “which there is foreign direct investment – that is, in which a single foreign person owns or controls, directly or indirectly, 10

**Graph 5: Total Commercial Property Owned by Foreign Affiliates<sup>8</sup>**



International commercial property sales in the U.S. were down in the first half of 2008 by 50% compared to the first half of 2007. This was due to reduced credit availability, the decline in major portfolios transactions, and the slowing of the global economy. Important international commercial markets have included Tokyo, London, New York, Hong Kong, Los Angeles, San Francisco, Chicago, and the District of Columbia. Emerging markets have become of increasing importance, including China (\$35B), Brazil (\$4.2B), India (\$6.4B), and Russia (\$4.9B). Consequently, Moscow, Beijing, Seoul, Taipei, and Sao Paulo are increasingly important cities for commercial transactions.

### **Residential Properties**

The top six countries of origin for foreign purchasers of U.S. residential real estate in the 2007/2008 time frame were Canada, the U.K., Mexico, China, India, and Germany according to a recently released NAR survey. The top four destination states were Arizona, California, Florida, and Texas. Over 25% of REALTORS® had at least one foreign client in the 2007/2008 time frame. The median price for a residential property was \$297,400, compared to a median price for all U.S. real estate in 2007 of \$217,900. Favorable currency exchange rates were mentioned as a major driver of transactions according to the survey.

---

percent or more of the voting securities or an equivalent interest. The financial and operating data of U.S. affiliates cover the entire operations of the U.S. affiliate, irrespective of the percentage of foreign ownership.” Under BEA’s definition, “commercial property comprises all commercial buildings and associated land owned by the affiliate that are either used or operated by the affiliate or leased or rented to others. Commercial buildings include apartment buildings, office buildings, hotels, motels, and buildings used for wholesale, retail, and services trades, such as shopping centers, recreational facilities, department stores, bank buildings, restaurants, public garages, and automobile service stations.” The BEA produces this data a year behind the foreign investment data. Consequently, 2003 is the most recently year of reported data.

<sup>8</sup>

Source: Bureau of Economic Analysis, Department of Commerce.

Overall, possibly as much as 10 percent of total REALTOR® time was spent on foreign transactions, suggesting that the foreign market represents a significant opportunity for some REALTORS®. In fact, more than 20 percent of REALTORS® indicated that their business with international clients had increased in the past five years. If one were to assume a median price of \$297,400, that completed transaction are proportional to time spent, and that for the top four destination states total residential sales are at their second quarter 2008 level (Arizona—110,000; California—390,000; Florida—270,000; Texas—500,000) then one has a rough estimate for the four leading states of the yearly value of international residential sales in the \$38 billion range. Additional work in firming-up this guesstimate is clearly needed, but the guesstimate does provide a first approximation of the overall importance of international residential transactions.

Another factor related to international real estate activity is the home buying behavior of foreign born U.S. residents. Foreign-born purchases of residential real estate are expected to rise steadily as a result of continued immigration. Nearly half of the recent increase in the overall U.S. population is due to newly arrived immigrants. Given the strong relationship between rising homeownership rates and the length of time in the U.S., home purchases by immigrants will have a sizable impact on the housing market for the foreseeable future. Foreign immigration into the U.S. in the 1990s was the highest since the wave of Eastern European immigration at the end of the 19<sup>th</sup> century. Over 18 million new residents have arrived since 1990. The homeownership rate rises rapidly the longer a new resident resides in the U.S. The homeownership rate is about 18% for new residents who have arrived in the country in the last five years, but is 78% among those who arrived more than 30 years ago.

### **Foreign Investment in the U.S.**

Foreign investment is an important component in the U.S. economy:

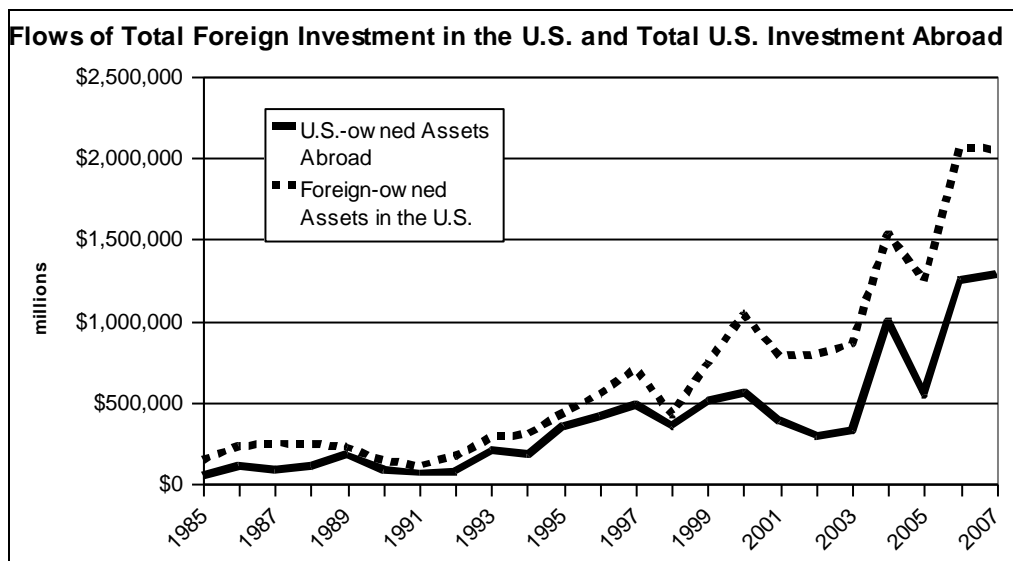
- Foreign market ownership of stocks and bonds in U.S. real estate related companies.
- The flow of foreign funds into the U.S. securities markets.
- The creation of jobs through either direct investment in a business by providing funding for domestic businesses to reinvest or spend money on expansion.
- Important international financial flows.

The United States has moved from a situation in which international trade was of minor importance and in which the U.S. was predominant in its overall economic capacity to a situation in which it is one of a number of major economic areas. International trade and investment flows are of increasing importance in the world economy; the U.S. is not an isolated island in economic terms. For example, according to a November 2008 study from the National Association for Business Economics, foreign trade is expected to provide a significant level of stimulus to the otherwise weak U.S. economy in 2008. The overall trade gap (balance of payments basis) is now slated to be just \$555 billion in 2009, well below the \$680-billion deficit predicted for 2008.

In terms of financial assets, the U.S. leads the rest of the world, but other areas have major resources: U.S. (\$56T), Euro Area (\$38T), U.K. (\$10T), Other Western Europe (\$6T), Russia (\$4T), Asia (\$14T), Japan (\$19T), Latin America (\$4T), Australia/New Zealand/Canada (\$7T), Middle East (\$7T), Hong Kong/Singapore (\$5T). Inflows of foreign savings to the U.S.

have been substantial. For example, the net capital inflow has been estimated to be in excess of \$500 Billion per year over the time period 2005-06. In comparison, net inflows to Eastern Europe were estimates at \$40 Billion, and to the U.K. at \$34 Billion. Major suppliers of capital to world markets were the Middle East (\$84 Billion), China (\$92 Billion), and Japan (\$122 Billion). The following graph illustrates the overall level of U.S. Foreign Investments.

**Graph 6: Flows of Foreign Investment<sup>9</sup>**



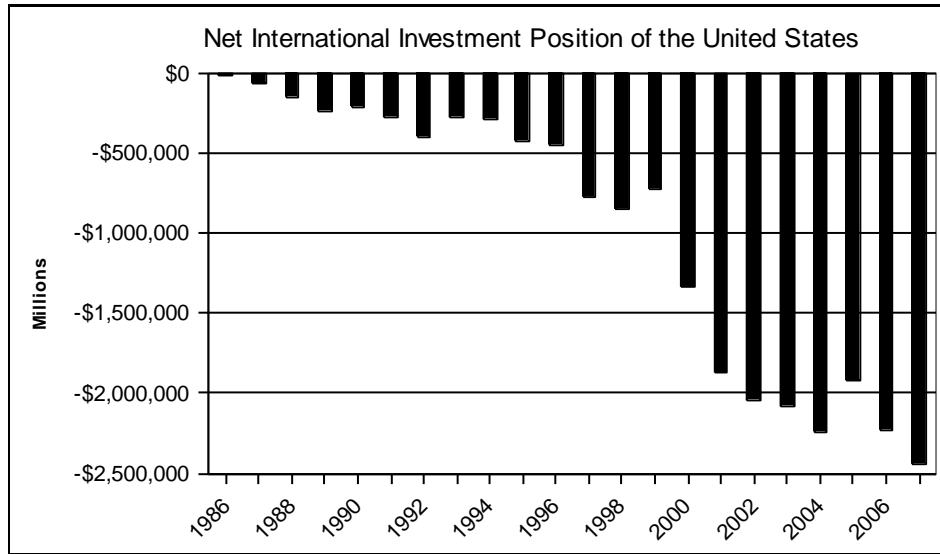
One noteworthy event in recent years has been the variability of direct investment by foreign investors in the U.S. and direct investment by U.S. investors abroad. For both groups these categories had trended solidly upwards in the 1980s and 1990s, reflecting steadily increasing movements of financial capital across borders from liberalized capital markets. However, direct investment by both parties fell in 2001 and 2002. The onset of global recession in 2001 and subsequent sluggish recovery in 2002 retarded international capital movement. By 2003, however, gross investment – both inflow and outflow - returned to positive growth, and in 2007 both figures surged to record highs.

