FOREIGN INVESTMENT IN U.S. REAL ESTATE

Current Trends and Historical Perspective

Prepared by the Research Division of
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Preface

The U.S. real estate market is the envy of most nations in the world. The homeownership rate in the United States was 68 percent in 2007 – a near record level; more than 75 million households in the country own their own homes. Housing activity posted record numbers in the first half of this decade. And even though home prices began to slip in 2007, home prices rose almost 50 percent from 2000 to 2006, enabling home-owning households to build wealth through the equity in their property.

Commercial real estate, after under-performing in the years after the 2001 recession, has also returned to health. Vacancy rates are declining, helping to push up asking rents in most of the commercial sectors. This has attracted more investment in commercial properties, and returns from investment in commercial properties have also been in positive territory. Underlying the robust health of both residential and commercial real estate are solid economic fundamentals.

One factor that has helped to support the U.S. real estate market and industry is foreign investment. 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, and have seen opportunities to take advantage of healthy returns on their investments. U.S. real estate provides safe haven for many foreign investors.

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

This report examines the trends in and impact of foreign investment in the U.S. economy with particular attention to U.S. residential and commercial real estate markets. It looks at the level of foreign investment in real estate companies through 2006 along with a breakdown of the major countries with significant holdings in the U.S. In 2007, foreigners made significant investments.

Executive Summary

The U.S. real estate market continues 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 helps to stabilize U.S. interest rates and, thus, helps to keep mortgage interest rates low, spurring business investment in commercial properties and enabling consumers to become homeowners.

Foreign Investment in the U.S.

Foreign direct investment holdings in U.S. real estate totaled $43.3 billion or 2.1 percent of total foreign direct investment holdings in U.S. markets. In 2006, Germany, Australia, Japan, and Latin America accounted for the major share – 54 percent -- of foreign direct investment in U.S. real estate. Foreign investment in all U.S. asset holdings increased 18 percent from 2005 to 2006. In 2006 the level of foreign direct investment (10% or more stake) rose to a record $2.1 trillion. The amount of private foreign market ownership of stocks and bonds in U.S. real estate related companies also rose -- to over $5.2 trillion in 2006, a 20 percent increase from 2005.

Impact of Foreign Funds on U.S. Real Estate Market

The flow of foreign funds into the U.S. securities market helps put significant downward pressure on long-term interest rates. NAR estimates that in the absence of foreign capital, long-term interest rates would be four percentage points higher than current levels. Such an increase would result in a four-percentage point rise in the 30-year mortgage rate, thus depressing home sales activity and, therefore, real estate industry revenue.

Impact on the U.S. Economy

Foreign investment helps create jobs through either direct investment in a business by providing funding for domestic businesses to reinvest or spend money on expansion. Those reinvestments and expansion spur job creation, which in turn fuels demand for commercial real estate.

In 2006, over $715 billion of foreign investment funds flowed into the U.S. economy. By the end of the year, total foreign entity (government and private) owned assets in the U.S. had increased by $2.480 trillion to a total of almost $16.3 trillion. Holdings of U.S. securities and bank liabilities by foreign governments totaled almost $2.8 trillion and foreign private holdings of all types of U.S. investments were $12.3 trillion.

As a comparison, total U.S. entity (government and private) holdings of foreign assets totaled almost $13.8 trillion. U.S. government owned assets abroad totaled only about $72.2 billion, while foreign assets (direct investments, stocks and bonds, etc.) owned by American private entities totaled over $12.2 trillion.

Looking Ahead

Prospects for continued increases in foreign direct investment in U.S. real estate are bright. The strong foreign currencies in relation to the U.S. dollar will permit greater investment in the U.S. Though U.S. economic growth has slowed to 2 percent in 2007, it will improve to about 3 percent growth rate in 2008. Consumer spending is showing some signs of diminishing, but it is still not substantial enough to push the economy into recessionary levels. Such a stable environment augurs well for the U.S. as a growth opportunity for foreign investors.

Demand for office and industrial commercial space looks positive as jobs in the service and financial services sector are expected to increase and from the rising demand for warehousing needs associated with sharp increases in imports and exports. The demand for retail and multifamily properties should continue to be solid into 2008.

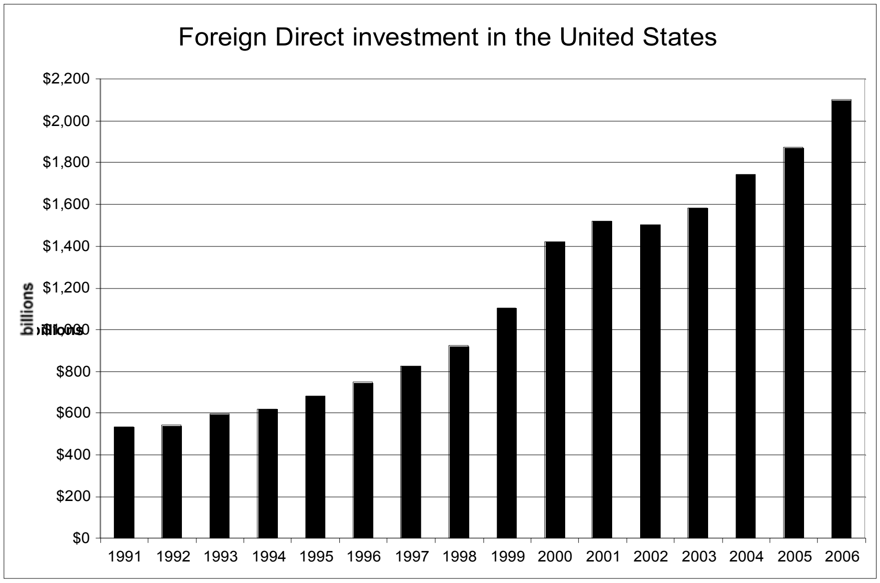
Foreign Direct Investment in the U.S. and Real Estate

