The Effect of Foreign Investors on Local Housing Markets: Evidence from the UK

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This paper examines the effect of foreign investment on the housing market using a dataset recently released by the Land Registry, which records all property transactions in England and Wales registered to overseas companies. To overcome endogeneity in the locational choice of investors, I construct an instrument for foreign investment based on economic shocks abroad. The instrument relies on two ideas: first, foreign investors are more likely to invest in the UK when their home countries experience negative economic shocks; second, foreign investors tend to invest in local areas where residents from their home countries live. The model is estimated on data for local authorities in England and Wales for the period from 1999 to 2014.

Foreign investment is found to have a positive and significant effect on house price growth. An increase of one percentage point in the volume share of residential transactions registered to overseas companies leads to an increase of about 2.1 percent in house prices. To have a better idea of the magnitude of this effect, I use the model to construct the counterfactual evolution of house prices when the share of foreign investment is set to zero. I find that average house prices in England and Wales in 2014 would have been about 19% lower in the absence of foreign investment (at approximately £174,000, compared with an actual average of about £215,000). Looking at the effect at different points of the distribution of house prices, I find that foreign investment does not just raise prices of expensive homes, but has a positive effect at different percentiles of the distribution. This suggests that foreign investment in the housing market has a "trickle down" effect to less expensive properties.

To examine how supply restrictions affect the propagation of foreign investment shocks to house prices, I estimate the model separately for local authorities with high and low house price-earnings elasticities. I find that foreign investment increases prices by more in local authorities with higher house price-earnings elasticities. These are areas where housing supply is particularly constrained, either because there is less land available for construction or because of regulatory constraints.

I also examine the effect of foreign investment on other outcome variables. Looking at the effect on the housing stock, I do not find evidence that an increase in foreign investment leads to an increase in housing construction. I also do not find evidence in favour of "buy-to-leave" - the hypothesis that foreign buyers purchase properties purely for capital appreciation and do not occupy them or rent them out. However, I do find evidence that foreign investment reduces home ownership rates, suggesting that some residents may be priced out of the market in areas where foreign investors are more active and have to rent rather than own their homes. These results should help inform the debate on the impact of foreign investment on the housing market.