

The effect of foreign investment on the UK housing market

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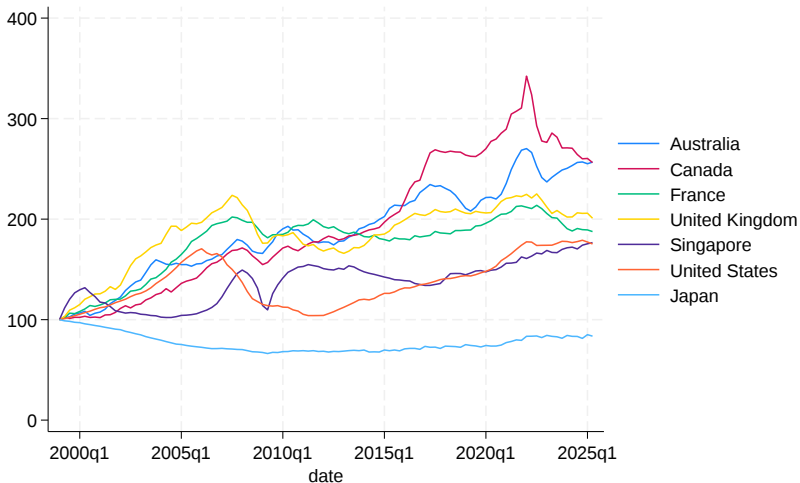
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House prices around the world

BIS real residential property price index, 1999q1=100



House prices in the UK

- Possible explanations for the trend increase
 - Lack of available land for construction and regulatory constraints — Hilber and Vermeulen (EJ 2015)
 - Demand by immigrants — Sá (EJ 2015) — and foreign investors — Badarinza and Ramadorai (J Finan Econ, 2018) and Sá (JOEG 2025)
- Macro literature on the effect of capital flows on house prices
 - Aizenman and Jinjark (J Urban Econ 2009)
 - Sá, Towbin and Wieladek (JEEA 2014)

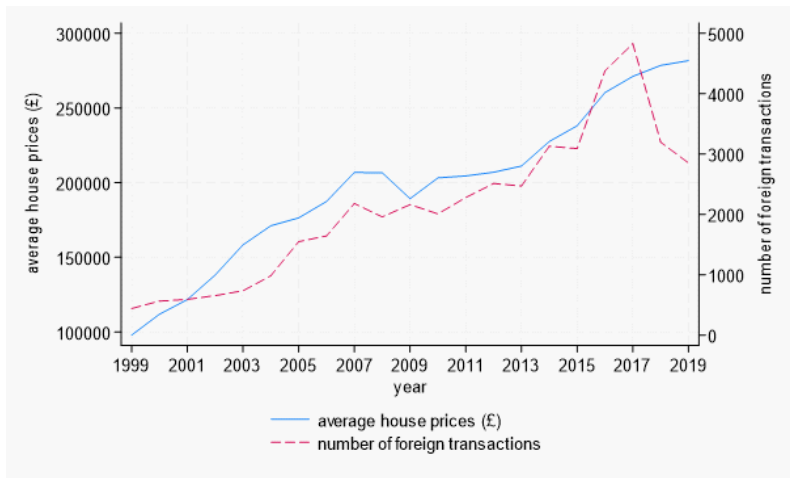
House prices and foreign investment

- In the UK, the March 2020 budget introduced a 2% Stamp Duty surcharge on non-resident buyers, with the revenue used to tackle rough sleeping
- Other countries have introduced policies to control foreign investment in the housing market:
 - Australia encourages foreign investment in new residential projects, but imposes tighter controls on the purchase of existing dwellings
 - Switzerland has restrictions on property purchases by non-residents
 - Canada has a ban on purchases of residential property by foreign nationals until January 2027
 - Israel has higher tax rates for foreign home buyers
 - Singapore also has an additional stamp duty for foreign buyers

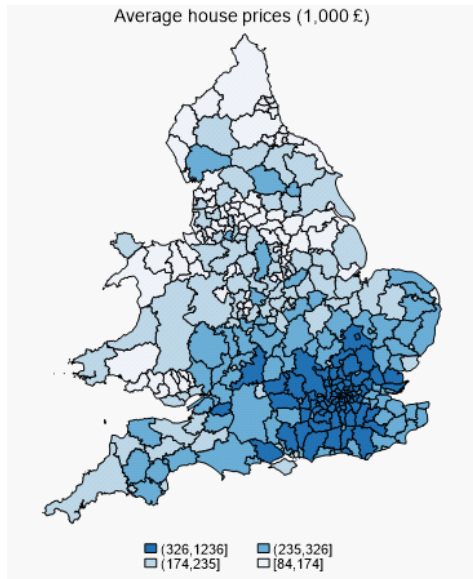
House prices and foreign investment

- I examine the causal link between foreign investment and house prices in England and Wales
- Foreign investment is measured by administrative data on all properties in England and Wales registered to overseas companies — Land Registry Overseas Companies Ownership Data (OCOD) and Private Eye offshore companies dataset
- I study the effect of foreign investment on:
 - Average house prices and different points of the distribution of house prices
 - Price to income ratio
 - Housing stock
 - Vacant homes

