

**FOREIGN INVESTMENT IN RESIDENTIAL REAL ESTATE AS FDI:
TO RECOGNISE OR NOT TO RECOGNISE AS FDI – THAT’S THE QUESTION**

by
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A ubiquitous form of Foreign Direct Investment (FDI)¹ is investment in residential real estate. However, neither trade and investment treaties nor reports on investment reflect this reality. Presumably, investment in housing purchases and construction form part of larger industry categories, e.g. “unspecified” or “business activities”², or is obscured due to the elusive nationality of investors,³ consequently escaping classification as greenfield, M&A, or portfolio investment. Yet, reports in the public media and experiences in local communities, hosts of such FDI, reflect a different reality.

Interestingly, the two most recent and consecutive semi-annual reports of the Bank of Canada list household indebtedness and house prices as the two most important key risks to the stability of the Canadian financial system.⁴ One report identifies “stress emanating from China and other EMEs” as the third most important risk factor,⁵ whereas due to the latest governments’ (federal and provincial) intervention in the mortgage and foreign investor driven housing market, the second report relegates “fragile fixed income market liquidity”⁶ to third place. However, no authoritative statistics are available to gauge the importance of residential real estate as a portion of total Canadian inward FDI.

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¹ Foreign Direct Investment (FDI) is when a firm registered in country A (“home” country) acquires assets in country B (“host” country) and the acquisition comprises of management rights and control. This is distinguished from Portfolio investment which doesn’t confer control but consists of acquisition of bonds, financial instruments, or stocks for the purpose of financial return. When a certain constellation of investor interests align, a foreign investment activity may consist of both FDI and portfolio investment. Although this applies to some real estate transactions, the subject is beyond the scope of this paper. FDI takes several forms: “Greenfield” investment refers to the establishment of productive assets by the foreign firm in the host country; mergers and acquisitions (M&A) happen when a foreign firm merges with a host country firm and/or acquires it (also referred to as “brownfield” investment where the purpose is to use the existing facility to engage in a new production endeavour); or the purchase by the foreign firm of stocks of a host country firm, which entitles the purchaser with management rights.

² “Investor Nationality. Policy Challenges”, World Investment Report 2016, UNCTAD, pp. 13 and 58, respectively.

³ *Ibid.* Where identified, e.g. as “real estate, renting and business activity” with sub-category “real estate”, the latest data available date 2012, with numbers applicable to the US only but not to Canada, the UK, or Australia. See “Foreign direct investment flows by industrial sector: United States”, OECD (2014), *OECD International Direct Investment Statistics 2014*, OECD Publishing, DOI:10.1787/idis-201-en, p. 218. The above categories do not figure in the report’s aggregate FDI sector summary.

⁴ Bank of Canada, “Assessment of Vulnerabilities and Risks”, December 2016, and “Overview”, Financial System Review, June 2016, *ibid.*, p.2 and 1, respectively, www.bankofcanada.ca.

⁵ Bank of Canada, “Overview”, *ibid.*

⁶ Bank of Canada, “Assessment of Vulnerabilities and Risks”, *ibid.*

I wish to emphasise three points. First, that foreign investment in residential real estate is a major factor impacting domestic conditions of developed economies, and although representing one of the most common and old forms of FDI,⁷ has eluded recognition as such for too long. Second, FDI in housing raises unique challenges to the prevalent international investment regime. On the one hand, it is a distinctive form of FDI because involving the most private interest of any member of any community, namely home. On the other hand, similar to other high profile investments, it may propel adverse socio-economic,⁸ cultural, and political impacts of the sort attributed to FDI in mining, large infrastructure construction, etc., or leading to the Namur Declaration.⁹ And thirdly, due to its prominence as a capital asset in Western capitalist economies and societies, FDI in residential real estate elicits issues akin to national security concerns.¹⁰ Indeed, the Investment Canada Act, to which Canada's investment agreements are subjected (including the Canada-China Investment Promotion Agreement)¹¹ describes national security as comprising of “[the] potential impact of the investment on the security of Canada's critical infrastructure. Critical infrastructure refers to processes, systems, facilities, technologies, networks, assets and services essential to the health, safety, security or *economic well-being of Canadians and the effective functioning of government*”.¹² This is further articulated in Canada's National Strategy for Critical Infrastructure, meaning that “[c]ritical infrastructure can be stand-alone or interconnected and interdependent within and across provinces, territories and national borders. Disruptions of critical infrastructure could result in catastrophic loss of life, *adverse economic effects, and significant harm to public confidence*.”¹³

Vancouver's current residential real estate market, similar to that of select metropolitan hubs in other developed economies, exemplifies this paper's arguments.

⁷ Thomas Piketty, *Capital in the Twenty-First Century*, Belknap Press HUP, Cambridge: Mass., 2014 (translated).

⁸ See, for instance, “Lotusland Blues: One-in-five Metro Vancouverites Experience Extreme Housing and Traffic Pain; Most of Them Think of Leaving”, Angus Reid Institute Public Interest Research, 18 June 2015, <http://angusreid.org/vancouver-real-estate/>; Kerry Gold, “Affordable House Hunters Priced out of Vancouver Housing Market”, *Globe and Mail*, 13 May 2016, <http://www.theglobeandmail.com/real-estate/vancouver/affordable-house-priced->

⁹ Namur Declaration of 5 December 2016, <http://declarationdenamur.eu/en/index.php/namur-declaration/>.

¹⁰ Definitions of “national security” are hard to find and where indicators exist, they vary from jurisdiction to jurisdiction as well as change overtime. See, April Tash and Kathryn Gordon, “Security-Related Terms in International Investment Law and in National Security Strategies”, OECD, May 2009, <https://www.oecd.org/investment/investment-policy/42701587.pdf>.

