The global economic and political turbulence evident since the start of the financial crisis has created a new impetus for cross-border investment in prime property assets around the world.

The movement of capital into residential property is most notable when looking at the key global cities, with overseas investors keen for a slice of premium real estate in locations offering more than just excellent investment opportunities, such as lifestyle and education.

In this report we investigate the factors that make London property such an attractive investment. While international interest in London property is not a new phenomenon, the economic and financial changes since 2007 have created a fresh model for overseas investment in new-build property.

In this report we share the most up to date analysis of these market trends.

Key findings:

- Overseas investors channelled £2.2 billion into the new-build sector in central London in 2012, up from £1.8 billion in 2011
- Buyers from Singapore and Hong Kong accounted for 40% of purchasers of new-build property in central London
- A third of investors buying off-plan buy property with their children’s education in mind, planning to use at least one property for their children to live while they attend a London university
- China and Indonesia are among the biggest potential new markets for UK property investment from 2013.

London: a global city

There has long been a trend for overseas buyers to purchase homes or investment properties in central London. In the 1980’s, Americans dominated the international market, as did those from the Middle East. Over the last decade or so, Russian and Asian buyers have become more active.

The crisis in the Eurozone has only boosted interest in London bricks and mortar among Europeans – there was a sharp rise in buyers from Italy, France and Spain in late 2011 and early 2012 as investors looked for ways to diversify away from Euro-denominated assets. A weaker pound served to make the opportunity even more attractive.

Buyers from Asia have also risen in prominence in recent years; the pound comes into play here too, as Asian buyers benefit from an effective discount on London property (figure 2). In addition, the new-build developments around central London appeal to buyers who are comfortable buying off-plan.

It is perhaps not surprising that London attracts international attention, given that it is such a multi-national city. As figure 1 shows, there are large overseas communities living in the UK capital. The number of Europeans living in London far outweighs the total population of Frankfurt, while the number of French nationals living in London rivals the population of Cannes.

The diversity of London’s population is reflected everywhere, for example the foundation of French Lycée schools in South Kensington and Clapham – areas popular with French families.

Knight Frank lettings agents rented out properties to tenants of 77 different nationalities in 2012.

The financial crisis has had an impact on the banking industry across the world, and London is no exception. But the UK capital is still a leading player in the finance industry, topping Y/Zen’s Global Financial Centres index in 2012, ahead of New York and Hong Kong.

At the other end of the scale, London also boosts a flourishing entrepreneurial sector, with small tech companies edging into the City of London, a traditional bastion of banks and insurance houses.

That is not to say there is not competition from other global cities, including New York, Sydney and Paris, for property investment but London boasts some unique benefits.
Below we examine these financial and socio-economic factors in more detail:

1. Safe-haven

London is often hailed as a ‘safe-haven’ location. But what does this mean?

On a pure investment basis, London has a transparent property market. Property tenure is clear cut and underpinned by the legal system. Given that it is such an established market, there are also good liquidity levels in every price band compared with some less established global hubs.

London is also physically and politically safe. There is clear rule of law and transparency in the political system that is not replicated in some emerging economies. An independent judiciary burnishes this reputation.

While there have been some property tax changes recently, there have been no wide spread ‘wealth taxes’ imposed unlike in France or Spain.

2. Currency

UK investment also offers a currency play. The surge in European buyers in recent years can largely be attributed to the crisis in the Eurozone. Buyers looked to diversify away from Euro-denominated assets, given the insecurity about whether the Eurozone would remain intact.

The pound also fell against many other currencies in the immediate aftermath of the economic crisis, and remains weak, offering buyers, especially those buying in US dollars or currencies linked to the dollar, an effective discount on purchasing property in London and the rest of the UK.

Forecasts show that the pound is likely to remain relatively weak in the years to come. The benefits for purchasing London property are shown in figure 2.

However it is worth noting that a sudden strengthening in the pound could affect the current market dynamics.

