London for sale?

An assessment of the private housing market in London and the impact of growing overseas investment

By Andrew Heywood

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Foreword

Ben Harrison, Director, Future of London and Paul Hackett, Director, The Smith Institute

That London faces a significant housing challenge over the years ahead is well recognised and documented. Even before the recent financial crisis and market downturn, the supply of new homes was consistently lagging behind the generation of new households, while the number of individuals who own their own home in London is significantly lower than the national average, and has been falling in recent years.

Those who work in London or who have other ties to the capital are increasingly finding that they cannot afford to live there, either by purchasing a home or entering the rental market. Though the London housing market remains buoyant compared to the rest of the country, it is clearly not serving the interests of the majority of Londoners. Many areas of inner London have become prohibitively expensive for local residents and too many luxury flats remain empty and treated as lucrative investments.

While recent debate has been focussed on the impact of the Government's reforms to the affordable housing sector in the Capital, analysis of London's private housing market has been in comparatively short supply - despite the fact that it represents over seventy five per cent of housing in London.

In commissioning this work we have sought to rectify this by putting the spotlight on patterns and trends in London's private housing market, with a particular emphasis on the role of overseas investment. It has, for example, been calculated that 60% of new-build property in central London in the first half of 2011 was bought by overseas investors, mainly from the Far East. Indeed, as the report notes the £5.2bn spent by overseas investors on housing in London in 2011 was more than total Government investment in the Affordable Housing Programme for the whole of England. This seems disproportionate and carries the risk of creating a damaging London housing bubble.

Although not the only challenge facing the private housing market in London, this report argues that the level and nature of this overseas investment is a critical issue for policymakers to get to grips with. In the first instance, it is clear from this report that a greater understanding of this phenomenon is required, together with a richer analysis of its impact on housing prices and affordability. Armed with this information, Government, the London Mayor and London boroughs must work together to develop a coherent strategy for intervention, not necessarily to stem the tide of this investment, but rather to ensure that it is truly beneficial for all Londoners.

Finally, we would like to thank the author of this report, Andrew Heywood, who is a visiting fellow of the Smith Institute, consultant and Editor of the journal Housing Finance International.

Executive Summary

Executive Summary

- London's housing market has become distorted and dysfunctional. This is partly due to the huge rise in overseas investment in expensive properties for the super-rich. Investment in luxury homes has doubled to over £5bn a year – five times more than the annual investment in affordable homes in London and a third of all loans made for house purchases.

- Over 60% of new homes in central London are currently being bought by overseas investors. Anecdotal reports suggest that a high proportion are kept empty.

- The growth in overseas investment in London property (mainly from the Far East) is set to continue, despite the higher stamp duty rate. There is a real risk that investment on this scale could create a "housing bubble".

- As overseas buyers seek out homes for investment purposes they risk pushing prices up and reducing the availability of homes to buy for local people.

- The surge in overseas investment in London homes will exacerbate the fall in home ownership, which is already down to 53.5% as opposed to 66% for England.

- London house prices remain far higher than those of the rest of the country, and look set to widen further. This is partly due to the surge in demand for 'high-'end' properties in "desirable" boroughs such as Kensington and Chelsea.

- Affordability has been tightening in England for four decades but in London the situation is significantly worse. Nevertheless, there is a contrast between Inner London and the "desirable" boroughs where affordability is deteriorating (a household on the median income for Kensington and Chelsea (£39,000 p.a.) would face an average price of £1.25 million in that borough; 31 times their income!)

- The increase in overseas investment in private housing is a major issue for London. However, the issue is overlooked. A new approach is needed which seeks to direct such investment into positive areas such as new affordable housing rather than capitalising on the asset values of new and second-hand luxury properties.

- The GLA and Government need to know more about the effects of overseas investment on the London housing market, particularly the extent to which properties held by investors domiciled abroad are kept empty and the impact on price, affordability and supply.

- London needs a housing strategy which ensures that overseas investment in housing is not simply capitalising on rising asset values but bears costs that are proportionate to the financial benefits. London could benefit from ring-fenced income from higher taxes on overseas investment in unoccupied high-value properties.

Introduction

Introduction

The private housing market in England has undergone profound changes since the onset of the banking crisis in 2007. The crisis and the turbulent economic and financial climate that it precipitated have initiated a major market correction, have exacerbated long-term trends and have altered the dynamics of the market in important ways.

House prices since 2007 have remained stagnant or fallen. Transaction volumes have plummeted. Mortgage finance has become less accessible and the importance of housing equity to facilitate house purchase has grown. The level of home ownership has fallen significantly over the past decade while the private rented sector has grown sufficiently that it is now on the cusp of overtaking social renting as the country's second largest tenure.

London has not been immune to the above influences. Indeed in certain respects such as falling levels of home ownership it has outstripped the country as a whole. Yet it is the contention of this report that in important respects the private housing market in London is distinct and that its current dynamics pose particular problems for politicians and housing policy makers. Though the London market remains relatively buoyant compared to England as a whole it is not serving the interests of Londoners.

Those who work in London or who have family or other ties to the capital are increasingly finding that they cannot afford to live there. London has a much higher percentage of households on local authority waiting lists than England as a whole and the highest rate of any single region except Yorkshire and Humberside. In inner London it is a staggering 14.3% of all households. Homelessness in London is almost double the rate for England as a whole.

The London housing market is increasingly being driven by overseas investment much of it from the Far East. It has been calculated that 60% of new-build property in central London in the first half of 2011 was bought by overseas investors, mainly from the Far East. The phenomenon of wealthy investors seeking a "safe haven" or an attractive return from residential property has been noted by virtually all serious London housing commentators. The £5.2 billion spent by overseas investors in London in 2011 was more than the entire Affordable Housing Programme for England administered by the Homes and Communities Agency for the whole of the four years 2011-2015. (HCA, 2011) (Financial Times, 2012).

However London itself is not a single homogenous market. There are clear divisions between the wealthiest and poorest boroughs and between inner and outer London.

In a very real sense the story of the London residential property market is a tale of two cities existing cheek by jowl. The borough of Kensington and Chelsea, for example has among the highest house prices in London and an international clientele. At the same time, 7.8% of the borough's households are on the local authority waiting list and 1.4% are homeless.

