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Finding Shelter

Overseas investment in the UK housing market

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SUMMARY

The Labour leader, Ed Miliband, has put the standard of living at the centre of public debate. So far, discussion has focused on energy prices and wages, particularly the minimum wage. This commentary asks whether additional measures are needed to control runaway house prices in London, and in particular to tackle demand as well as supply. It recommends that the UK adopts a policy, implemented in Australia, which prevents non-residents and short-term visa holders from investing in residential property unless their investment will add to the housing stock. They are not allowed to purchase already-existing dwellings either as investments or as homes.

Overseas interest in the London property market has grown in recent years. Foreign buyers are chiefly interested in costly central London properties, on which they spend billions of pounds a year, but the impact ripples out to the suburbs and beyond. The new-build market in central London is dominated by interest from overseas, meaning that even relatively well-paid young people wanting to buy their own home now struggle to do so. The extent of the change can be seen by comparing the ratio of average prices to average incomes in the UK. In 1980 it was 2.3; by 2013 it had doubled to 4.6. In Greater London it was 6.1.[1] Rents have also been forced up, so that many people in London find it necessary to pay half or more of their income in rent. There are significant social consequences arising from this.

London property is now seen for many in terms of its investment potential, as a safe haven for cash in an unstable global economic climate, rather than something that should be meeting a basic social need for the capital's residents. For too many it is providing financial shelter rather than human shelter.

House price growth in London and the UK

House price growth is well and truly back in Britain. In 2013, the average British home increased in value by 8.4%, according to the Nationwide.[2] But in London the figure was 14.9%.[3] Moreover, while the average UK house price is still 5% down on 2007, in the capital – where the property crash came and went in the blink of an eye – it is now 14% higher than its pre-recession peak.[4] Few comparisons demonstrate better the stark reality of Britain's two-speed economy. But the runaway train that is London property prices is not just leaving the rest of the UK behind, further reinforcing the North-South divide, it is leaving many young London-dwellers behind, too. With the average home now costing £345,186,[5] it is not only manual workers on low wages but relatively well-paid graduates that are increasingly finding it impossible to get on the housing ladder.

The difficulty presented by soaring prices has been compounded in recent years by more stringent lending criteria from the banks, that have rightly increased their minimum deposit requirements. Not only have prices gone up, but the proportion of the price which must be met from savings has as well – and this while other costs of living have risen substantially too. Savills, the estate agency, estimates that the number of first-time buyers is down by 200,000 a year compared with 2009.[6]

As people have had to delay buying a home of their own, this has driven up the demand, and therefore the rent, for lettings. Rents have been at record levels following a surge in activity, although the government claims that they are now falling both in London and across the UK.[7] Even so, rents are eating up an enormous proportion of salaries, which have failed to keep pace with the inflation in accommodation costs, particularly in the capital. According to the housing charity Shelter, the typical London family spends more than half their income in rent.[8]

According to the Greater London Authority's London Rents Map, in January 2014 the median rent for a one-bedroom flat in Southwark was £250 a week (£13,000 a year). In Hammersmith and Fulham it was £300 a week (£15,600 a year). In Kensington and Chelsea it was £450 a week (£23,000 a year).[9] The median London weekly wage was £658 (£34,216 a year) in 2013, according to the Office for National Statistics.[10]

A growing number of young people are responding to this pressure by sharing or by living at home for longer.[11] Those who don't have the option of living with mum and dad, are increasingly having to borrow to meet their housing costs, a deeply regrettable trend.[12] Worse, there has been a three-fold increase in the number of families finding themselves homeless and taking emergency shelter in bed and breakfast accommodation. Between March 2010 and September 2013, those families who have been forced to fall back on B&Bs rose from 630 to 2,100.[13]

While politicians and commentators wring their hands about the impact of rising prices, to buy or to rent, little has been done to improve the situation. Attempts to increase the housing stock, while welcome, have quite evidently been inadequate. House prices are only expected to climb in the year ahead.

Prices have boomed across the UK since the early 1990s, but the experience in London has been more pronounced given the even greater mismatch between supply and demand. The Mayor of London, Boris Johnson, reckons that for 30 years only half of the new homes needed were actually built.[14] The population of London has increased 12% since 2001, to 8.2 million,[15] significantly higher than had been forecast. It is expected to increase even more quickly, to 10 million, by 2031.[16] Boris Johnson says he wants the capital to build 42,000 new homes every year for the next two decades.[17] Fewer than 30,000 are being built at present.[18]

The increase in London's inhabitants has in part been caused by people from the regions moving to London, encouraged by the economic strength of the capital compared with the rest of the UK through good times and bad. Again, with the coalition government having made little progress in rebalancing the economy away from financial services in particular and the South-East in general, the trend for jobs to gravitate towards London is only likely to continue. But there is another factor at play in the demand for residential property in London which has little to do with people going there to work. In recent years, the capital has become firmly established as a favourite destination for international investors.