3. Education

The lure of world renowned schools and universities in and around London cannot be overstated. As figure 3 shows, a third of buyers of off-plan new-build properties do so with their children’s education in mind. In many cases, the property or properties will be used by their offspring while they study at a university, and then rented out once the child or children move elsewhere or return home. If the children are not yet at the correct age for university, the property may be rented out until they are.

London is among the top cities when it comes to tertiary education – it boasts 12 universities ranked in the top 700 world institutions, according to QS – rivalled only by Paris with 16. Berlin, Zurich, Milan and Amsterdam have fewer than five. The popularity of these establishments is clear, as London has the highest number of overseas students anywhere in Europe. At the London School of Economics (LSE), a highly regarded institution across the globe, international students make up more than 65% of the student body. Two-fifths of students at Imperial College, London and UCL are from outside the UK.

The fact that courses are taught in English is seen as an added advantage.

The most recent data from UCAS, the UK’s university application system, showed that the number of applications from overseas students rose again for the academic year 2013/14.

The lure of a British education is nothing new, and many investors may have been educated in the UK themselves, or have family or friends who have done so. In fact, when we surveyed high-net-worth individuals about what attracted them to invest in London property, one of the main reasons given was the network of contacts they already had in the City.
**Market fundamentals: who is buying?**

UK buyers accounted for the majority of property purchases across the prime market in London in 2012, with 58% of homes being bought by domestic purchasers. Europeans accounted for 13% of sales during the year, while one in ten sales were to Asian buyers. Nearly 5% of sales were to Russian purchasers.

But when we focus solely on new-build sales, rather than sales of all new and older housing stock, the picture changes quite significantly.

UK buyers remain the largest segment, accounting for 27% of transactions in the new-build market in central London, broadly similar to 2011. Buyers from Singapore and Hong Kong were integral to the market in 2012, with a 23% and 16% share of the market respectively. Chinese and Malaysian buyers accounted for 5% and 4% of sales in 2012, as shown in figures 5 and 6.

Overseas buyers purchased new-build property in London worth some £2.2 billion in 2012, according to Knight Frank analysis. This is up from £1.8 billion in 2011.

When ordered by total investment rather than number of transactions in 2012, Singapore and Hong Kong still top the charts, although Russia pips China to third place. By average investment per property, Hong Kong investors tend to spend slightly more than those from Singapore or China. The typical purchase price for new-build property in prime central London among Asian buyers stands at around £680,000. The average spend by Russian buyers tends to be the highest.

Some overseas buyers, especially Asian buyers, are more comfortable with the idea of buying a property off-plan, as this practice more closely reflects the property market in their own countries.

This trend has had an important impact on the market in London, allowing developers to secure funding to develop schemes in a...
housing market largely starved of development finance. This has been a crucial part of financing many developments, which has resulted in London’s construction levels holding up relatively well compared to the rest of the country in the wake of the financial crisis, although there is still a significant undersupply of new housing in the capital.

But not all developments will meet the criteria of exacting investors. Neil Batty, head of International Project Marketing at Knight Frank, said: “Investors prefer properties based in zones 1 or 2, and ideally in close proximity to a tube station. Schemes close to the river are also popular, as well as regeneration schemes which guarantee that the public realm surrounding the property will be attractive and well maintained.”

Areas that have opportunity for outperforming on price because of local factors are becoming more sought after.

**TAXES**

In March 2012, the Chancellor increased the stamp duty charge for properties worth more than £2 million from 5% to 7% for individuals and 15% for those buying through a company structure.

Other tax structures for individuals, such as capital gains tax treatment, remain unchanged, but for those buying through a company, additional charges will apply from April 2013. The scope of the charges is narrower than was initially expected however, with investors welcoming the relief on offer for those renting out a property to a third party.

However the uncertainty over the new rules, which were not published until December, created an effective multi-speed market in prime London property for much of last year. Activity remained strong under the £2 million threshold but there was a notable decline in transactions above this price band. This is expected to remain the case, with the sub-£2m market outperforming in 2013.

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<th>Purchase price/lease premium or transfer value</th>
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<td>Up to £125,000</td>
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<td>Over £2 million (purchased by certain corporate bodies)</td>
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**Future markets**

One of the key questions facing developers is where future demand for new-build schemes will come from. Perhaps counter-intuitively, we see domestic demand for new-build properties in prime London rising from the current rate of 27%.