The ever-increasing annual influx of funds from abroad has also resulted in steadily increasing holdings of U.S. financial assets by foreigners. By the end of 2007, the U.S. net international investment holding position (foreign holdings of U.S. assets minus U.S. holdings of foreign assets) was a (negative) \$2.44 trillion – reflecting the fact that the value of foreign investments in the U.S. continues to exceed the value of U.S. investments abroad. Most of this increase was due to the strong net foreign purchases of U.S. securities.

<sup>9</sup>

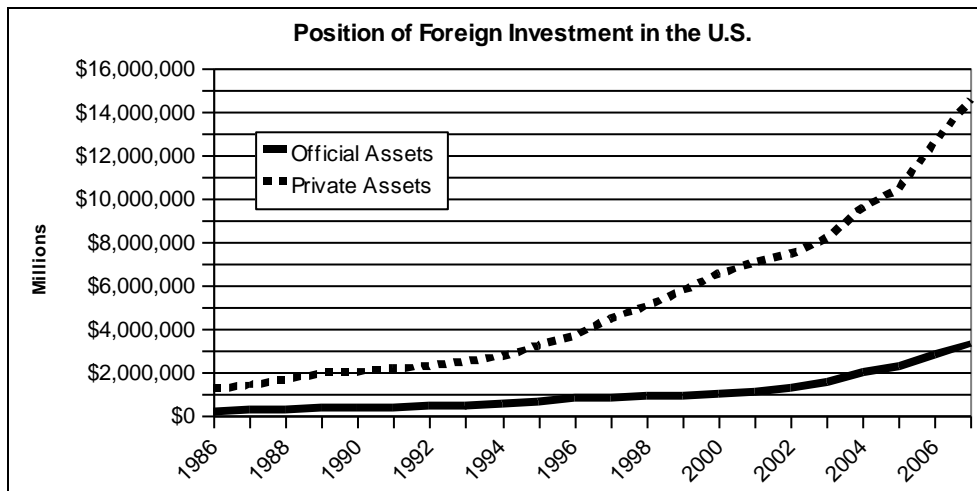
Source: Bureau of Economic Analysis, Department of Commerce.

**Graph 7: Net International Investment Position<sup>10</sup>**



In terms of gross foreign investment holdings of U.S. assets, more than \$14 trillion of private assets were held by foreigners in 2007 along with more than \$3 trillion of official (government) assets. Private foreign investment has sharply outpaced official foreign government investment in recent years. Because private capital is not subject to negotiations and agreements between governments, a sudden pullout of funds could disrupt U.S. financial markets and the U.S. economy.

**Graph 8: Position of Foreign Investment in the U.S.<sup>11</sup>**



<sup>10</sup>

Source: Bureau of Economic Analysis, Department of Commerce.

