



## Foreign direct investment in the UK real estate market

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### ABSTRACT

The aim of this paper is to identify the key factors affecting foreign real estate investment (FREI) in the UK, with a particular focus in London. The panel regression method was used as a data analysis approach for this paper. Two panel regression equations were developed. The first equation has five explanatory variables including GDP, wage, property price, land price and interest rate. The second equation has the sixth explanatory variable, tourists, as well as the five variables used in the first equation. Pearson coefficient analysis was also conducted to identify the correlation between the dependent variable, FREI and the explanatory variables. For the first equation of panel regression analysis showed all five explanatory variables are statistically significant and have an expected impact on FREI. That is GDP and house price, have positive impacts on FREI, while wage, land price and interest rate have negative impacts. For the second equation, all explanatory variables, apart from interest rate and tourists, are statistically significant. Tourists have an unexpected negative impact on FREI. Pearson coefficient analysis showed that FREI has a statistically significant correlation relationship with GDP, wage, house price, land price and interest rate. FREI also has a positive relationship with all explanatory variables except interest rate.

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## 1. Introduction

Research into foreign real estate investment (FREI) has been a popular topic in different countries including Australia, China, Korea, Malaysia, Spain, Vietnam and OECD countries (Gholipour, 2013; Gholipour, Usama Al-mulali, & Mohammed, 2014; He, Wang, & Cheng, 2011; Hui & Chan, 2014; Jiang, Chen, & Isaac, 1998; Jung, Huynh, & Rowe, 2013; Kim, Han, & O'Connor, 2015; Rodríguez & Bustillo, 2010; Rogers, Lee, & Yan, 2015). There is a lot of foreign investment in real estate in the UK, especially in London, due to the high investment return, favourable taxation terms and the attractiveness of the location. FREI is a popular topic in the public medias, such as newspapers: e.g. *The Guardian*, *Financial Times*, *Reuters*, *The New York Times* (Conlin, 2014; Goldfarboct, 2013; Hammond, 2014; Osbourne, 2013), publications by property firms, e.g. BNP Paribas Real Estate, Knight Frank and Savills (Bailey, 2013; BNP Paribas Real Estate, 2015; Gilmore, 2013; Savills, 2013) and Think Tank e.g. Civitas: The Institute for the Study of Civil Society (Green & Bentley, 2014). However, there is not yet any academic research on FREI in the UK and development of the

findings based on statistical analysis of publicly available data. The aim of this paper is to fill this gap. This paper's contribution to the academic literature is the identification of important factors and their level of influence on FREI in the UK. This information can be used by potential foreign real estate investors as market intelligence to inform their investment decision-making. The research findings of this paper can also be used by fellow academics to gain further knowledge of the foreign direct investment (FDI) in UK real estate. The finding of the paper can also be used to benchmark and compare the factors affecting FREI in the UK and in other countries such as China, Vietnam and Australia (Hui & Chan, 2014; Jung et al., 2013; Rogers et al., 2015).

This paper aims to identify the factors which affect FREI in the UK, with the focus on the London residential market. The reason for focusing on London is that it is the capital city and attractive to foreign investment. There is also a chronic shortage of residential property which further enhances its attractiveness. This paper is divided into five sections. The first section discusses the current status of FREI in the UK with the focus in London. The second section is a discussion of the existing literature on this topic of FREI. The third section discusses the research method. The fourth section is information about the research findings. The last section is the conclusion, which also includes discussion on the limitations of this study and suggested future research areas.

## 2. Foreign real estate investment (FREI) in the UK

### 2.1. Current status of the FREI in the UK

There is an increasing level of foreign inward investment into the UK. According to the UK's 2012/2013 Inward Investment Annual Report prepared by the UK Trade and Investment (UKTI), 1559 investment projects were secured in Britain during the financial year of 2012 to 2013, which showed an increase of 11% from the previous 12 months. The number of FDI initiatives in England outside of London in the year leading to April 2013 rose by 10%, totalling 759 projects. The same report stated that the inflows of FDI in the UK have risen by 22% between 2012 and 2013, while global FDI inflows have fallen by 18% during the same period (UKTI, 2012/2013).