The expanding globalization of the world economy has spurred greater investment across international borders. Real estate - though a physically immovable investment - is no exception. This report measures the impacts of foreign investment in U.S. assets and real estate and analyzes the resulting effects on the overall U.S. economy.

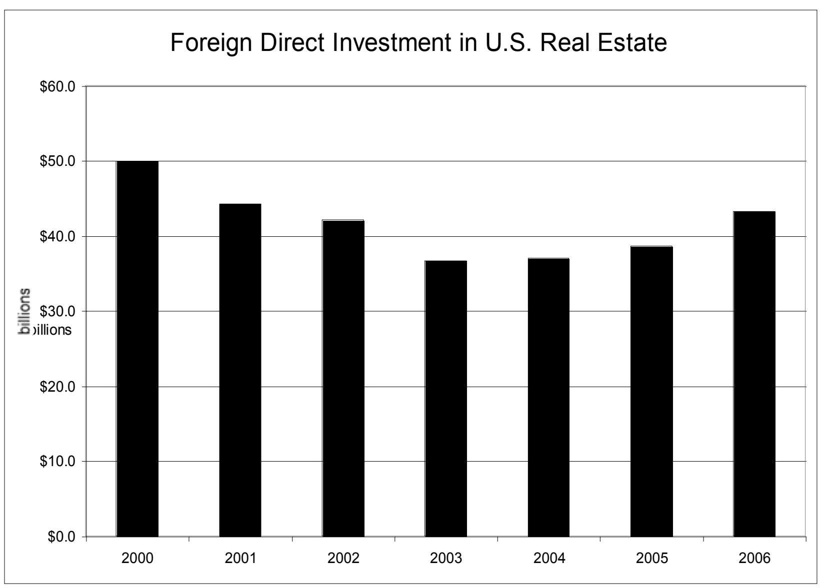
In 2006, the U.S. housing market entered a period of slower activity with an 8.5% decline in existing unit home sales. New home sales dropped more than 18% from their peak level in 2005. Nevertheless, median existing home prices still managed to increase 1% over their previous high posted in 2005 and new home prices rose 2% above 2005 levels. But it is important to note that these real estate sales and appreciation rate declines followed a sequence of four record years of sales and the highest increases in inflation-adjusted home price appreciation in over 40 years. In 2007, home sales have fallen further and the national median home price is projected to have decline 1 to 2 percent.

A precursor of the change in the market was the gradual rise in interest rates begun by the Federal Reserve over the past two years and their effects on the high-risk adjustable-rate mortgages taken out by many buyers. The rising interest rates and rising national default rates put pressure on market prices and lowered mortgage security values. In turn, investor demand for high-risk mortgage securities dropped precipitously causing a 'crunch' in credit availability to many higher-risk mortgage borrowers.

During the recent real estate boom period, foreign investment in the United States helped maintain lower domestic interest rates as well as increased the demand for foreign ownership of U.S. 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 show a continuing rise in investment by foreigners from 2005 to 2006. By the end of 2006, the level of foreign direct investment (FDI) in the U.S. reached an all-time high of almost $2.1 trillion, an astonishing 12% increase over the level in 2005. (For a relative perspective of these magnitudes, the U.S. budget deficit is currently running at a $239.4 billion rate – slightly over 11% of the 2006 FDI figure.)



The amount of foreign investment specifically in the U.S. real estate sector (including rental and leasing) sector rose to $43.3 billion in 2006. That represents a third consecutive year of increase, an encouraging sign after foreign investment in real estate fell successively for four years from a peak of about $50 billion in 2000 to $36.7 billion in 2003.[1] 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.[2] However, they do include transactions related to commercial real estate. as well as supporting stock prices of residential