A shelter for global investment

When 866 luxury apartments in the redeveloped Battersea Power Station went on sale last year, most were sold within a few days – many to Singaporean investors looking for a safe haven.[19] Estimates vary, but billions of pounds of overseas money are pouring into the London residential property market every year. The totals have been rising in recent years, most notably at the top end of the market. When it comes to prime central London property, Savills says £7 billion of international money was spent on high-end London homes last year, with only 20% of prime property purchases being from the UK. Most importantly, two-thirds were investors rather than owner-occupiers.[20] London Property Partners found up to 85% of prime London property purchases in 2012 were made with overseas money. Just 15% were by UK buyers.[21]

But while the figures are most pronounced in the prime market, the trend isn't confined to just high-end properties. Estate agency Knight Frank says foreign buyers spent £2.2 billion on all new-build central London property in 2012, up from £1.8 billion in 2011.[22] It estimates that 85% to 90% of new-build purchases in Greater London have been to UK residents in the past two years,[23] meaning 10% to 15% of purchases are from abroad. In central London, only 27% of new homes went to UK buyers. More than half were sold to buyers from Singapore, Hong Kong, China, Malaysia and Russia.[24]

"We have seen a sea-change over the past year in terms of the kind of price point foreign buyers are chasing, whether it's a studio apartment in Clerkenwell or a one-bed flat in King's Cross," Tom Rundall of Knight Frank told the *Financial Times*. "This is not the jet-set but rather the working middle classes expanding into the world, often for the first time."[25] Property services firm Jones Lang LaSalle predicts that foreign buyers will spend £5 billion on new-build London homes in 2014.[26]

Money comes from not only Asia and Russia but the Middle East, Europe and beyond. Why? Because the tax regime is preferable, the legal system is transparent and the property market has performed consistently well. The UK has been a relatively stable part of the world amid such uncertainties as the Eurozone debt crisis and the Arab Spring. The exchange rate for sterling has also given London property an edge for international investment portfolios. London is now the favourite city in the world for real estate investment opportunities among overseas investors, according to the latest annual survey by the Association of Foreign Investors in Real Estate (AFIRE).[27]

As the London-dwelling American writer Michael Goldfarb put it last October, the capital's property has become, first and foremost, "a global reserve currency". "The property market is no longer about people making a long-term investment in owning their shelter, but a place for the world's richest people to park their money at an annualized rate of return of around 10%," he wrote. "It has made my adopted hometown a no-go area for increasing numbers of the middle class."[28]

The UK property market is being used as an investment vehicle by the global super-rich – and increasingly the simply well-to-do. The inflationary impact of this extra cash is good news for property owners (until they want to trade up the housing ladder). It is good news for estate agents on commission, who report with glee every pulse and surge in the market. But it is not good for those already being priced out at the bottom.

There are even warnings that, as well as driving up prices for domestic buyers, the nature of investments from overseas is distorting house-building priorities, with developers disproportionately attracted to high-value developments while ignoring the undersupply at lower levels of the market. Susan Emmett, director of residential research at Savills, says: "Builders' focus on wealthier, equity rich and credit-worthy buyers since the credit crunch, means that a disproportionate amount of stock is being delivered at what we call 'New Prime' levels – at prices between £1,000 and £2,000 [per square foot]."[29]

A supply-focused response

In tackling the housing shortage the government is focused on increasing the supply. There is no doubt that the UK, with or without investment from overseas, needs more homes. But the supply of housing is only one side of the equation, which is being exacerbated further by an unwillingness to address the question of demand.

In fact, through Help to Buy[30] the coalition has bolstered demand. This government scheme may be supporting first-time buyers that would otherwise struggle to afford their own home, but it is necessarily finite in its reach and will only serve to inflate prices further. The Bank of England has already stopped another government equity programme, Funding for Lending, from being used to support home loans. But amid increasing warnings that the property market is overheating again, there seems little interest from the Treasury – little more than a year from a general election – in curbing prices.

Unfortunately, not only is the government's default setting to quietly encourage house price growth, it is also to do nothing that would impede overseas investment – without regard to whether it is having a deleterious effect.