The economic and financial changes since 2007 have created a fresh model for overseas investment in new-build property and a new impetus for cross-border investment in prime property assets around the world (Gilmore, 2013). Deloitte reported that £20 billion was spent by foreign buyers in the UK property industry in 2012 (Select Property, 2014). Research from BNP Paribas Real Estate also showed that 82% of property transactions in the City of London during the first six months of 2013 were made by international investors, amounting to £4.15 billion in total (BNP Paribas Real Estate, 2015). London has been a popular city for foreign investment for the last several decades. In the 1980s, Americans were the dominant international investors for the London market. Over the last decade or so, Russian and Asian buyers have become more active. Investors from the Middle East and Europe are the other main overseas London property buyers in recent years (Gilmore, 2013).

Spending by investors from Asia grew by 166% during the three months leading to June 2013 compared with the previous quarter, rising to £1.04 billion (BNP Paribas Real Estate, 2015). Savills's research shared the same finding, their report stated that £7 billion of international money was spent on high-end London residential properties in 2012, with only

20% of prime property purchasers from the UK. Significantly, two-thirds of purchasers were investors rather than owner-occupiers (Savills, 2013). Conlin (2014) summarised London's attractiveness and stated that London ranks as the top city for having a FREI opportunity, beating out last year's winner, New York, according to a survey by the Association of Foreign Investors in Real Estate.

Foreign investors are particularly interested in new-build properties. According to research conducted by Savills in 2013, overseas investors channelled £2.2 billion into the new-build sector in central London in 2012, up from £1.8 billion in 2011, with the prices rising by 56.3% from January 2009 to June 2013. The buyers from Singapore, Hong Kong, China, Malaysia and Russia accounted for more than half of new-build property sales in central London. China and Indonesia are among the biggest potential new markets for UK property investment from 2013 (Gilmore, 2013).

The increasing demand for properties in London is not without a negative impact. The increase in property prices in London is higher than the national average and has become unaffordable to the people already living in London, both in buying or renting properties. Green and Bentley's (2014) study stated that the comparison of the ratio of the average prices to average incomes in the UK. It was 2.3 in 1980 and doubled to 4.6 in 2013, it was 6.1 in Greater London. The rents have also been forced up and many people in London have to pay half or more of their income in rent.

Developers have taken up measures to ensure the foreign investors can have priority access to the prime properties in London. Hammond (2014) stated that most new homes in central London were being sold at overseas events before being advertised to the UK buyers. Foreign buyers accounted for nearly three-quarters of new home purchases in inner London in 2012 compared with 27% for UK buyers, according to data from Knight Frank, the property group. More than half of the homes were sold to buyers from Hong Kong, China, Malaysia and Singapore (Gilmore, 2013).

The developers have also implemented marketing strategies, such as off-plan sales, which is particularly familiar and convenient to overseas buyers. There is a high rate of overseas sales through off-plan sales at a discounted price, where developers sell sites before properties are built to fund further new development. Knight Frank is one of many UK-based estate agencies offering London properties for sale at off-plan sales exhibitions in Hong Kong, Singapore and Kuala Lumpur in Malaysia. Developers often spend up to £150,000 putting on an event for a weekend but the initial investment is frequently justified. The well-attended events can lead to large numbers of residential properties being sold in 48 h, compared to the low single-digit weekly sale rates in the UK (Hammond, 2014).

## ***2.2 Reasons for attracting foreign investors into the UK real estate market***

The economic strength and financial stability of the UK is one of the reasons the UK's real estate market is so attractive to foreign investors. It is also seen as a safe location for investors because of its property market's long-term successful performance and legal transparency free from political and economic strife that have affected countries such as Nigeria, France and Greece in recent years (Samuel Warren, Head of Residential Developments at Nationwide, cited in Select Property, 2014). The growing stability of emerging markets following the financial crisis also means investors from these countries are becoming richer and have more capital to invest. The status of the UK as a member of the European Union is

also attractive to foreign, and especially EU investors. Furthermore, the UK Government's actions to improve the economy recently have also attracted international interest. The EY 2013 UK Attractiveness Survey reported the number of projects coming into the UK increased by 2.6% in 2012, amounting to 697, which is the third highest figure in the last 10 years. This is likely to be the result of the UK's appealing tax laws, its ongoing support for small and medium-sized enterprises and trade missions, all of which are popular among investors from overseas (Ernst and Young (EY), 2013). However, with the result of the BREXIT referendum of June 2016 indicating that the UK wishes to leave the EU, uncertainty in the foreign investment market in the UK appears inevitable.