There is an urgent need to make London one city that can actually house its citizens decently at a cost that they can afford. This will involve taking radical measures to correct profound market failure. In the end markets exist to serve the needs of people. It is very difficult to argue that the London market serves the needs of Londoners and in that sense it is dysfunctional. With the mayoral elections over, the private housing market in London remains the most intractable problem facing the Mayor and his advisers. To address the problems requires analysis, strategy and then action. This report has provided some analysis. It is up to politicians to develop the strategy and to act.

Chapter 1

Private housing market trends

Private housing market trends

The private housing markets in England as a whole and in London show many similarities in trends but also some important differences. While some of the current market trends originated with, or at least were precipitated by the banking crisis since 2007, others are more long term. The sections that follow analyse the two markets in some key respects.

Tenure balance

England and London present distinct pictures in terms of current tenure:

Table 1: Tenure balance England and London

	England (2010-11)	London (2009-10)
Owner occupation	66%	53.5%
Private renting	16.5%	23.0%
Social renting	17.5%	23.5%

Source: English Housing Survey

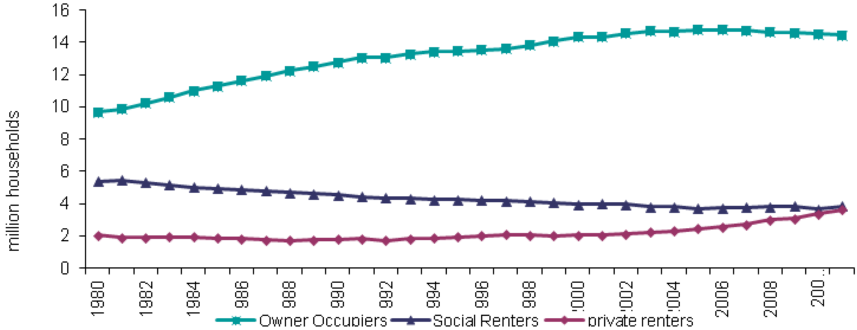
As can be seen, home ownership is significantly lower in the capital than in the country as a whole, something of an irony given the commitment of successive Westminster governments to the promotion of home ownership. London houses a total of 46.5% of its citizens in rented accommodation, with the private and social rented sectors very close in terms of size.

Home ownership in England is falling in absolute and relative terms having peaked at 70.7% in 2004 (Heywood, 2011). The private rented sector is now only 200,000 homes away from overtaking the social rented sector in size (see figure 1).

It has been predicted that on present trends home ownership levels will be around 60% by 2025 and the private rented sector above 20% by 2020 (Heywood, 2011). It has been estimated that 68% of new households formed in 2010-11 were in the private rented sector and only 14% were owner occupiers and that there was a strong net movement of c. 27,000 existing households from owner occupation into private renting during that year- a continuation of an existing trend. (CLG, 2012d).

The picture of falling home ownership in London is still more striking (see table 2).

Figure 1: Trends in tenure trend England



Source: English Housing Survey Headline Report 2010-11

Table 2: Owner occupation levels London, 2000 and 2009-10

	2000	2009-10
Owner occupation	59.6%	53.5%
Private renting	15.2%	23.0%
Social renting	25.2%	23.5%

Source: English Housing Survey

It has been predicted by Oxford Economics (see figure 2) that on present trends home ownership in London could be around 40% by 2025 (Oxford Ecomomics, 2011).

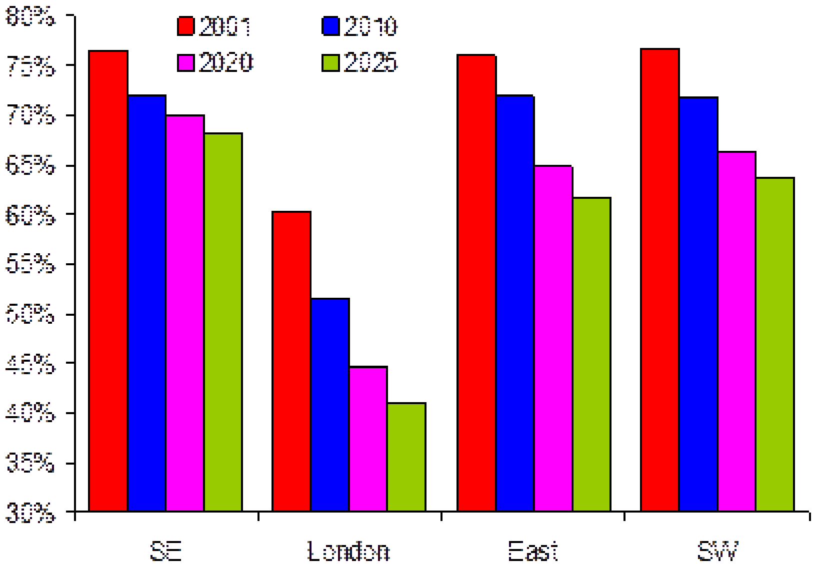
The London housing market is clearly failing to meet the current high aspirations for home ownership amongst London households. While those aspirations are being modified by a sense of realism about the likelihood of achieving home ownership within a reasonable timescale they still exist and should be respected by policy makers. Falling home ownership does of course have important negative implications for the ability to save and to meet the financial burden of old age and life's uncertainties (Heywood, 2011).

House prices

According to the Land Registry in April 2012 the average[1] house price in England

1 Not mix-adjusted.

Figure 2: Owner occupiers – South and East
Proportion of households owner occupied



Source: Oxford Economics/Haver Analytics

and Wales was £160,417. This represented a fall of 1% compared to April 2011. By contrast London prices averaged £360,721. This represented a year-on-year rise of 5.2% (Land Registry, 2012). These simple figures illustrate some important points of contrast:

- London prices remain far higher than those of the rest of the country.
- While prices nationally are stagnating or falling, those in London continue to rise.
- The gap between London and the rest of the country is still widening.

Average prices in England and Wales in April 2012 were 9.2% lower than in April 2007- before the start of the banking crisis.[2] London prices by contrast were 10.6% higher than in 2007 (Land Registry, 2012).