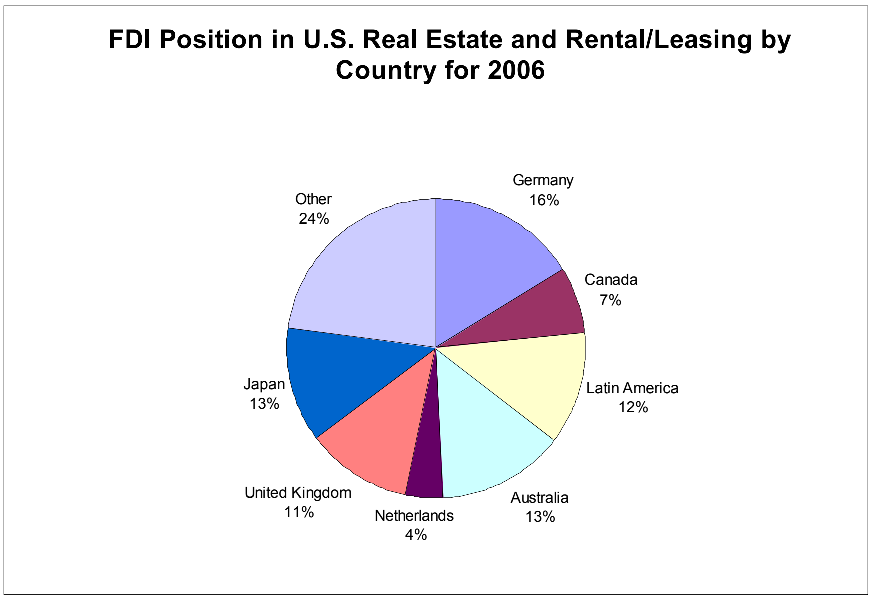
1 There was a significant revision to the past years' data in the 2005 report. For example, FDI in real estate was $41 billion in 2000 prior reports, but was now revised to much higher $50 billion.

2 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.

real estate companies like Reology (previously known as Cendant) which provides those companies with greater opportunities tap investors' funds for expansion.

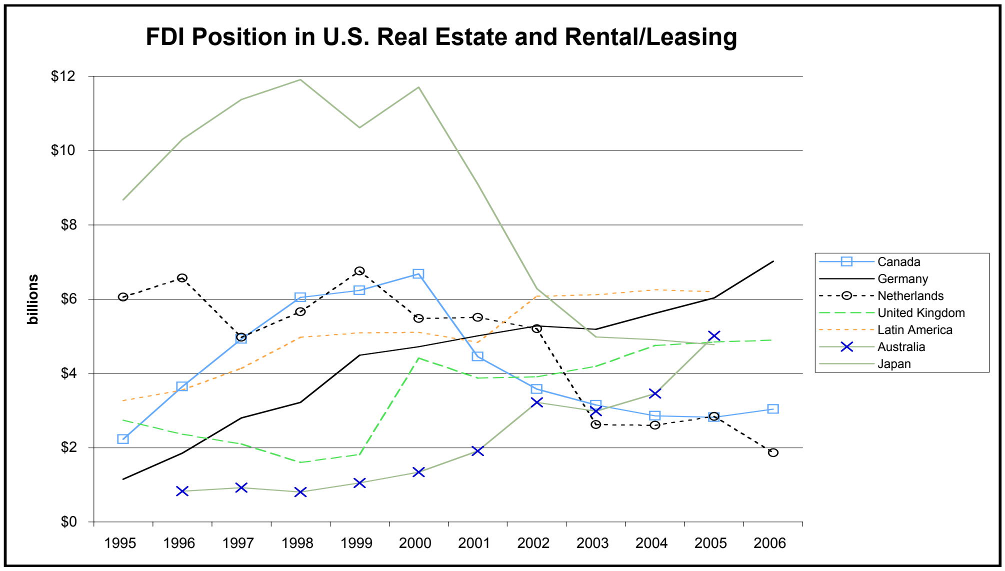
Foreign investment in U.S. real estate comes from many different countries, but several dominate. The primary players, in order of their level of U.S. investment in 2006 were:

- Germany
- Australia
- Japan
- Latin America
- United Kingdom
- Canada
- the Netherlands



Japan, which until 2004 had consistently accounted for the highest investment share, dropped to third place in 2006. In the past seven years Japanese investment in U.S. real estate plummeted from $11.7 billion in 2000 to $5.4 billion in 2006. Meanwhile, investment shares from Germany and Australia steadily rose over this same period – more than sufficient to offset the declines in investment by the Japanese. In 2006, Germany and Australia accounted for 16.2% and 13.4% percent, respectively, of real estate and rental/leasing investment. Japan and countries in Latin America accounted for 12.5% and 12% , respectively.

Real estate investment from Latin America, after being relatively flat from 1998 to 2001, began a steady ascent from 2002. Investment from the United Kingdom rebounded nicely in the past year to surpass its previous peak investment level set in 2000. The U.K. accounted for nearly $4.9 billion dollars in U.S. real estate markets in 2006. Foreign investment from Canada has been steadily declining from a high of about $6.7 billion in 2000. In 2006 Canadian investment in U.S. real estate totaled only $3 billion. Investment from Australia took the opposite path, rising from $1.3 billion in 2000 to $5.8 billion in 2006. Investment by Germans has also been steadily rising since 2000 to exceed $7 billion in 2006.



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, lower transport costs or take advantage of America's skilled workforce. Whatever the reason, direct purchases of U.S. properties can result in new construction, new real estate purchases, and more jobs at home.

The best measure of foreign purchases of U.S. commercial properties is the change in holdings of U.S. properties by U.S. affiliates of foreign companies. Unfortunately, this data has a two-year lag time. Consequently, the most current information is for 2004. Foreign holdings through U.S. affiliates of U.S. commercial properties rose strongly in 2004 - following another strong gain in 2003. Direct holdings of U.S. commercial properties rose to nearly $190 billion in 2004, an increase of $15.7 billion from 2002 to 2004. That trend is certainly encouraging given the declines in the three prior years. Over a longer time frame, total holdings of U.S. commercial properties more than doubled from 1987.[3]

3 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 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.