We expect the core Asian markets of Hong Kong and Singapore to remain strong, especially for the very best developments in the most desirable areas in London.

But we forecast that some overseas markets may also rise in importance.

Perhaps the biggest growth is expected in China. There has long been talk of a surge in investment in London property from China as the rising middle classes look for alternative investment opportunities, but this has yet to fully materialise. Knight Frank forecasts that the medium-term outlook for the Chinese market is strong, as while it may take some time for restrictions on overseas investment to be eased – a move which would open overseas property markets up to more Chinese investors – there is real interest in the region for prime London property.

Turkey is also an emerging market in terms of buyers of prime London homes. Healthy economic growth during the last three years – far outperforming crisis-hit Western economies, has led to continued wealth creation.

Buyers active in the market are largely drawn to London because of their existing connections with the UK, whether they were educated or have family in the country.

The future of the overseas investment market is not without risks however. Any sudden and unexpected weakening of the dollar against the pound could undermine the effective discount enjoyed by many investors. However, the lure of London does extend beyond the currency play. Despite the currency discount being eroded for Eurozone buyers, there is still strong activity from French, German, Spanish and other European buyers in the wider London market.

Another risk is tinkering by politicians. The effect on the market of the new taxes for £2m+ properties owned by overseas companies was clear, and is explored in the box above. Political rhetoric also has the scope to damage the market. Recent calls by the Liberal Democrats party to curb purchases of property by overseas buyers in London gained little traction, but risked sending a confused message to international buyers. However, the majority of policymakers understand that overseas investment is playing a crucial part in financing new developments in London.

52

Number of nationalities who bought new-build property in prime London, 2012

India has often been hailed as a rising market for new London developments. While there is no doubt there is a long-standing connection to London, and a strong interest in London real estate among Indian investors, buyers are not solely drawn to new-build developments. In terms of marketing, buyers are often keen to visit the UK themselves before purchasing, rather than doing so off-plan.

Indonesia is tipped to become a stronger player in the investment market in the coming years. For example, the number of searches for prime London property from Indonesia on Knight Frank’s global property search jumped by 22% in 2012, compared to 2011.
Private rented sector

Given the interest that most overseas buyers have in renting out their property, it is important to consider the fundamentals of this market in London.

London’s population growth is outpacing the increase in its housing stock. Recently published data from the 2011 census showed that the population in London has grown much faster than expected since 1991. The total population last year was 8.2 million, up 12% from 2001 and some 350,000 higher than had been forecast.

Migration within the UK has played a part in the rising population. The draw of London for those moving to the capital becomes clear when comparing the economic forecasts for London and the UK, as London is expected to continue to lead the way in terms of economic growth over the next four years.

In fact, recent analysis showed that while the UK as a whole fell back into recession in 2012, there were some notable regional differences in economic performance. Indeed, on a localised basis, the data suggests that London and the South East did not see a ‘double dip’ recession last year, registering continued, albeit modest, economic growth throughout 2012.

The relative economic outperformance of London is certainly reflected in its employment data, with a quarter of all jobs created in England in 2012 being generated in London, further underlining its attraction to workers from all over the UK as well as further afield.

The demand and supply dynamics of housing in London, especially in central areas, is also boosting the private rented sector (PRS). Knight Frank’s recent London Development Report showed that supply for property across London was set to be far outstripped by demand in the coming years – further exacerbating a shortage of housing already affecting the capital.

Add to this demand the current constraints in the UK mortgage market, which has become a major challenge for first-time buyers trying to buy their first home, and it is clear how the PRS has grown in importance.

17%
Forecast capital growth for prime central London property 2013-2017

The census data shows this trend clearly (figure 8). London has seen the biggest rise in the number of households, which range from people living alone to large families, in the PRS over the last 20 years compared to every other region. Since 1991 the number of households in the PRS in the 13 inner London boroughs has more than doubled, climbing by nearly 190,000 to 372,000. There are more than 100,000 households in the PRS in the four boroughs of central London, up 50% from 1991.