2 Note that different price indices can produce variations in prices due to differences in coverage and methodology. For instance the Halifax index has offered a more negative picture of London prices since 2007

London is subject to wide geographical variability in terms of price:

Table 3: Mean house prices within London 2007 and 2010

Region/district	2007	2010	% increase/ (decrease)
London	£354,632	£408,384	15.2%
Inner London	£440,460	£517,491	17.5%
Outer London	£300,535	£327,404	8.9%
Kensington and Chelsea (highest in London)	£1,033,470	£1,246,588	20.6%
Richmond	£512,207	£548,376	7.1%
Islington	£438,910	£479,414	9.2%
Croydon	£248,198	£254,688	2.6%
Barking and Dagenham (lowest in London)	£193,314	£179,178	(-7.3%)

Source: CLG

It will be noted that the higher priced inner London boroughs had almost double the rate of price increase of outer London. It is also significant that Kensington and Chelsea, with the highest prices in London experienced a rise of over 20%, while Barking and Dagenham at the other end of the price scale suffered a fall in prices over the same period of 7.3%.

The data above raise two serious questions about the performance of the London market. Firstly, how could prices rise in London at a time when real incomes were falling when this did not happen over England as a whole? Secondly, why should the most expensive properties and the properties in the most expensive areas be subject to greater than average rises? These phenomena both point to something specific occurring in London that is not happening elsewhere.

High London house prices are sometimes rationalised as being inevitable in a capital city. It is true that a sample of other capitals tends to reveal higher residential property prices than their hinterlands. The prices per square metre of city centre apartments in Paris and Rome for instance are both more than double the price of such apartments in other cities in France or Italy. In Tokyo the position is similar.

However, in Brussels and in Stockholm, variations between prices in the city and elsewhere are less extreme (Numbeo, 2012). House prices in The Hague in March 2012 were actually lower than those for the country as a whole (Statistics Netherlands, 2012). It is beyond the scope of this report to analyse city house price trends internationally. However, it would be wrong to simply accept the existence of high residential property prices in London and an extreme differential compared to the country as a whole without searching for specific causal factors.

Housing supply
The chronic national shortage in new housing supply has been well documented. According to current household projections new households will form at an average of c. 233,000 per year to 2033 (CLG, 2012f). New supply has lagged consistently behind for two decades. A 14 year peak in supply of 170,610 was achieved in 2007-08 but since then the financial crisis and market downturn have taken their toll. New supply in England totalled 111,250 in 2010-11 and was little improved at 119,910 in 2011-12.

In London new supply has lagged behind household projections also. These suggest that household numbers will grow at an average of c. 36,000 per year to 2033 (CLG, 2012f). New supply in London amounted to 20,040 homes in 2011-12 and has averaged 20,458 per year for the past five years.

The above data suggest that while supply in London and the country as a whole is chronically deficient, the situation in London is not significantly worse than the national picture. Indeed, percentage shortfall of new homes in England over the past three years would appear to be higher than in London.

In terms of affordable housing provision London is also currently doing better than England. In 2011-12, the affordable sector (housing associations and local authorities) built 44% of new homes in London compared to only 25% in England as a whole (CLG, 2012f). In England in 2011-12, some 51% of new housing supply was classed as affordable compared to 71% in London. The social rented sector is largely outside the scope of this report. Nevertheless, it should not be forgotten that future new supply of social rented housing remains problematic both inside and outside London. Data from the Home Builders Federation suggest that planning approvals for the first 3 months 0f 2012 are, at 5,446, 20% down on the same period in 2011 (Inside Housing, 2012). There is a real need for a viable funding model for affordable housing going forward given the widespread recognition that the affordable rent model does not represent a long-term solution.

There is some limited emerging evidence that the geographical distribution of new homes in London may contribute to an imbalance in supply and demand in some of the lower priced boroughs. Research commissioned for the *Financial Times* suggests that supply may be disproportionately concentrated in some lower price boroughs where development is easier to achieve and may in some cases exceed demand, thus putting downward pressure on house prices in these areas (Financial Times, 2012b).

Table 4: New home supply planned and in the pipeline relative to projected demand over 20 years

Borough	Percentage of demand
Barking and Dagenham	155%
Brent	127%
Greenwich	185%
Hackney	79%
Newham	253%

Source: Financial Times/Knight Frank

It is difficult to decide how much to read into the above data. Home buyers do not necessarily choose to buy a home in the borough where they currently live so localised effects will tend to be dispersed, particularly over time. Certain patterns of development may be temporary such as those generated by the 2012 Olympics. However, it may be that there is some limited effect here which may contribute to, but probably does not cause the uneven pattern of prices between boroughs.

Overall, while shortage of new supply in London and England remains a chronic problem and places an underlying upward pressure on prices and affordability it is not clear that there is a disproportionate shortfall in supply in London sufficient to account for the distinct house price trajectory of London or for the inner/outer London divide.

Affordability

A key factor in declining home ownership across the country has been deterioration in affordability over nearly four decades. By 2000 the ratio of house prices to median incomes in England was 4.21. By 2007 On the eve of the banking crisis it was 7.23. In 2011, in spite of falling real house prices it was still 6.65. This is still well above the long-term figure.

The situation in London is significantly worse. Between 2000 and 2007 the ratio of prices to earnings rose from 5.62 to 8.17. However it did not fall back after 2007. In 2011 the ratio of prices to median earnings was 8.54 (CLG, 2012f)

The picture within London is not uniform. There is a clear division between inner and outer London. In inner London the ratio rose from 9.17 in 2007 to 9.73 in 2011. By contrast, in outer London the ratio fell back from 9.04 to 8.16 (CLG, 2012f).

The picture at individual borough level is also startling. At the top comes Kensington and Chelsea with a price to income ratio of 27.07. At the bottom is Tower Hamlets at 6.48 (CLG, 2012f).

The perception that incomes in London are higher than elsewhere is correct. Yet incomes are lower than many would believe. In London the median household income was £33,430, or £643 per week in 2009- a small decrease over the previous year. This was indeed 35% higher than the median income for Great Britain at £29,363 (Datastore, 2012). Nevertheless, when compared with an average house price for London of £408,384 for 2010 one cannot but gain a keen sense of the hill to climb for those aspiring to home ownership. Only 17% of Londoners earn more than £60,000 per year (Datastore, 2012). Thus for over 80% of Londoners the price income ratio on the purchase of an average priced property would be close to 7 and for those on the median income it would be over 12.