International Capital Flows and the Impact on the U.S. Real Estate Market

In addition to direct foreign investment and the number of foreign visitors to the country, there is another area of international importance that impacts U.S. real estate. The flow of foreign funds into the U.S. securities market has helped put significant downward pressure on long-term interest rates. Residential real estate is one of the largest sectors of the U.S. economy. Nearly two trillion dollars are exchanged each year in the sale of both new and existing homes. These transactions provide millions of Americans with jobs and result in hundreds of billions of dollars of economic activity each year. In total, the housing sector directly accounts for about 15 percent of U.S. annual gross domestic product (GDP). Some analysts suggest that if one includes the housing wealth contribution to consumer spending, the housing sector could account for up to 30 percent of GDP. The significant contribution of housing to the economy means that stable and low interest rates are ever more critical in keeping the housing market intact. And the strong inflow of foreign capital has played a vital role in helping to stabilize interest rates.

According to a Federal Reserve research paper,[4] it is estimated that a one-percentage point increase in the federal deficit-to-GDP ratio raises long-term interest rates by roughly 25 basis points. Money is fungible – and upward interest rate pressure from excessive borrowing by the federal government can be alleviated by an increase in the foreign capital supply. The NAR economic research staff estimates that in the absence of foreign capital, long-term interest rates would be four percentage points higher than recent levels. Specifically, a four- percentage point rise in the 30-year mortgage rate would have resulted in existing home sales of 6.1 million in 2005 rather than the record 7.1 million sales actually posted. Regarding impacts on the commercial real estate market, low mortgage rates force cap rates used to value commercial properties lower. This raises the overall value of commercial property.

Thanks in part to the significant inflow of foreign capital into the U.S. markets, mortgage rates in the U.S. have remained near 45-year lows, averaging around 6.0 percent in 2006 and rising into the low 6% range in 2007. During the same time period, the Federal Reserve raised its key short-term rate by about 450 basis points in 18 increments of a quarter of a point each. Because of stable long-term rates, home sales and home prices set new records in 2005 for a fifth consecutive year.

However, in 2006 the new and resales markets began to slip from the 2005 highs; by early 2007 the higher interest rates and the ‘crunch’ on less affordable financing caused housing affordability conditions in many housing markets to deteriorate. Moreover, increases in defaults and foreclosures -- as well as buyers and investors pulling out of contracts and “dumping” properties onto the market -- had shifted what once was a tight housing inventory to a housing oversupply situation by the spring of 2006. This situation continues and will likely be with us through at least part of 2008.

As of November 2007, existing-home sales are on-track to decline nearly 18% in 2007 from their record 2005 figure. Home prices began to decline in the latter half of 2006; and, the annual average home price appreciation is expected to be about one percent in 2007. The more cyclical new home sales market is projected to experience an even a larger swing in 2007. Sales

4 Laubach, Thomas, “New Evidence on the Interest Rate Effects of Budget Deficits and Debt,” Finance and Economics Discussion Series 2003-12. Washington: Board of Governors of the Federal Reserve System, 2003.

of newly constructed homes are on track to decline by 24% in 2007, with a two percent decline in prices. Without foreign capital, these adjustments in the current housing market would have resulted in far greater declines. Moreover, analysts are still concerned about the possibility that the housing collapse may push the overall economy into a recession.

Reasons for Foreign Financial Investments

There are two major reasons underlying the significant growth of foreign capital inflow into the United States. The first is a natural outcome of domestic consumption preferences and foreign demand for safe U.S. investments. Because of the U.S. demand for foreign goods and services, the U.S. is supplying the 'currency' that is then "loaned back" to us in the form of foreign financial investment capital spending. Foreign investors have always had a strong appetite for the ownership of U.S. assets, primarily because we are a safe place to invest and our assets help diversify their investment portfolios. That helps keep U.S. interest rates low, which in turn supports spending by American consumers and companies.

A second reason, put forth by current Federal Reserve Chairman Ben Bernanke, is that there is a global savings glut, particularly in China and Japan, and the U.S. is the only logical place to park the money. Similarly, the strong run-up in oil prices in 2005 that continues to the present has fattened the coffers of oil-exporting countries. Those nations have used much of this money to invest in America. The net result of these economic effects is a seeming paradox that the U.S. has been running a huge international deficit on commodity and services trade while at the same time attracting a huge offsetting inflow of foreign financial capital. The high foreign demand for U.S. government securities has also kept those interest rates lower than they would be otherwise, as well as the cost of government borrowing.

Trends in International Flow of Goods and Services and Financial Investments

Over the past several years, the U.S. has been running record goods and services trade deficits -- called "the current account" -- but also a record investment account surplus -- called "the financial account." To better understand how these trends work themselves out, we need to explain the U.S. Balance of Payments accounts. The current account and financial account provide measures of the annual net international flows to and from the U.S. The current account values the amount of goods and services the U.S. is exporting relative to (minus) its imports of these same goods and services. The financial account indicates how much foreigners are investing in the U.S. economy versus (minus) the outflow of U.S. financial investments abroad. For several years now, the U.S. has had huge net current account trade deficits (the value of imports exceeds exports) but offsetting net positive capital inflows from abroad. However, the overall net still has remained negative. Usually, when one hears reports on the U.S. trade "deficit," they usually mean the current account export/import trade difference. However, the financial account investment for years has been a net positive for the U.S. and only slightly less than the trade deficit.

