Why Chinese investors find Australian real estate so alluring

Chinese investors are often blamed for Australia's escalating house prices but a number of factors might mean the demand will drop off in coming years.

A recently released report found investment in residential real estate by the Chinese is slowing. As the gap in rental yields between the two countries closes and house prices increase, Australian residential real estate is beginning to look less attractive. The lifting of restrictions on Chinese urban residential property ownership and personal investment monetary restrictions may also play a part.

China has A$1.34 million high net worth individuals and 568 billionaires. Their combined net worth is equivalent to Australia's GDP.

Many Chinese investors have access to both legitimate and hidden income and wealth and seek to invest both in overseas real estate. This is at a time when China is in the grip of its own housing affordability crisis.

Why Australia has seemed attractive

In 2015, Chinese investors ploughed approximately A$6.8 billion into Australian commercial and residential real estate. Current Foreign Investment Review Board (FIRB) policies channel international real estate investment funding into new dwellings, creating additional jobs in construction and supporting economic growth.

Though temporary Australian residents may be required to sell older residential property when they leave Australia, many foreign nationals are able to retain, rent out, sell or live in newly constructed dwellings. This is a major draw card for Chinese investment in new residential buildings.

Other pull factors include Australia's stable financial institutions, compared to China, well regulated land title system, buoyant real estate market, high capital gains rates in major cities and lower deposit requirements when compared to China.

Australia's Foreign Investment Review Board (FIRB) may keep an eye on these factors when considering new foreign investment in the housing market, but it struggles to counteract the push effect of Chinese property law restrictions and investor needs.

Factors in China at play

Conditions in China's economy and regulatory environment push Chinese investors to focus on overseas markets. The depreciation of the Chinese currency is a significant force. As this currency is devalued, Chinese investors reconsider what and where they can afford to purchase.

Australia's rental yields of 2-3% in major cities are twice that of China's. Legislative changes to residential property investment in China also makes Australia look appealing.

China has a dual property ownership system that segregates rural and urban land ownership systems. Rural cooperatives own the rural land ownership rights. Cooperative members can only sell to other members of the same rural cooperative. This limits competition for rural land and keeps rural land prices low. It also means that rural land in China is an unattractive investment choice for Chinese.

Urban land, on the other hand, remains state owned with a 70 year lease system to housing owners. The system limits ownership of urban residential buildings to people with urban registration or those that have lived in and paid taxes in the same urban area for five consecutive years. This situation stops many Chinese from being able to purchase urban residential property.

Between 2011 and 2015, those who did have the appropriate registration were limited to a maximum purchase of two residential properties within their urban area – one property to live in and one as an investment. This limitation still applies in Beijing.

The limitation was put in place to counteract major housing affordability discontent as an increasing number of people were locked out of the housing market. This problem is exacerbated by the 30% deposit requirement on residential real estate purchases. The combination of these factors forces many Chinese investors and home owners into purchasing properties on China's black market where ownership is uncertain or seek investment opportunities outside China.

The Chinese State Administration of Foreign Exchange introduced new regulations to tighten the flow of capital from China in November 2016. This agency is tasked with the approval of outgoing overseas payments of more than US$5 million. However, most housing acquisitions in Australia fall below this limit.

From 2017, a new rule was introduced to limit the yearly foreign currency holding to US$50,000 for individual investors. However, this is sufficient for a minimum housing deposit in Australia.

Additionally, larger Chinese development companies operating in Australia are known to sell individual residential units "off the plan" directly to Chinese property investors. Where this is the case, the developer has a vested interest in finding ways to circumvent the new limits on foreign currency holding in order to settle a contract. However, it will take time for developers to adjust their methods.

As house prices increase, rental yields generally fall. This is due to the large amount borrowed by investors compared to what they receive in rental income.

Though rent prices have increased significantly in Melbourne and Sydney, they have not kept pace with house prices. Rental yields have fallen in major cities.

In China, where the rental yield is 1-1.5%, some investors reassess whether it is worth the effort of renting out their properties. Instead, they rely on the capital gain to create a profit while leaving the property vacant, preventing wear and tear to it. This practice has serious implications for the supply of rental properties in China.

As Australia continues to struggle with escalating house prices and decreasing rental yields, residential real estate investment becomes less attractive as a long term investment for Chinese investors. The reliance on capital gains may result in higher numbers of vacant properties in Australia, counteracting the FIRB's intentions.

The restrictions enacted by Chinese regulators may slow the flow of money out of China in the short term. However, Chinese investors are likely to find ways to circumvent these restrictions. The lifting of restrictions on Chinese residential property ownership may refocus investment choice location to within China, however, there are indications that Chinese interest in Australian commercial real estate will remain strong for the present.