In inner London the position is worse. For example, the median annual income for households in Kensington and Chelsea is £39,249 (Datastore, 2012). With the average price of £1,247,000 such a household would face a price to income ratio of 31! Were this household lucky enough to afford the typical first-time buyer deposit of 20% (£249,000!) they would be seeking a mortgage loan of 25 times their income. Such a loan would of course be impossible to obtain and in any case impossible to service (see mortgage market section below).

Affordability: private rents

Given the burgeoning importance of private renting within the private housing market in London and its function as an alternative to owner occupation for an increasing proportion of Londoners as well as a conduit for investment (see below) some analysis of affordability is appropriate. In both England as a whole and in London the private rented sector is poised to become the second largest tenure, ahead of social renting. However in London the sector already houses 23% of all households.

Median rents in Greater London for the 12 months to February 2012 were £275 per week for a 2 bed property (GLA, 2012). For a household on the median income of £643 per week this represents 43% of weekly income, a very high figure. Upper quartile properties at £350 per week represent an unacceptable 54% of weekly income for this group. Even lower quartile properties at £219 represent 34% of income.

Large areas of London, particularly inner London, are simply out of reach of those on median incomes. Even the rent on a lower quartile 2 bedroom property in Kensington and Chelsea would take 77% of a London median income and 65% of the median income of a resident of Kensington and Chelsea. Two bedroom properties in Westminster have a median rent of £550 per week. This represents 85% of a London median household income. It should be noted that even in inner London only 17% of households earn more than £60,000 per year or £1,154 per week while 14% earn less than £288 per week (Walker, 2010).

Even in outer London the position for many households is precarious. For the 14% of families on £288 per week or less, even a lower quartile 2 bedroom rent in Barking and Dagenham (£185 per week) will be unaffordable.

For those currently supplementing their income with Housing Benefit the position is set to become significantly worse. The GLA has estimated that up to 9,000 London households will have to move when caps on benefits are introduced under the Government's welfare reforms. While this is a very small proportion of the 697,000 households currently renting privately in London the reforms will further erode choice of property and area for the less affluent (McCarvill P, 2012).

It is also clear from even a cursory examination of rents and affordability that for a large number of households in London, as in much of the UK, renting is not a stepping stone towards buying a home. In many cases rent costs are at or above the costs of buying a similar property or they simply do not leave a margin to enable a would-be first-time buyer to save for a deposit (Guardian, 2012). It should not be forgotten that a typical first-time buyer deposit is now 20% of the value of the property. For an average price London house that represents a deposit of £81,700. This represents over two and a half years income for a household on the median income for London. For many households the private rented sector does not mean home ownership deferred but home ownership denied. A recent survey for London Councils reported that 50% of private renters in London believe that they will never own their own home (Hollander, 2012).

This brief analysis of affordability in London re-enforces a key question running through this report; who is sustaining this buoyant market and why?

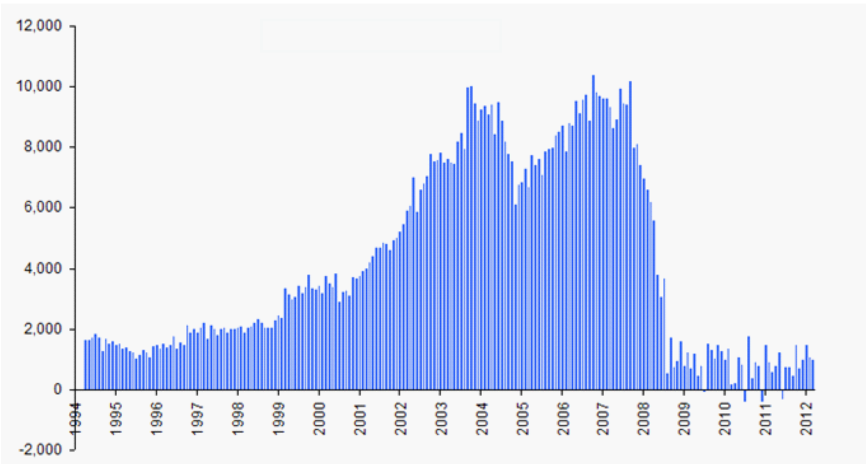
The mortgage market

The UK mortgage market has changed profoundly since the onset of the banking crisis in 2007. Those changes are unlikely to be reversed over the medium term at least.

The causes of the banking crisis have been discussed fully elsewhere. (Financial Services Authority, 2009) Suffice it to say that a prolonged global expansion of bank balance sheets coupled with a tendency to under estimate and under price risk led to a virtual collapse of the banking system. In the aftermath of the crisis lenders have been rebuilding their capital base and have been forced to review how risk is assessed, managed and priced.

The less favourable economic and financial climate since 2007 has re-enforced the tendency of banks to retrench in terms of new mortgage lending. Lending has been drastically reduced:

Figure 3: Net mortgage lending, £ millions



Source CML

The cut back in lending has hit certain groups particularly hard:

- Those seeking loans with a high loan to value (LTV) or high loan to income (LTI) ratio;
- Those with low and/or insecure incomes, and;
- Those with impaired credit histories.

FSA data provides some indication of the conservative lending policies now in force. In Q2 2007, 5.6% of mortgage lending was at an LTV of over 95% with 14% over 90%. In Q4 2012, only 0.4% of lending was at over 95% LTV and only 2.9% over 90%. In Q2 2007 8.8% of new lending was at a combination of more than 90% LTV and a high income multiple (more than 3.5 times income). In Q4 2012 such lending made up only 1.01% of the total. Lending at above 95% LTV plus a high income multiple stood at a tiny 0.2% of all lending.