The Current Account Trade Deficit

The 2006 current account balance set a new deficit record at nearly $811.5.[5] For the second quarter of 2007, the U.S. current account deficit was $190.8 billion, or negative $763.2 at an annualized rate. If that level were to continue for the remaining two quarters of the year, the 2007 current account balance would register a deficit of about $769.5 billion; an improvement over the balance of the past. Over the past few years, high oil prices have contributed to the widening of the deficit and recent futures spot market prices have hit all-time highs over $90/bbl. Indeed, during early November 2007, oil prices were flirting with $100/bbl. Clearly, the worsening of America's trade deficit has been primarily due to the demand for foreign goods and services, but that is partly a function of the fact that we have the world's strongest economy with consumer free choice.

It is also the case that the accumulated effect of a strengthening dollar from 1995 to 2001 made U.S. products more expensive and foreign products more affordable to Americans. In addition, weak foreign economies in relation to the U.S. economy hampered U.S. exports. Recently, this situation has begun to turn around and the current account trade deficit has started to narrow. The declining dollar has been raising the prices of imports and making U.S. exports more affordable to foreign economies.

The dollar is now much weaker compared to five years ago, particularly against the euro. This is a fortunate development from the perspective of the trade balance: it makes U.S.-made products more competitively priced. So the weaker dollar has helped stabilize the U.S. current account trade position in mid-2007. However, recent tensions in the Middle East and global forecasts for increasing energy demands have continued to place upward pressure on oil prices and that could still maintain the U.S. trade gap. Of course, there is a downside of the weaker dollar: import prices rise allowing domestic prices to increase as well. That creates inflation and it puts upward pressure on interest rates. A feedback effect is that higher U.S. interest rates may slow the domestic economy but also attract a greater inflow of financial investment from abroad. A declining dollar makes it more difficult for government policy makers to lower interest rates when the domestic economy is weakening.

The Financial Account Surplus

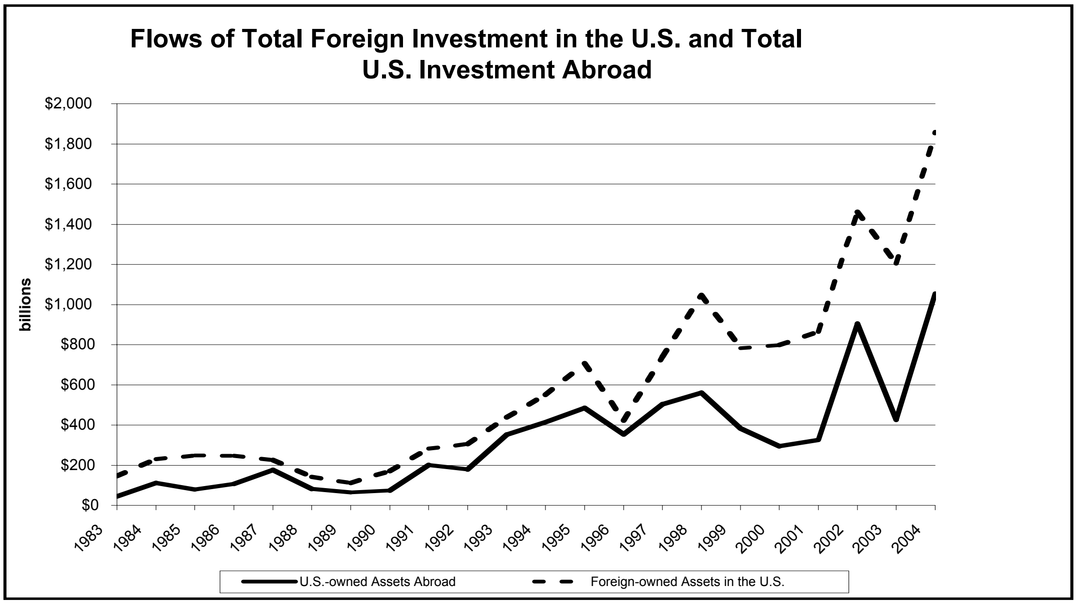
The U.S. financial accounts of the Balance of Payments have worked in the opposite direction of the current account. A high U.S. trade deficit naturally means a large amount of U.S. currency is flowing to foreign countries. These countries have to invest these dollars somewhere in the world and the U.S. is a good place to park the money. The upshot is that this increase in foreign flows of U.S. dollars tends to show up in the financial accounts and is the result of the current account trade deficit. The U.S. financial account, therefore, has been running a large surplus in recent years. That is, foreign financial investment in the U.S. has significantly outpaced U.S. investment abroad.