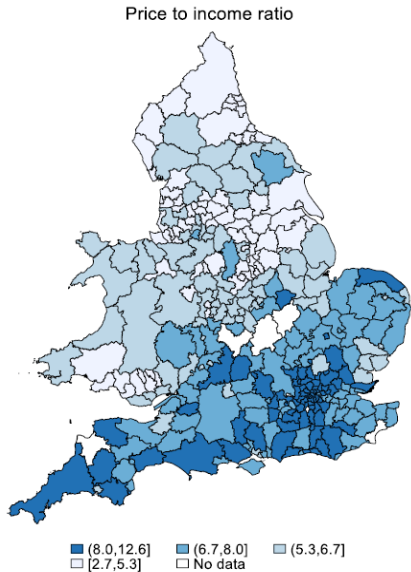
House prices and foreign investment



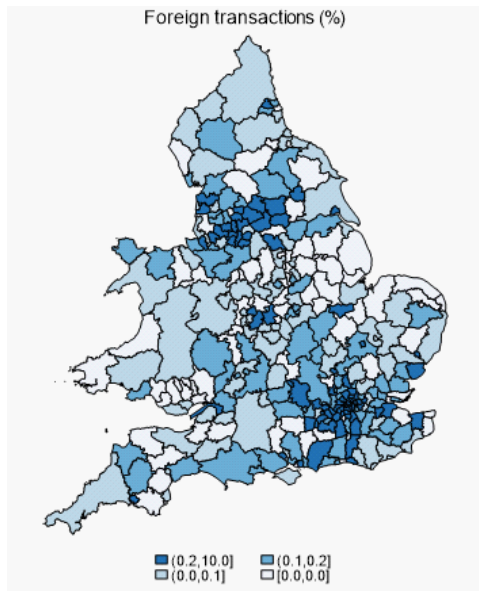
House prices - regional variation



Price-to-income ratio - regional variation



Foreign investment - regional variation



Regional variation

Local authorities with the largest share of foreign transactions, 2019

Local authority	Foreign transactions (%)	House prices (£)
Westminster	10.0	952,896
Kensington and Chelsea	8.2	1,235,957
Salford	6.8	165,730
Rochdale	4.4	141,243
Cambridge	3.2	433,115
City of London	2.9	796,387
Rossendale	2.5	137,997
Newham	2.2	363,956
Wandsworth	1.9	587,915
Camden	1.9	848,158

Methodology

- I use this regional variation and identify the effect of foreign investment on house prices from spatial correlations
- Identification challenge:
 - The direction of causality between foreign investment and house prices is not clear
 - Foreign investors are not randomly allocated across geographic areas
- Instrumental variable approach:
 - Construct an instrument for foreign investment based on political and economic shocks abroad and "home bias"

Empirical model

- Model:

$$\ln(P_{it}) = \beta \ln(FT_{it}) + \gamma X_{it-1} + \phi_t + \rho_i + \varepsilon_{it}$$

- Controls (X_{it-1}): lagged median income (in logs) and lagged share of local population with high school degree and above.
- Instrument for share of foreign investment follows Badarinza and Ramadorai (2016) and is based on two ideas:
 - Foreign investors are more likely to invest in the UK property market when their home countries face negative economic and political conditions — "safe haven" effect
 - Foreign investors exhibit "home bias abroad", i.e., they tend to choose areas in the UK where people from their home country live

Empirical model

- Instrument:

$$\sum_c f_i^c z_{t-1}^c$$

- f_i^c is the share of residents in local authority i that were born in foreign country c from the 2001 Census
- z_{t-1}^c is a measure of economic and political conditions in country c in year $t - 1$: the index of government stability from the International Country Risk Guide (ICRG)

Empirical model

- Dynamic effects measured using a local projection instrumental variable (LP-IV) approach:

$$\ln(P_{it+h}) = \beta^h \ln(FT_{it}) + \phi_t + \rho_i + \varepsilon_{it}$$

$\{\beta^h\}_{h=0,1,\dots}$ measures the effect of foreign investment on house prices at horizon h

- Effect at different percentiles of the distribution of house prices:

$$\ln(P_{pit}) = \beta_p \frac{FT_{it}}{TT_{it}} + \gamma_p X_{it-1} + \phi_{pt} + \rho_{pi} + \varepsilon_{pit}$$

β_p captures the effect of overseas investment on each percentile of the distribution of house prices

Empirical model

- To explore how the response of housing variables depends on supply conditions, I include an interaction term with the house-price earnings elasticity - from Hilber and Vermeulen (2015) - splitting local authorities at the median value:

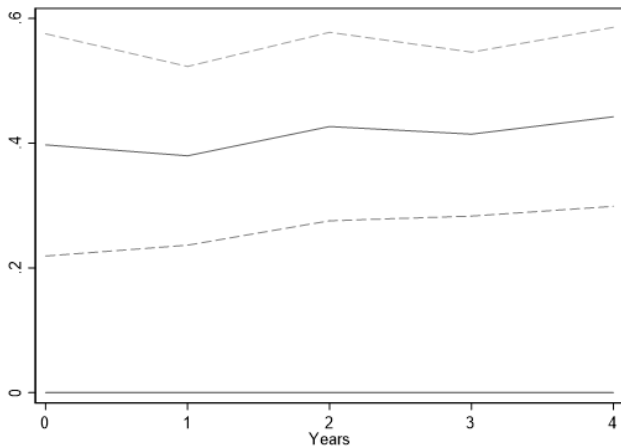
$$\ln(P_{it}) = \beta_1 \ln(FT_{it}) + \beta_2 \ln(FT_{it}) \times HighElast_i + \gamma X_{it-1} + \phi_t + \rho_i + \varepsilon_{it}$$

Results - house prices

	log house prices		
	(1)	(2)	(3)
Panel A. OLS			
log foreign transactions	0.012*** (0.003)	0.007** (0.003)	0.007** (0.003)
Panel B. IV			
log foreign transactions	0.397*** (0.109)	0.443*** (0.126)	0.441*** (0.128)
First-stage F-statistic	15.07	16.75	16.78
Observations	4,397	3,714	3,714
Number of clusters	332	324	324
Socioeconomic controls	No	Yes	Yes
Control for immigration instrument	No	Yes	No
Endogenous immigration share	No	No	Yes

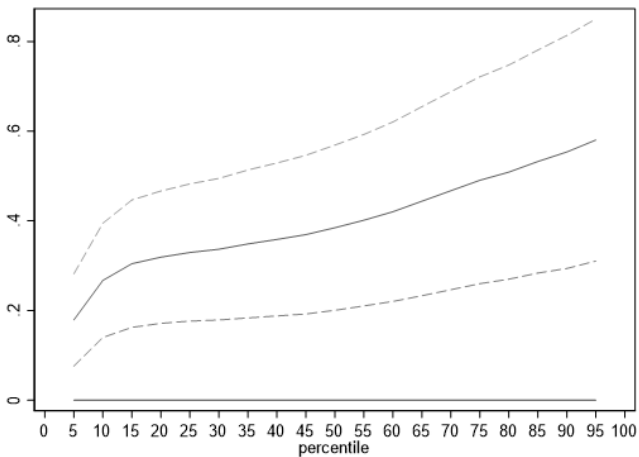
Results - house prices

Impulse response of house prices - LP-IV



Results - house prices

Effect of foreign transactions across the distribution of house prices



Results - housing construction

	log housing starts		
	(1)	(2)	(3)
Panel A. OLS			
Log foreign transactions	0.020 (0.014)	0.020 (0.015)	0.020 (0.015)
Panel B. IV			
log foreign transactions	0.139 (0.247)	-0.210 (0.261)	-0.206 (0.265)
Observations	3,919	3,323	3,323
Number of clusters	312	304	304
Socioeconomic controls	No	Yes	Yes
Control for immigration	No	Yes	No
instrument			
Endogenous immigration share	No	No	Yes

Results - vacant dwellings

	log long-term vacant dwellings		
	(1)	(2)	(3)
Panel A. OLS			
Log foreign transactions	-0.035*** (0.010)	-0.032*** (0.010)	-0.033*** (0.010)
Panel B. IV			
log foreign transactions	-0.721*** (0.232)	-0.818*** (0.292)	-0.818*** (0.300)
Observations	3,620	3,399	3,399
Number of clusters	312	304	304
Socioeconomic controls	No	Yes	Yes
Control for immigration instrument	No	Yes	No
Endogenous immigration share	No	No	Yes

Vacant dwellings

Local authorities with the largest share of long-term vacant homes, 2019

Local authority	Long-term vacant homes (%)
City of London	4.0
Barrow-in-Furness	2.6
Copeland	2.3
Burnley	2.2
West Suffolk	2.1
Blackpool	2.1
North East Lincolnshire	2.0
Bradford	1.9
Torbay	1.9
Middlesbrough	1.8

% dwellings that have been unoccupied or substantially unfurnished for more than six months

Results - supply elasticity

	log house prices		
	(1)	(2)	(3)
Panel A. OLS			
log foreign transactions	-0.001 (0.006)	-0.009** (0.004)	-0.009** (0.004)
log foreign transactions × high elasticity	0.024*** (0.008)	0.029*** (0.007)	0.030*** (0.007)
Panel B. IV			
log foreign transactions	0.333*** (0.104)	0.347*** (0.115)	0.320*** (0.116)
log foreign transactions × high elasticity	0.049 (0.055)	0.087 (0.072)	0.104 (0.071)
Observations	4,201	3,532	3,532
Number of clusters	311	303	303
Socioeconomic controls	No	Yes	Yes
Control for immigration instrument	No	Yes	No
Endogenous immigration share	No	No	Yes

Summary of the results

- A 1% increase in the number of foreign transactions increases house prices by about 0.4%
- Foreign investment has a larger positive effect on the prices of expensive homes, but increases prices at different percentiles of the distribution
- No effect on housing construction
- No evidence of "buy-to-leave"
- No evidence of heterogeneous effects across local authorities with different housing supply elasticities