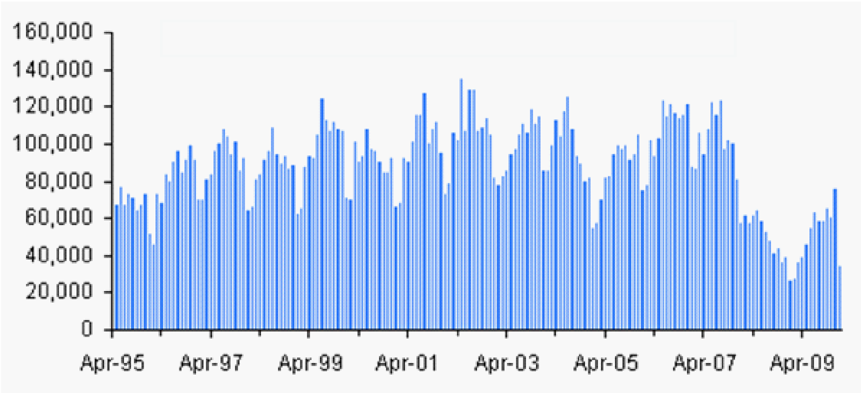
It will be noted that such conservative criteria will tend to favour those with higher incomes and with greater savings or with substantial housing equity in an existing property. Such an effect will be more pronounced in a market with high property values and moderate median incomes such as London.

A long term reduction in the number and proportion of first-time buyers in the housing market has been re-enforced by a more conservative mortgage market. A typical first-time buyer must now find a deposit of 20% of the property price (CML, 2012a). This is a particularly daunting task for a household in London on the median income of less than £35,000. The median age of London first-time buyers at 31 remains higher than for the UK at 29.

Overall, there has been a large drop in the volume of property transactions since 2007 (see figure 4)

This has been a particular result of the fall in mortgaged transactions. This fall off in mortgaged transactions has accelerated since 2007 but had become a trend even before then. In 2,000 there were 953,000 mortgage loans granted in England. By 2011 that figure had shrunk to 432,500. London has seen a similar trend. In 2000 there were 115,600 loans in London. In 2011 the number had reduced to 68,400.

Figure 4: HMLR property transactions, England and Wales, number



Source: Land Registry/CML

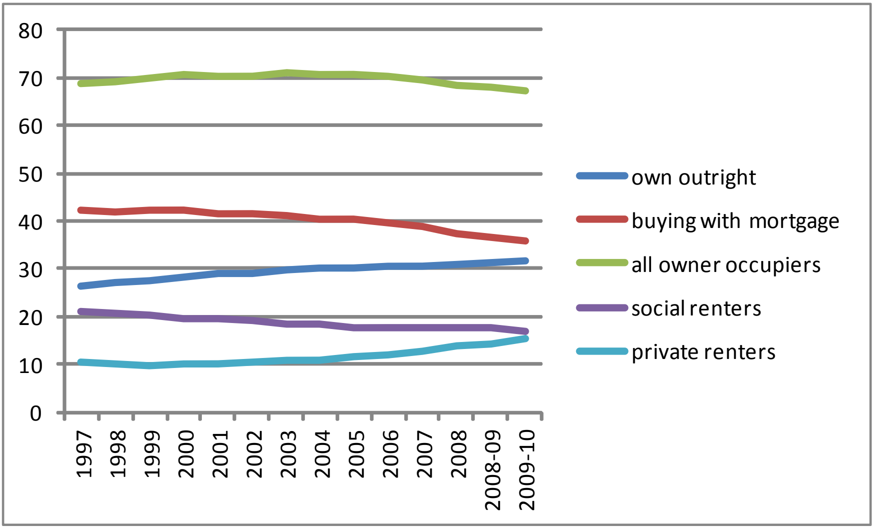
Chapter 2

Housing tenure

Housing tenure

The effects of a reduction in mortgaged transactions can be demonstrated by a closer examination of the data on housing tenure.

Figure 5: Tenure trend – England and Wales (%)

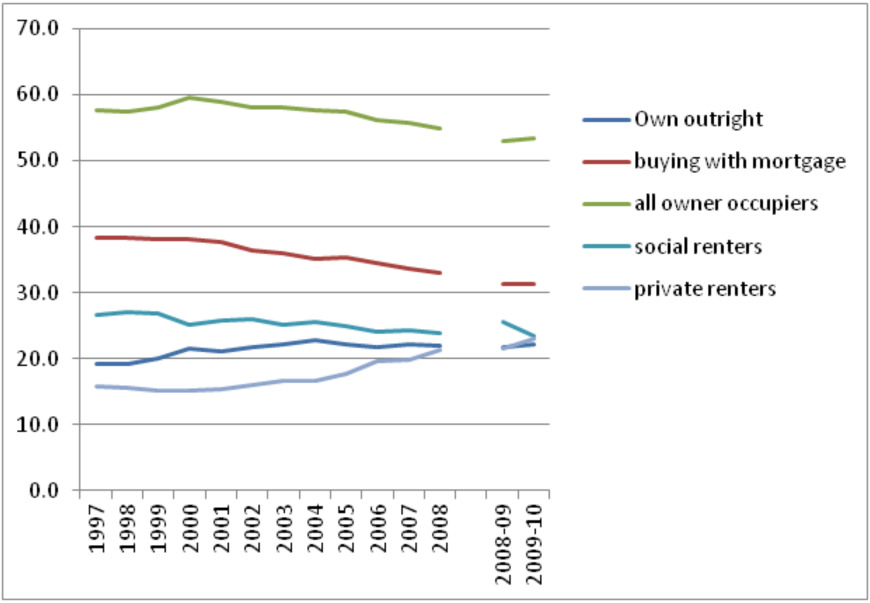


Source: English Housing Survey

Between 2000 and 2009-10 the percentage of outright owners rose from 28.4% to 31.7%. The percentage of mortgaged owner occupiers fell still more steeply from 42.2% to 35.7%. These data illustrate what Savills has described as a "fundamental change in the DNA of the housing market" (Savills, 2011). That change is essentially the declining importance of mortgaged buyers within the housing market and the growing importance of equity, derived either from sale of a previous property or from savings. As Savills put it, "It is impossible to explain recent housing market behaviour and price growth since 2009 if all that matters in the housing market is household incomes and mortgage rates" (Savills, 2011).

The position in London is consistent with that for the country as a whole:

Figure 6: Tenure trend – London (%)



Source: English Housing Survey

The reduced importance of mortgaged transactions and increased importance of cash or high-equity buyers implies a number of other changes, many of which have already been noted:

- A fall in the proportion and number of first-time buyers who will typically have to save a high proportion of their initial deposit.
- A fall in the overall level of home ownership, with lower levels in areas where affordability is particularly stretched.
- A shift towards a more affluent profile for homeowners; those with more savings or housing equity and higher incomes.