¹¹ Articles 1 and 2, Annex D.34, Exclusions, Agreement Between the Government of Canada and the Government of the People's Republic of China for the Promotion and Reciprocal Protection of Investments - Brought into force: October 1, 2014, <http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/china-text-chine.aspx?lang=eng>.

¹² Government of Canada, Guidelines on the National Security Review of Investments, Canada Investment Act, <http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81190.html> [emphasis added].

¹³ Government of Canada, Executive summary, National Strategy for Critical Infrastructure, Executive summary, <https://www.publicsafety.gc.ca/cnt/rsrscs/pblctns/srtg-crtcl-nfrstrctr/index-eng.aspx> [emphasis added]. The resilience of Canada's critical infrastructure depends, among other things, on “stimulating economic growth”. *Ibid*. When applied to residential real estate, and in the context of the Bank of Canada's warnings, this may sound paradoxical since real estate transactions and constructions translate into financial gains. But of course, it is the conditions underlying the growth in this sector (domestic household over-indebtedness, housing crunch for the working population, tax evasion, corruption involving FDI host and home countries, etc.), not the pecuniary benefit alone, that are determinative for resilience.

In the 21st century, FDI targeting Metro Vancouver has increased unprecedentedly, exponentially, and almost overnight. The demolition of 5,297 dwellings in Vancouver between 2010 and mid-2015 amounted to an average of about three residential demolitions per day;¹⁴ and its attribution to luxury residences belies the spillover effect it unleashed, which has been engulfing the entire urban region.

For long, data on the size and number of the residential real estate transactions in Metro Vancouver, and the identity of the purchasers, have been publicly inaccessible although rumours abounded regarding the foreign driving source of investment, associated practises, and its economic scale.¹⁵ This fog had dramatically dispersed in 2016, as the three levels of government (federal, provincial, and municipal) could no longer afford turning a blind eye to the unfolding housing crisis and persistent media reports.¹⁶ In an impulsive about-face, governments introduced regulations inconsistent with a decade long policies that welcomed FDI in residential real estate as a boon the domestic home construction industry and government coffers. Notably, the provincial government introduced an additional 15% property transfer tax applicable only to foreign buyers' (natural and corporate) purchases in the Greater Vancouver Regional District.¹⁷ This triggered a class action pending before the Supreme Court of British Columbia, maintaining among other things breach of the non-discrimination principle by which Canada is bound in some thirty treaties.

The fact that similar experiences have been registered in other metropolises – New York and San Francisco, London, Sydney and Melbourne,¹⁸ as well as in Hong Kong; and that some of these jurisdictions have awoken to the challenge – justifies express recognition of foreign investment in housing as FDI meriting a distinctive approach. It also begs several questions, for instance, whether limits on the definition of investment (and concurrently, expropriation) are justified for the purpose of protecting local populations economically and against dislocation; or, do foreign tribunals represent appropriate judicial instances to

¹⁴ Kerry Gold, “Demolition Derby: Vancouver’s Older Houses Are Disappearing Fast”, *Globe and Mail*, 10 July 2015, <http://www.theglobeandmail.com/life/home-and-garden/real-estate/demolition-derby-vancouver-older-houses-are-disappearing-fast/article25420356/>.

¹⁵ Josh Gordon, “Vancouver’s Housing Affordability Crisis: Causes, Consequences and Solutions”, 2 May 2016, <http://www.sfu.ca/content/dam/sfu/mpp/pdfs/Vancouver%27s%20Housing%20Affordability%20Crisis%20Report%202016%20Final%20Version.pdf>; Adam Ross, “No Reasons to Hide. Unmasking the Anonymous Owners of Canadian Companies and Trusts”, Transparency International Canada, 2016, www.transparencycanada.ca.

¹⁶ Saeid Fard, “Vancouver Is Mortgaging Its Future for a Market That’s Anything But Free”, *Globe and Mail*, 18 July 2015, <http://www.theglobeandmail.com/report-on-business/rob-commentary/vancouver-is-mortgaging-its-future-for-a-market-thats-anything-but-free/article25558615/>; Mike Hager, “B.C. Releases First Set of Data on Foreign Home Ownership in Vancouver”, *Globe and Mail*, 8 July 2016, <http://www.theglobeandmail.com/news/bc-government-releases-preliminary-data-on-foreign-home-purchases/article30790277/>.

¹⁷ Ministry of Finance of British Columbia, “Additional Transfer Property Tax on Residential Property Transfers to Foreign Entities in the Greater Vancouver Regional District”, Tax Information Sheet 2016-006, 27 July 2016, <http://www2.gov.bc.ca/assets/gov/taxes/property-taxes/property-transfer-tax/forms-publications/is-006-additional-property-transfer-tax-foreign-entities-vancouver.pdf>.

¹⁸ Charlie Gillis, Chris Sorensen, and Nancy Macdonald, “China Is Buying Canada: Inside the New Real Estate Frenzy”, *Mclean’s*, May 9 2016, <http://www.macleans.com/economy/economicanalysis/chinese-real-estate-investors-are-reshaping-the-market/>.

hear relevant claims? Essentially, it is time to engage in a careful and thorough examination of existing investment treaties and their application to FDI in housing, and employ diligence in negotiations of future investment treaties. Here, the treatment of environmental concerns (public commons) in investment treaties and dispute settlement provides guidance. The concept of sustainable development can be expanded to require parties to protect the general life-style and survival of vibrant residential neighbourhoods/communities; commit to maintaining market conditions allowing for reasonable housing affordability that is independent of the public purse (e.g. “social housing” and anti-poverty programs); and legislate and implement anti-corruption monitoring and law enforcement to counter the circumvention and abuse of municipal residential real estate regulations and development policies.