The Mayor of London recently told a Mansion House dinner it would be "utterly nuts" to do anything that would deter international investment in the capital's property market, even while admitting there was a "desperate shortage of homes".[31] His comments were taken as a slight on the Chancellor, George Osborne, who announced in December's Autumn Statement that he would be closing the loophole that allows foreign investors to profit on UK property without paying capital gains tax (CGT). But even while making that announcement, Mr Osborne was careful to stress that he "welcomes investment from overseas".[32] As he had doubtless calculated, making non-resident investors pay CGT is unlikely to dampen interest in London property.

Estate agents, rarely to be found defending anything that will diminish the trade in homes, have been very relaxed about the announcement. They do not believe it will have any meaningful impact on interest from non-resident buyers. The draw of London's property is not just the tax regime, but the attractiveness of the market. In any case, taxes will still be higher in many other key investor spots, like Paris and New York, than the 28% rate it will be levied at here.[33]

"It's an easy and populist win for the Chancellor, George Osborne," says Andrew Turner of Smiths Gore. "It closes what many will see as a tax loophole. This is unlikely to have much impact on the market."

Some commentators have even pointed out that the exchange rate advantage is likely to absorb any costs from CGT when selling up. According to analysis from the foreign exchange broker Currencies Direct, because the bulk of UK foreign property owners hail from Russia, the Far East, and the Middle East, the projected exchange rates from those countries against sterling mean that investments are still likely to pay off.[34]

A proposal from overseas

The case is made that most foreign money is going into new-build properties and that a great many developments would not go ahead without such purchases.[35] Both of these assertions are probably true, but nobody can be sure about the precise impact of foreign investment because it is not regulated. Nobody can be sure how may properties in London (or the UK, for that matter) are purchased by non-residents without adding to the housing stock, or how that is affecting prices.

London is one of the most attractive – if not *the* most attractive – property markets for international investors all over the world. It is also at the centre of an affordability crisis in the UK which is having serious consequences for younger people and the less well-off. It is time for the government to consider what can be done to tackle demand, alongside efforts to boost supply, to ensure that London property is not put forever beyond the reach of its residents by global capital. Overseas investments in the residential property market should be monitored to ensure that all such purchases serve to improve the housing stock rather than increase demand.

Britain would not be alone in taking such an approach. Australia, Switzerland, Denmark and Singapore all have controls on foreign investment to ensure, essentially, that any non-resident purchases are in the public interest. Switzerland, for example, has a highly decentralised system and relies on its local authorities to exert control. We could follow their example, but it would be quicker to emulate the Australian system, whereby all foreign non-residents and short-term visa holders wishing to purchase property must apply to that country's Foreign Investment Review Board (FIRB).[36]

FIRB guidance states that foreign non-residents can only invest in Australian property that adds to the housing stock, generally by acquiring new dwellings, off-the-plan properties under construction or yet to be built, or vacant land for development. They are not allowed to buy an existing home but they may be allowed to buy an unoccupied new dwelling, so long as they can satisfy the FIRB that the housing stock has increased. In the UK, we could set up a 'non-resident housing investment agency'. Non-residents would need to apply for permission to buy. It would not be given unless the agency believed that a genuine increase in the housing stock would take place, thereby helping to reduce house prices in current market conditions. Under EU law, Britain cannot prevent EU citizens from buying properties in the UK. This restriction will weaken the impact of our proposal, but much of the external capital has been coming from outside the EU and so applying controls will still have a decisive beneficial effect on house prices.

Developers in London will be concerned that demand will fall. Often they hold back the start of a development until about 30% of properties are sold in advance – 'off-plan' sales as estate agents call them. However, such sales to non-residents could still be permitted so long as the total housing stock was increased as a result of the development. Interested parties who gain from the status quo will say that we are creating another quango, as if all government intervention were always harmful. But if we want our young people to have the same chance of buying their own home as their parents' generation, strong measures are needed.

CONCLUSION

The coalition government appears to have shifted its emphasis in recent years. In 2011, the then housing minister Grant Shapps (now chairman of the Conservative Party) announced that the era of dramatic house price growth was over and that he wanted an era of long-term price stability. No longer, he said, should owning a home be seen as an investment for retirement: housing was principally about shelter, a fundamental need that was increasingly difficult to obtain for today's 20- and 30-somethings.

"The main thing everyone requires for their subsistence is a roof over their head and when that basic human need becomes too expensive for average citizens to afford, something is out of kilter," he said. "This government absolutely supports peoples' aspiration to own a home. But we also believe that [property] should be primarily thought of as a place to be your home."[37]

A few years later, increasingly desperate for economic growth, the coalition has been quietly encouraging the housing market to inflate again, despite siren warnings of another bubble. The lure of foreign money, always strong, is not one the government is likely to resist in the current economic climate. But if it is really concerned about the plight of younger people and the soaring cost of housing, it must cast a more critical eye on some of the investment the UK is attracting.

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