London, like the rest of the country is increasingly sustaining its housing market through buyers who are not mortgaged or who have high levels of equity and require only limited mortgage finance. The increased importance of equity in the housing market has to some extent sustained the English market though at a much lower level of transactions. Similarly London will have seen its market underpinned by cash and equity-rich buyers. However, this is not a London specific phenomenon and it does not on its own explain the divergence of the London market from the rest of the country and the Inner London high price borough versus outer London low price borough distinction. To explain London's recent housing market performance at least one more factor is required. If the present section of this report suggests anything it is that such a factor is unlikely to rely heavily on the UK mortgage market. Savills puts the point strongly:

With the new property world dominated by cash and not mortgage borrowing, the time for residential investment has arrived.

Chapter 3

Overseas investment

Overseas investment

The increase in overseas investment in residential property in central London has been slow to gain attention but it has become a key factor within in the London housing market, a situation whose full implications are only now beginning to be recognised.

While London has always had an international dimension to its housing market, the scale of that investment has increased dramatically since 2007. In 2009 it was reported that inward investment totalled £2.4 billion. In 2010 it rose to £3.7 billion (Savills, 2011). In 2011 that investment increased to £5.2 billion. In March 2012 the Financial Times reported that there had been arise in the value of sales of £5 million plus properties to £723 million in the first 11 weeks of 2012. This represented a 98% increase over the same period in 2011. The stage seems set for a record year (Financial Times, 2012).

By summer 2011 Drivers Jonas Deloitte was able to report "Over 60% of new home sales in Central London are to overseas investors, primarily in the Far East." (Drivers Jonas Deloitte, 2011a). By winter 2011 the sentiment was still confident: "Far eastern investor interest remains extremely strong, and for many developers this source of demand is now every bit as important as that from domestic owner-occupiers, many of whom are still struggling to obtain finance at competitive rates." (Drivers Jonas Deloitte, 2011b). Savills reported that overseas investors accounted for over 50% of buyers in the prime London property market in 2010.

In spring 2012 Agents Knight Frank enthused: "Prime central London property prices have been rising strongly for three years, on the back of foreign demand and London's status as a safe haven for investors" (Knight Frank , 2012). Their own index suggested that the strongest central London price rises in Q1 2012 were for properties in the £1-£2 million bracket with a quarterly rise of 3.2%.

Anyone doubting the scale and potential impact of overseas investment in London should note that at £5.2 billion in 2011 it was a larger sum than the whole Government investment in the Affordable Housing Programme for England for four years. The Programme stands at £4.5 billion for the entire 2011-15 period (HCA, 2011). Two years of overseas housing investment in London would total more than the public sector funding package (£9.3 billion) for the 2012 Olympic Games. In 2011 the £5.2 billion overseas investment represented c. 32% of the total value of the £16.3 billion of mortgage loans issued for house purchase in London in that year (CML, 2012b).

It also represents over 13% of the value of the entire London residential market in 2011 (McCarvill P, 2012).

If the growth in overseas investment since 2009 is to be continued until the next London mayoral elections in 2016 then a new administration for London could find itself addressing an annual inward investment of around £15-20 billion, larger than the totality of mortgage loans originated for house purchase in London in 2011. While such a projection is somewhat fanciful, it illustrates the capacity of this phenomenon to grow under the right conditions.

It has been suggested that overseas investors can by divided into three broad groups: (McCarvill P, 2012)

- European and North American buyers who may purchase to gain a residence or for investment purposes.
- Buyers form a range of non-OECD countries who may be seeking economic security and/or a political "safe haven" from potential troubles in their own countries or regions. Of this group Russia appears to be most common country of origin, followed by the United Arab Emirates and then Singapore. Europe is not immune however; following reports that Italian investors have increased their activity overseas including in London the Italian Government has introduced new taxes on overseas properties to dissuade the purchase of second homes abroad. (Cummings, 2012)
- Investors, often from East Asia, with an interest in a combination of rental yield and capital growth and who are often attracted by new-build properties.

It is clear that such groups are by no means mutually exclusive. Common motives can be found amongst investors from a range of nationalities. Nevertheless, in the absence of systematically gathered comprehensive data the distinctions have value. It has been estimated that some 64 different nationalities invest in London (Financial Times, 2012b). The Land Registry can only identify overseas investors who are incorporated. In February 2012 it had a list of 123 different countries where incorporated bodies own property in England and Wales (Land Registry, Feb 2012). Knight Frank has calculated that for the six months November 2010-April 2011 60% of new-build property was bought by Asian buyers. Of these the most active buyers were from Hong Kong, followed by Singapore and then China (Knight Frank, 2011b).

An additional motivation for many overseas purchasers has been the relative weakness for the pound from 2008 until 2011. This meant that for investors in certain currencies, notably the US dollar and the Euro, London property could effectively be purchased at a significant discount. Though this advantage has now waned, particularly in relation to the Euro there is little sign that appetites have declined (Knight Frank , 2012).

While the motivations cited above will in many cases prevail over time, the interest of some investors may fluctuate and contribute to market volatility. Those seeking a "safe haven" provide examples. Knight Frank reported that "French web searches for prime central London property spiked in February following election candidate Francois Hollande's proposal for a new wealth tax." (Knight Frank , 2012) Hollande has also proposed to increase taxes on foreign-owned second homes and sharply increase capital gains tax on property sales.

While permeation of the second-hand market is high, overseas investors have an even stronger hold on the London new-build market. As Savills put it: "The new build market in London has a higher proportion of international buyers than the second-hand market. This means its dynamics have more in common with Hong Kong and Singapore real estate than with average UK property" (Savills, 2012b).

The implication of investing in overseas property for reasons that may not focus on rental return is that much of this property may be empty for all or much of the time. Some will simply be left vacant as investors wait for capital appreciation. Other property will be used as a "pied a terre" empty for much of the year. Anecdotal reports suggest that a high proportion is in fact kept empty. Unfortunately quantitative research remains to be done in this area. It is urgently needed.

