China's capital flight is distorting Vancouver, Toronto housing markets

By Barrie McKenna
June 4, 2016 – *The Globe and Mail*

It's time to stop tip-toeing around the root cause of recent froth in the Vancouver and Toronto real estate markets.

It's not about record low interest rates or shadowy foreign buyers.

It's about an unprecedented influx of Chinese money.

This week, another prominent voice – Bank of Nova Scotia chief executive officer Brian Porter – endorsed the idea of slapping a temporary luxury tax on foreign buyers, coupled with new tighter mortgage lending rules for everyone. Vancouver Mayor Gregor Robertson similarly advocates a special tax on foreign buyers and speculators.

It would be nice to think that the governments could wave a magic wand and make these two overpriced markets more affordable for young home buyers.

So far, neither the federal nor B.C. governments are biting.

It's not at all clear that restricting foreign buying and engineering devaluation would even work.

The experience has been mixed in Britain, Australia and New Zealand, which are facing similar surges of foreign buying. Australia moved in mid-2015 to limit foreigners to purchases of newly built houses and apartments, but the market continues to sizzle. In the past 12 months, prices are up more than 12 per cent in both Sydney and Melbourne, the country's two hottest markets. Britain and New Zealand have raised capital gains taxes to try to curb foreign buying.

This isn't primarily a Canadian issue; it's about China. The Vancouver and Toronto real estate markets are collateral damage in a global phenomenon. An unprecedented flight of capital out of China is under way. As much as $1-trillion (U.S.) in capital flowed out of China last year and the trend shows no sign of slowing down.

Canada is an attractive destination for Chinese buyers. We may think paying $1-million (Canadian) for a tiny bungalow is outrageous. But the weakened loonie and Canada's reputation as a safe haven could well make the same house look relatively cheap to a buyer in Shanghai.

Even more powerful than the lure of Vancouver and Toronto are the forces causing money to flee China. These include the risk of further devaluation of the yuan, imposition of more stringent capital controls, slower economic growth and the desire of many wealthy Chinese to educate their children overseas. Moving money offshore is all about wealth preservation.

No one knows exactly how much Chinese money has found its way into Toronto condos and Vancouver luxury homes. Canada Mortgage and Housing Corp., which only recently began trying to track foreign purchases, estimates that 7.4 per cent of condos built in the Greater Toronto Area since 2010 are owned by foreign buyers. The comparable figure for Vancouver is 6 per cent. It's still working on collecting data for single-family homes.

Foreign buyers now account for a quarter of Canada's luxury home market, according to a recent Royal LePage survey of real estate agents. If that's accurate, the share in some pockets of Vancouver or Toronto markets could be much higher. A back-of-the-envelope calculation by National Bank of Canada estimated Chinese buyers pumped roughly $20-billion into real estate in the two cities last year.

Determining what constitutes a foreign purchase is not easy. A typical scenario for many Chinese buyers is that a family member living in Canada – a student or spouse – purchases a property with offshore cash.

Proponents of restricting foreign purchases should be careful what they wish for. Deflating hot markets would have sweeping economic ramifications. The B.C. Finance Ministry has estimated that trying to curb foreign buying likely wouldn't work and could cause a raft of unwanted economic consequences, according to a document obtained by The Canadian Press. The document estimated that a 10-per-cent price decline in Greater Vancouver real estate prices would wipe out $60-billion worth of home equity and cause the loss of 4,000 construction jobs.

Governments could take measures to discourage house flipping and speculators who sit on vacant properties. They could also get a much better handle on what's happening in the market, including collecting reliable data on who's buying and where the money is coming from. But none of that is likely to affect the powerful forces driving prices higher.

A better course than engineering a devaluation would be to wait for the market to unwind naturally.