The rising demand for rental property has pushed up average rents in recent years. This coupled with strong capital growth, has resulted in enviable returns on London investments, as shown in figure 7.

However the consolidation in the financial sector had a knock-on effect on rents in prime central London in 2012, with modest declines in average rents which ended the year down 3.2%. Yet the picture is much more localised than this. Some areas saw rents rise last year, including Kensington (0.6%) and the City (3.2%) while Belgravia saw rents climb by 0.9% in the last three months of 2012 alone. The appetite for rental property also remains undimmed, especially in the sub-£1,000 a week price band.

The recent dip in average rents, coupled with high capital values has put a further squeeze on yields. Finding a yield of more than 4% in prime central areas is now the exception rather than the rule.

Investors have typically been more interested in a central location than an extra percentage point or two in annual yield however.

There is also potential for more capital growth, coming on the back of a 53% rise in prices since the market trough in 2009. After pausing this year, we forecast that prime central London property prices will climb by a further 17% by the end of 2017, which will be coupled with increased demand in the private rented sector as the economy gets back on track, and the sector grows in importance as a whole.

Figure 8
Proportion of households in the private rented sector 1991-2011
Based on census 2011 data

Source: Knight Frank Residential Research, Census 2011
ASIAN HOUSING MARKETS

Mainstream house prices in markets where a significant proportion of buyers of new-build London property are based have largely outperformed those in the UK over the last year, as shown below.

This comes despite the cooling measures, that have been introduced by policymakers in China, Hong Kong, Singapore and Malaysia. These range from limiting loan-to-value ratios for mortgage lending for those buying a property that will not be their main residence to taxing any gains made on properties disposed of within a certain timeframe.

However, when we turn to the performance of prime prices on the main cities in these countries, the toll taken by the additional tax measures becomes clearer, as shown in figure 7. Despite this, the tax changes have only partially removed the gloss of local property investment.

Nicholas Holt, Knight Frank’s Asia Pacific residential research director, explains: “There is no doubt that the cooling measures have acted as a spur for many potential investors to look at overseas markets, but there is still an appetite for bricks and mortar in home nations or elsewhere in Asia. Most of those from the Asia Pacific region who invest in property in London or in other overseas markets already own one or more investment properties at home, and they are continuing to look for more.

Yet the attraction of overseas ‘safe-haven’ investment locations that boast strong fundamentals as well as added attractions such as world renowned opportunities for education and a currency advantage remains strong.”

Conclusion

Overseas investment has become a more prominent feature of London’s new-build housing market in recent years, especially investment from Asia, which accounted for nearly 50% of new-build sales in 2012. But is this trend here to stay?

The ramifications of the financial crisis are still felt around the world, and the political instability that emerged after the Arab Spring is still evident in many countries. Amid such uncertainty, London is seen as a stable, safe-haven for investors.

Agents report that the appetite for London property remains strong, especially in Asian markets, but increasingly the desire is for good schemes in the best locations. A second-tier scheme in an outlying location will no longer attract the same level of attention among investors who are sophisticated in their knowledge of UK capital.

Given the tighter yields and higher capital values in the market, it will become increasingly important for investors to choose areas that are traditionally strong or have the potential to outperform, for example, where prices will be spurred by infrastructure projects such as Crossrail, or large scale regeneration.

There is increasing interest in London property from widening range of overseas buyers, especially some emerging economies which have seen high levels of GDP growth, and a resulting surge in wealth creation.

China remains the biggest market opportunity, but the restrictions on overseas investment are currently acting as a barrier against the high levels of interest in London property evident within the country. While some investors can invest via Hong Kong, the market will not fully open up until these restrictions are relaxed.

The city of Wenzhou on China’s eastern coast has dipped its toe in the water, proposing its citizens be allowed to invest in overseas enterprises, at up to $3 million per project. It now remains to be seen how quickly the rest of the country will follow suit.

As outlined throughout this report, there are risks that could threaten the current buoyancy of the overseas demand for prime London property, but there is no evidence that the city’s reputation as a safe-haven is at risk.