There is a real lack of data to underpin a systematic study of the market impact of overseas investment in London. Such information as exists is usually either anecdotal or is relevant to the activities of particular agents within the property market in London. Even where data is collected spatial definitions do not always correspond to those used in other housing related research. Nevertheless it is clear from such reports that overseas buyers probably make up the majority of the new-build market in central London and possibly of the prime residential market across London as a whole. In such a situation their influence on house prices and affordability must be very significant indeed and this is confirmed by all commentators. Whilst overseas investment appears to focus on the top end of the residential market and on properties above £1 million in particular, that interest is clearly not confined to that section. It has been reported that Asian buyers were particularly successful as buyers or property in the £400,000-£1 million bracket during the period November 2010 to April 2011 (Knight Frank, 2011b). Nevertheless the influence of overseas buyers is clearly greatest within the £1 million plus property bracket and in the up-market boroughs in Inner London in particular.

According to the Land Registry the top ten boroughs where overseas incorporated bodies owned property in February 2012 were, in order:

- City of Westminster
- Kensington and Chelsea
- Camden
- Wandsworth
- Lambeth
- Tower Hamlets
- Hammersmith and Fulham
- Hounslow
- Barnet
- City of London.

The first two, Westminster and Kensington and Chelsea, had more such properties than the next eight boroughs put together. This list should be treated with a degree of caution as it does not include non-incorporated persons who own property (Land Registry, Feb 2012)

Land registry sales data offers some limited confirmation of the scale of influence of overseas investors on the London market. For example in February 2012 the changes in sales volumes of high value properties in London and in England and Wales were as follows:

Table 5: Percentage change in sales volumes London and England and Wales February 2012

	Property Categories (value)		
	£1 million -£1.5 million	**£1.5 million–£2 million**	**Over £2 million**
England and Wales	-3%	-2%	-7%
London	+14%	-13%	+19%

Source: Land Registry

A real risk associated with the scale of overseas investment in London is the possible contribution to market volatility particularly in the new-build market where permeation is highest. Inward investment contains an element of unpredictability in any case since it is driven at least in part by motivations that are not directly linked to the fundamentals of the London property market but which are associated with investor perceptions of economic, financial and political developments in many parts of the world. However, whatever its source, investment on this scale into a market where supply is constrained must create at least the possibility of a housing "bubble" which could burst should such investment be suddenly curtailed or should overall market conditions be perceived to have deteriorated. With overseas investors driving around 60% of the central London new-build market such a risk is real and could have very serious consequences for future development as well as posing a threat to homeowners and to the housing finance system.

In March, the Budget made two proposals aimed at curbing the excesses of the high end of the residential property market. The first was an increase in Stamp Duty Land Tax (SDLT) on properties over £2million in value from 5 to 7%. The second was a 15% SDLT levy on properties over £2 million transferred to a "non natural person" (i.e. a corporate vehicle). The latter properties will also be subject to Capital Gains Tax (HM Treasury, 2012).

Well intentioned as these measures may have been, it would appear that they have affected overseas investors little if at all. Knight Frank reported: "The number of new £2 million plus applicants in April was 13% higher than in March, signalling that prospective buyers were not deterred by the stamp duty rise announced in March." Savills pointed out that "a 7% stamp duty charge does not cause London to be substantially out of kilter with other global cities. Before the Budget, London was less expensive than Paris for property acquisition, now it is marginally more expensive." (Savills, 2012). If Government believed that it had solved overheating in the London residential property market it appears to have been mistaken. Savills is currently forecasting that the London prime property market will rise 22.7% during the period 2012-16. Their comparable forecast for the UK mainstream market is just 6%; less than inflation (Savills, 2012).

It is clear that the impact of overseas investment in inner London has been very significant and that it provides at least some explanation for the continuing climb in London prices since 2007, in clear contrast to England as a whole. Because of the focus of investment in a few boroughs in central London inward investment also provides an explanation for the divergence between inner London and the lower priced boroughs found manly in outer London. Unfortunately, though the influence of overseas investors can be identified it is difficult to analyse or quantify. Data is lacking and reports are partial or anecdotal. It is unacceptable that such a major intervention in the housing market of the UK's capital city should be so poorly documented and understood. Providing data and analysis is a clear and urgent task for policy makers.

Chapter 4

A housing bubble in the making?

A housing bubble in the making?

The private housing market in London can be characterised as buoyant but dysfunctional. House prices in London have been higher than for the rest of the country for many years. However since the onset of the banking crisis prices in London have continued to rise while those in the rest of England have stagnated or fallen.

Home ownership is falling across the UK but in London it has fallen further and faster. By 2025 it could be down to 40% with the burgeoning private rented sector not far behind. While falling levels of home ownership may be inevitable, in London particular factors have led to an intensification of this trend. Given the continuing aspiration towards home ownership amongst UK households this represents blighted hopes and expectations. Policy makers have responsibility to further deeply held aspirations where this is realistic. After all, access to home ownership is not just a matter of aspiration; it is an important means by which households accumulate assets to meet life's vicissitudes and the demands of old age. The state has been keen to shift such burdens from the exchequer onto individuals over the past two decades or more. Policy makers must decide the extent to which the acceleration in falling home ownership levels is acceptable from a policy perspective and how the wider implications of such a change can best be managed.

Affordability has modestly improved in England since 2007. However in London it has deteriorated to the point where much of London is a no-go area for households on median incomes whether buying or renting. With the mortgage market unlikely to return to the heady days of the millennium this situation is not likely to improve of itself. Like England as a whole London is becoming a housing market that is increasingly dependent on buyers with cash or high levels of equity. This market is characterised by low transaction volumes, which limit mobility across the capital and which further reduce opportunity.

Housing supply in London lags behind demand and has done for many years. However this is also true for the country as a whole and the evidence is that the ongoing deficit in new supply in London is no worse than elsewhere. In discussions concerning supply it is usually the social rented and "affordable" sectors that come under scrutiny. In London the record on affordable supply has been at least as good if not better than that of the country as a whole in recent years. More affordable supply is always needed, but this is not a London specific issue. The chronic lack of new supply affects prices and affordability in London and England as whole. It rightly requires attention but shortage of supply does not explain the particular behaviour of the private housing market in London.