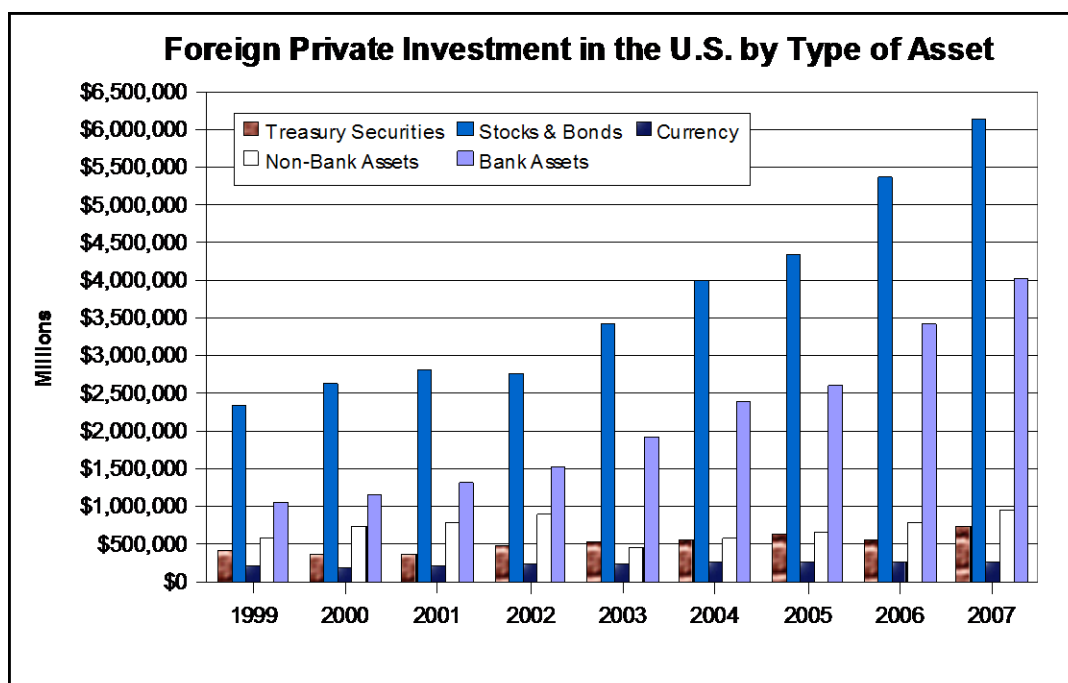
<sup>11</sup>

Source: Bureau of Economic Analysis, Department of Commerce.

Private foreign investment posted record levels in both 2006 and in 2007. This private investment was in the form of annual financial flows into assets such as stocks, bonds, U.S. currency, and other paper assets such as CDs and money market accounts. An increase in the flow of funds from abroad can help reduce domestic interest rates. In turn, lower interest rates stimulate investment and consumption of larger purchases such as homes and automobiles.

While investment in currency has been relatively stable over the last ten years, annual private foreign purchases of U.S. Treasury securities (bills and bonds) have risen consistently in recent years. Although the demand shows some cyclicality, it has had a generally increasing trend as global instability continues to generate high demand for safe assets like Treasuries, bank assets, and cash. By far the largest share of foreign investment in the U.S. is in stocks and bonds; the level of foreign investment in these assets rose to more than \$6.1 trillion in 2007.

**Graph 9: Foreign Private Investment<sup>12</sup>**



As of the end of 2007, the total U.S. investment position holdings of foreign government and private entities totaled more than \$17.9 trillion. Foreign governments owned about \$3.3 trillion (mostly in U.S. stocks and bonds) while private holdings totaled over \$14.5 trillion. Of that figure, holdings of U.S. Treasury securities totaled over \$734 billion; private direct investments (10% or greater company ownership) totaled about \$2.4 trillion; general ownership of private sector stocks and bonds was almost \$6.1 trillion; U.S. dollar currency deposits held were \$271 billion; and U.S. bank assets owned were over \$4 trillion.

<sup>12</sup>

Source: Bureau of Economic Analysis, Department of Commerce.

## CONCLUSIONS

Much foreign investment in the U.S. comes from investors searching for assets with superior, but safe, performance. The continuation of this trend will depend on whether foreign economies are performing well, thereby creating new capital for investment, and if they are doing well, whether they are outperforming the U.S. economy and, in so doing, providing an alternative place for investment. We live in a global economy – what happens on Wall Street impacts the markets in countries around the world.

Despite the housing slowdown which began in 2006 and the current economic recession, international clients account for a significant share of both residential and commercial business in the U.S. As the world's economies become increasingly integrated one would expect international transactions to become of increasing significance—both in terms of foreign residents and investors purchasing real estate in this country and in terms of U.S. residents and/or investors—including retirees and vacationers—acquiring foreign properties. Current market conditions in the U.S. make U.S. property very attractive to foreign buyers, particularly if the buyers can bring financing during these times of reduced credit availability.

The U.S. economy performed well, albeit not spectacularly – in 2007. This was reflected in the healthy activity of foreign investment. But we are unlikely to see any improvement for 2008. Until the U.S. economy recovers from its current crisis, it is probable that foreign investors – much like U.S. investors – will wait for that recovery before increasing their share in U.S. real estate.