5 All trade numbers are on a current-cost basis unless otherwise specified. Source: Bureau of Economic Analysis.

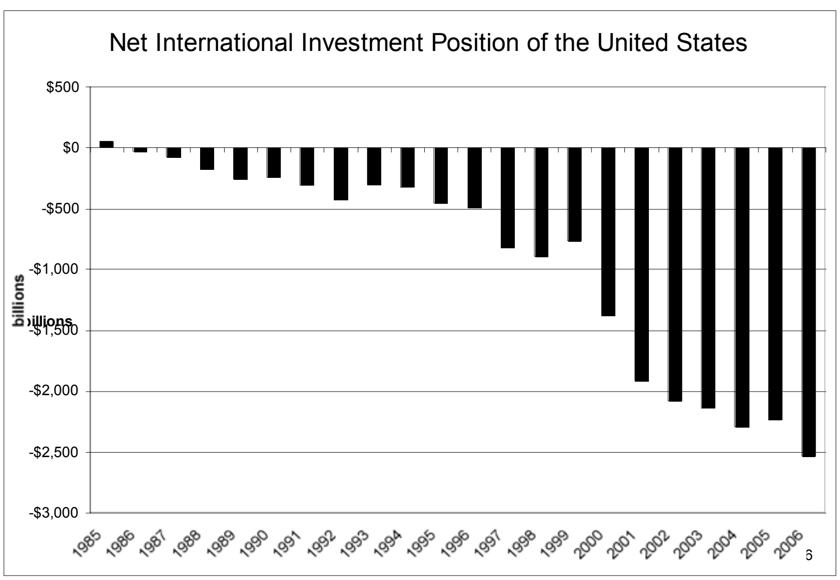
Balance of Payments Accounting
The international trade position of the U.S. is summarized by the balance of payments. The balance of payments is an accounting standard that is equal to the sum of the current and capital accounts. The current account is the sum of goods and services exported by the U.S. minus those goods and services that are imported from abroad (the current account also includes net investment receipts and net unilateral transfers, but these make up a small portion of the account). The capital account measures the flow of capital between the U.S. and abroad and is the sum of all foreign investment in the U.S. minus total investment abroad by the U.S. government and individuals. In theory, these two accounts should directly offset one another (i.e., balance), but this is not the case in practice. The rationale for this assumption is that to increase purchases, one must borrow to do so and an increase in capital accounts reflects borrowing from abroad.

In fact, in 2006 there was a $715 billion total investment inflow of foreign funds into the U.S. In the 2006 balance of payments financial accounts, the value of foreign-owned assets in the U.S. exceeded the value of U.S. assets owned abroad by $804.4 billion. So, while purchasing a Mercedes in the U.S. may cost more because of the trade deficit, the reverse financial flow into U.S. investments will help provide the car buyer with the lower interest rates to be able to finance it. Obviously, if the U.S. were not a good place to invest and did not have very efficient and sophisticated financial markets, U.S. consumers would find themselves paying much higher prices for foreign goods and struggling to provide low-cost finance and jobs for consumers. The feedback loop is fairly virtuous for U.S. consumers because of America's economic strength and efficient markets.

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 2006 both figures surged to record highs.



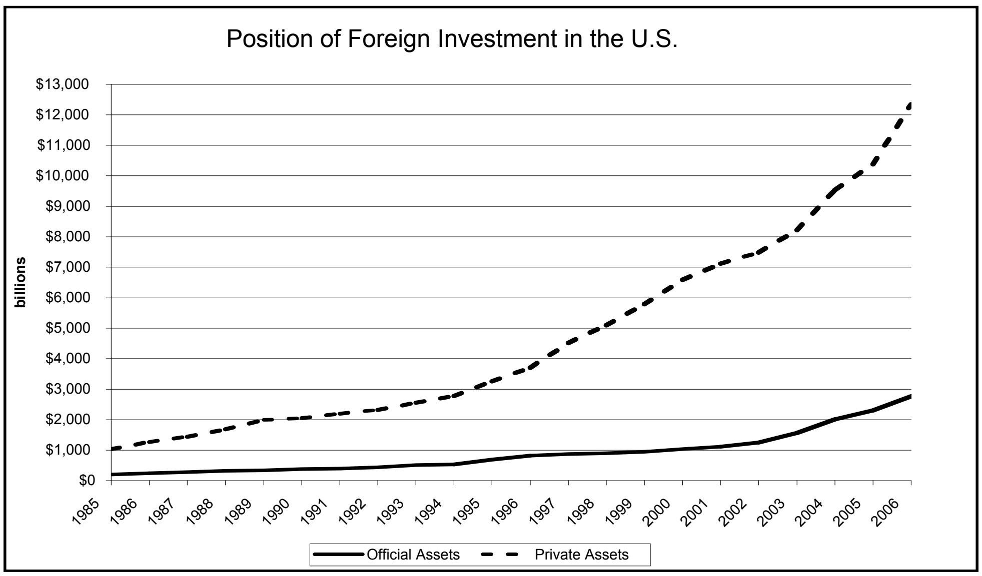
The ever-increasing annual influx of funds from abroad has also resulted in steadily increasing holdings of U.S. financial assets by foreigners. By the end of 2006, the U.S. net international investment holding position (foreign holdings of U.S. assets minus U.S. holdings of foreign assets) was a (negative) $2.54 trillion -- a 13.5% increase from 2005, and reflected 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.



Trends in Foreign Investment in the U.S.

In terms of gross foreign investment holdings of U.S. assets (not adjusting for U.S. holdings abroad), nearly $13.8 trillion were held by foreigners in 2005 and rising to $16.3 trillion in 2006. Each of these figures roughly equals one year of U.S. current dollar gross domestic product.