There is a tendency for housing policy makers to focus on the social rented and affordable sectors. This is understandable; these sectors have traditionally been the areas where policy can exercise most influence due to the existence of direct levers for control via regulation, grants and ownership. However in London the affordable sector makes up only 23% of all tenures. However well that sector functions, London's housing problems will not be solved without a focus on the private housing market which currently houses 77% of all households. The private housing market in London is dysfunctional from the perspective of its citizens and it is where the focus of policy should be.

Perhaps the key difference between London and the rest of the country is the presence of huge inflows of overseas investment into the London residential market. This inflow represents a massive influx of demand into a constrained domestic market. It is primarily focussed on existing homes (new and second-hand) as an asset class. In 2011 the £5.2 billion overseas investment in London represented 32% of the value of all mortgage loans for house purchase issued in London in that year.

This inward investment is focussed primarily on the upper end of the housing market, in inner London and on certain higher value boroughs. This pattern offers an explanation for the inner/outer London distinction perceived by many, but the picture is never so simple. Such a large influx of additional demand will inevitably have an impact across London as a whole. It is clear that overseas investors are significant purchasers of properties in the £400,000-£1 million bracket. In any case if domestic purchasers of higher value are displaced through completion from overseas investors this will inevitably have a demand/price impact lower down the value chain. If significant numbers of properties held by overseas investors are kept empty rather than being rented out then this again has an overall impact on supply.

In addition to driving up prices, if overseas investment continues to grow on present trends it creates an increasing threat of a housing bubble that could, when it bursts cause huge disruption of new development and pose a real threat to home owners and to the broader house and mortgage markets. At present this threat appears to be largely unmonitored.

The high levels of overseas investment in the London residential market has been identified by a number of commentators but is as yet poorly documented or understood. There is a strong and urgent need to develop the tools for a proper analysis of this phenomenon and to make strategic and targeted policy decisions to deal with it.

Chapter 5

Intervening in the market

Intervening in the market

It is not the task of this report to promote a blueprint for a revised London housing strategy. Its purpose is to stimulate renewed debate about the private housing market and in particular the impact of high levels of overseas investment. It is this investment that appears to be shaping the progressive divergence of the London market from England as a whole.

The London elections are over and the political landscape of the capital has been settled for the next four years. The London Housing Strategy, published in 2010 has some significant aims under the banner *Raising aspirations, promoting opportunity*:

- Promoting more homes
- Helping homeowners and first-time buyers
- Improving the social rented sector
- Improving the private rented sector. (Mayor of London, 2010)

It is the contention of this report that if such aspirations are to be achieved then the prime focus of analysis, strategy and policy must be the dynamics of the private housing market. Within that focus the most urgent task is to understand and develop a strategy in relation to overseas investment. Without intervention the unattractive phenomenon of a financially buoyant but socially dysfunctional housing market will continue and may worsen. Global financial instability, including the Eurozone crisis, will continue to promote the search among investors for a financial and political safe haven and for positive returns. London continues to fit those criteria.

The high level of overseas investment is not the only issue facing those analysing the London housing market. House prices will still be higher than in the rest of the UK and affordability more constrained. However, the level and nature of overseas investment is arguably the single largest issue as well as the most urgent. It is also politically sensitive. Xenophobic diatribes against foreigners taking our houses represent a misunderstanding of the problem and will fuel dissension within London and internationally.

The issue is not foreign investment per se. If this investment was being funnelled directly into the development of affordable housing for rent it would be viewed differently and rightly so. The problem is with investment that treats existing housing as an asset class and which drives the costs of that housing out of reach of the majority of those who live and/or work in the capital. Such a situation, if allowed to continue unacknowledged and unaddressed will of itself fuel the xenophobia and racism that politicians and community leaders have worked so hard to combat.

Work on the issue of overseas investment should proceed in three stages:

- *Collection of data and information*. This would include establishing and/or identifying comprehensive granular data sources on the scale, distribution and sources of overseas investment into London and elsewhere in the UK. A key area where more research is needed is on the extent to which properties held by investors domiciled overseas are kept empty for all or much of the time.

- *Analysis*. Building on improved data and information, there is a need for thorough analysis of the impact of overseas investment on prices, affordability and supply, segmented geographically, by property type, by price and by other relevant factors. Analysis should go beyond narrow market impacts to assess related issue such as the contribution of such investment via taxation and the indirect costs in relation to the additional burdens on infrastructure and service provision. The impact of overseas investment on other housing policy objectives such as the impact on tenure balance should also be considered.

- *Strategy development*. Intervention in relation to overseas investment should be targeted and informed by clear objectives. The aim should not be simply to cut back overseas investment in housing. However the aim should be to ensure that such investment is not simply capitalising on rising asset values and that it bears costs that are proportionate to the financial benefits. If such investment can be channelled directly into new development then so much the better. It may be that the tax system could be used to penalise owners of unoccupied high-value properties and to privilege inward investment directly into new residential development. If such an approach is not viable then measures to create disincentives for such investment may be inevitable.

Policy makers and politicians have long been wary of intervention in markets. According to the neo-liberal ideology that has gained so much currency over the past thirty years such intervention risks unforeseen consequences and courts inefficiency of outcomes. However, if five years of international financial turmoil have taught us anything it is that untrammelled markets do not necessarily optimise social outcomes. Public intervention saved and sustains the banking sector in the UK and internationally. In the end markets exist to serve the interests and needs of real people. Arguably the London private housing market serves the interests of few people and fails to serve the needs of the majority. There is a case for intervention.

Chapter 6

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Andrew Heywood

Andrew Heywood is a consultant specialising in housing and mortgage markets, regulation, governance and European issues, with significant clients in the housing and mortgage sectors. He is editor of the journal Housing Finance International and a visiting fellow of the Smith Institute. In his former role as deputy head of policy at the Council of Mortgage Lenders, Andrew had specific responsibility for lending for social and affordable housing, low-cost home-ownership products and the private rental sector. He led the council's work on European issues, focusing particularly on mortgage and consumer credit regulation and also co-ordinated its position on UK consumer credit issues. Andrew has excellent contacts with lenders, politicians and officials in the UK government, the regulatory authorities and in Europe. He has held board level positions with a number of organisations. Andrew writes for a number of publications and is a regular columnist for Social Housing magazine.

Email: a.heywood53@btinternet.com

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