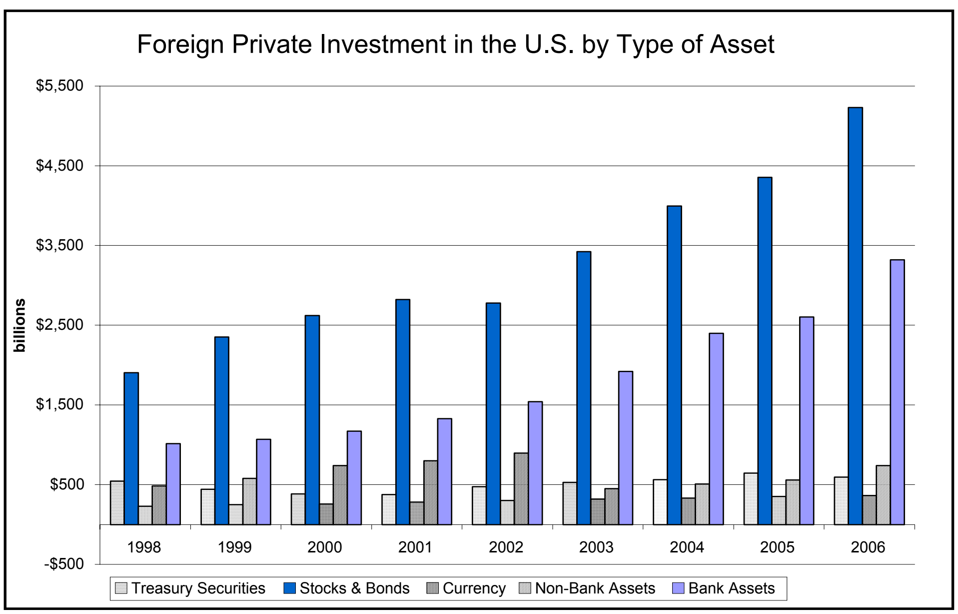
Dividing the gross foreign holdings into government and private sources also reveals an important trend. Private foreign investment has sharply outpaced official foreign government investment in recent years. The stock of foreign investment in the U.S. by private individuals reached over $12.3 trillion in 2006, accounting for 82 percent of the total foreign investment position. Because private capital is not subject to negotiations and agreements between governments, a sudden pullout of funds could potentially wreak havoc on U.S. financial markets and the U.S. economy.



In the U.S. economy, official (i.e., government) foreign investment plays a relatively small role; this report focuses primarily on private foreign investment. Private investment in U.S. real estate companies can come in two forms: direct investment in real estate and other private investment in real estate. An example of direct investment would be a German company purchasing a 10% or greater share of direct ownership in a U.S. real estate company. However, the category "other private investment" covers standard financial market purchases of stocks, bonds, or cash that are held by portfolio investors who want a market return on their securities rather than a controlling ownership. The lion's share of foreign private investment in the late 1990s came in the form of other private investment. Total direct investment holdings (position) in U.S. real estate (and rental and leasing) peaked in 2000 at $50 billion. Since then it has declined to a level of about $43.3 billion in 2006, valued on an historical cost basis.

Other private investment, however, has been surging and posted record levels in 2006. This private investment is annual financial flows into assets such as stocks, bonds, U.S. currency, and other paper assets such as CDs and money market accounts. As discussed above, 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 surged in recent years. They fell to as low as $375 billion in 2001, but have since then risen to a level of almost $644 billion in 2005, and then slipped to a little over $594 billion in 2006. 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.

As of the end of 2006, the total U.S. investment (position) holdings of foreign government and private entities totaled almost $16.3 trillion. Foreign governments owned about $2.77 billion (mostly in U.S. stocks and bonds) while private holdings totaled over $12.3 trillion. Of that figure, holdings of U.S. Treasury securities totaled over $594.2 billion; private direct investments (10% or greater company ownership) totaled about $2.1 trillion; general ownership of private sector stocks and bonds were almost $5.23 trillion; U.S. dollar currency deposits held were $364 billion; and U.S. bank assets owned were over $3.3 trillion.



Projections for International Growth

Much of foreign investment 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.

GDP growth is a strong indicator of return on investment. The U.S. looks to perform better in 2007 based on forecasts of GDP growth. The Euro zone as a whole will improve, but the US faces its strongest competition from Eastern Europe, India, China, and South America. However, these areas are not likely to absorb a large part of investment in the U.S. as each of them face serious questions about market stability and the security of the investment.

APPENDIX

There are many reasons why foreign firms, individuals and other non-U.S. entities invest in U.S. real estate markets. Many of them are elaborated earlier in this report. In addition, there are several qualitative reasons underlying foreign direct investment in U.S. real estate.

Establishment of Market Presence

The United States is the world's largest and most open commercial real estate market. Undoubtedly, foreign firms want to establish presence in the U.S. They do this in a variety of ways. They make direct investment in properties. In addition, they may choose to build businesses or establish joint ventures with U.S. companies in real estate development, design, construction, property management or brokerage.

Safe Asset

Certain U.S. investments are viewed as safe alternatives compared to what, at times, are more risky foreign assets. During periods of economic uncertainty in foreign markets, funds are often redirected into U.S. assets that have low default rates such as U.S. Treasury bonds, high-grade corporate bonds, U.S. backed mortgage securities, and U.S. real estate. This trend was particularly apparent during the Asian economic meltdown of 1997-1998 and the Russian ruble collapse of 1998. Similar market instability have led to panic among investors and resulted in foreign investors shifting their monies into U.S. dollars and U.S. markets. The Argentinean debt crisis of 2001-2002 did not have as great an impact because many investors had learned their lessons from the previous experiences and had adjusted their portfolios accordingly.

Institutional and Technical Factors

Institutional and technical factors also explain the increased foreign involvement in the U.S. economy. These factors include worldwide liberalization of financial markets and technological change.

Liberalization of Financial Markets

As the U.S. economy has become increasingly international in recent years, so has the U.S. real estate market. Since the early 1970s, the industrialized nations of the world have been steadily removing restrictions on international capital flows. In 1971, the Bretton Woods system of fixed exchange rates was abandoned in favor of floating exchange rates. By allowing currencies to float, nations permitted the market to determine the relative value of goods and services traded across borders.

In addition to allowing exchange rates to float, many of the world's industrialized nations have removed most controls on capital and restrictions on foreign participation in domestic financial markets. In the early 1970s, the United States eased administrative guidelines that inhibited foreign access to U.S. financial markets, and in 1984 abolished the withholding tax on non-resident holders of bonds issued by U.S. residents. The United Kingdom lifted exchange controls in 1979, liberalizing cross-border transactions using pounds sterling. In the 1970s, Germany removed authorization requirements for non-resident purchases of domestic bonds, and also lifted a withholding tax imposed on foreign holders of domestic bonds. In the 1980s, Japan opened up participation by foreign firms in Japanese securities markets and liberalized approval procedures for firms seeking to make direct investments abroad.

This pattern of liberalization continued into the late 1990s with many Asian, Latin American, and former Soviet countries opening their doors to foreign capital. However, the downturn caused by the implosion of the Southeast Asian economies in 1997 sparked a spate of new controls on capital flows in many of these countries. Although the International Monetary Fund (IMF) has conditioned its bailouts on continued expansion of liberalized trade policies, the going has been slow. This liberalization is crucial to maintaining the flow of foreign capital into U.S. real estate markets, and it enables foreign investors to transfer capital abroad in order to diversify their portfolios, including investment in U.S. real estate. In the face of these controls on foreign investments, the U.S. economy offers an advantage for investors who want to be certain that they can get their money back after investing.

Technological Change

At the same time that governments have been liberalizing their trade and foreign investment policies, technology has been revolutionizing the world. In the U.S. alone, private sector spending on information processing equipment and software increased from $218.9 billion in 1996 to over $600 billion in 2006 after adjusting for inflation. Telecommunications, computing, and information technology now permit almost instantaneous transmission and processing of information around the globe. This capability lowers financial transaction costs and fosters a financial environment in which capital flows rapidly from one country to another seeking the highest yield. As a result, foreign investors can respond quickly to opportunities to invest in the U.S. real estate market.

The residential real estate market has also benefited from technological change. From anywhere around the globe, prospective home buyers can browse online listings with pictures and even 360-degree virtual tours. Web sites like Realtor.com and Worldproperties.com allow housing shoppers to search at minimal cost and to start the home buying process. The benefits of these capabilities are being realized. According to ***the National Association of REALTORS® 2006 Profile of Home buyers and Sellers***, 24% of home buyers first learned about the property that they eventually purchased through the Internet -- up from 15% in 2004. In 1995, this figure was less than one percent. Furthermore, 73% of survey respondents listed the Internet as a "very useful" source of information for their housing search. Further technological advancement will undoubtedly lead to even lower transaction costs and higher international transactions.

Foreign investment in U.S. markets plays a significant role in stimulating the U.S. economy. The total flow of financial investment helps expand the pool of funds available to grow U.S. businesses, boosts the stock market, and lowers interest rates. Furthermore, lower interest rates bid up home and stock prices, which can boost consumer confidence and thereby stimulate spending.

Foreign companies may buy stock in a U.S. company for several reasons: as a simple investment, to satisfy the need for international diversification in a portfolio, or to gain strategic positioning within an industry. In addition, the U.S. economy is seen by many foreign investors as a "safe haven" – by and large not prone to big shifts. (Even U.S. economic recessions are relatively mild compared to those of other national economies.) A weaker U.S. dollar against foreign currencies attracts those European foreign investments to American markets. Political stability in the U.S. can also be a factor in deciding to invest in U.S. markets. For whatever the reasons, foreign direct investment in the U.S. has more than tripled in the past 15 years, rising from $533 billion in 1991 to nearly $2.1 trillion in 2006.

The reasons for foreign direct investment in U.S. real estate are the same. In addition, because the U.S. real estate market has a proven track record of healthy returns, investing in the U.S. real estate industry often makes more sense than investing in foreign real estate markets or in other domestic industries. U.S. interest rates are low, which is an attractive incentive for investors from abroad. Demographics are playing their part as well. Other countries – especially those in Europe – are experiencing the same "aging" of their population as is the United States. Foreign baby-boomers – like their American counterparts – are looking for ways to maximize their return on investments as they approach retirement.