The improvement in the UK's property market in recent years has also encouraged real estate investors to consider purchasing property in the UK. According to Nationwide, new build properties have risen significantly in value, growing by 47.7% in price since 2009 (Nationwide, 2016). The increase in demand and limited new supply of properties are also reasons pushing up property values the UK and particularly London. The cash-rich investors regard London property as a means to diversify from bonds, which they are currently inclined to do as a result of low interest rates and unpredictable equity markets.

The UK's financial and property laws can be one of the biggest reasons why investors are keen to put their money into the country. According to the UKTI, the relatively simple taxation has reduced the UK businesses tax bill of around £1 billion from 2012 to 2013 (Select Property, 2014). The proposed reduction of main corporate tax to 20% in 2015 in order to encourage international investment will be the lowest rate in the G7 and the joint lowest in G20. Many overseas investors consider the UK to have more favourable taxation legislation compared to their own countries, especially when it comes to property transactions. For example, Singapore has a steep stamp duty with foreign and corporate buyers having to spend 15% in tax on properties they buy in the country. This was a rise from 10% only one year after the levy was introduced in Singapore. Another example is Hong Kong, with a seller's stamp duty of up to 20% on properties that were owned for a short amount of time and a 15% stamp duty for buyers who are not Hong Kong permanent residents or citizens (Select Property, 2014). Despite the tax rate in the UK seems to be higher than in some countries, such as Hong Kong and Singapore, the relatively simple taxation structure still makes it attractive for foreign investment in the UK.

Furthermore, the weak exchange rate for sterling against other major currencies has also given London property an edge for international investment portfolios (Boyce, 2013). Green and Bentley (2014) concluded the foreign investment situation in London and stated that

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. (p. 2)

### **2.3 Measures to control FREI impacts in the UK**

The UK Government has taken measures to control the level of FREI in the UK. In the December 2013's Autumn Statement, the Chancellor announced that he was closing a loophole that allowed foreign investors to profit on sales of UK property without paying capital gains tax (CGT) and this was implemented from 6 April 2015. Before the implementation of this tax policy, only UK citizens and residents paid CGT, which is charged on profits

made from the sale of any property that is not the owner's main home. Basic rate taxpayers pay 18% of the profits, whilst higher rate payers pay 28%. A foreign buyer who bought a property for £1m and later sold it for £3m could pocket the proceeds tax-free, whilst someone based in the UK would face a bill of up to £560,000 (Osbourne, 2013). The tax rate for the foreign investors CGT policy broadly mirror those for UK residents, with individuals and trusts taxed at up to 28%, and companies at 20%. Tax will be levied only on the part of the gain arising after 6 April 2015: the taxpayer will be able to choose either to apportion the gain on a time basis or to treat the property as having been acquired on 6 April 2015 at its market value on that date (HM Revenue & Customs, 2016). However, this measure has not been without resistance. The former Mayor of London, Boris Johnson stated at a Mansion House dinner not long after the announcement of this Autumn Statement that 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" (Pickford, 2014).

Think Tank organisations, such as Civitas have recommended the UK Government implements a stronger policy on controlling overseas investment (Green & Bentley, 2014). Green and Bentley (2014) recommended that the UK adopts a policy which was implemented in Australia by preventing non-residents and short-term visa holders investing in residential property, unless their investment added to the housing stock, by not allowing them to purchase already-existing dwellings either as investment or for owner-occupation purpose. Green and Bentley (2014) also mentioned that the UK would not be alone in taking a proactive approach in an attempt to control foreign investment levels. Apart from Australia, Denmark, Singapore and Switzerland, all have controls on foreign investment to attempt to ensure that any non-resident purchases are not at the expense of public interest. Switzerland, for example, has a highly decentralised system and relies on its local authorities to exert control. This Civitas' report did not recommend following the Switzerland approach but suggested following the Australian system as it is a more appropriate strategy for the UK.

### 3. Literature review

#### 3.1 Research of FREI in different countries

There are numerous previous studies investigate FREI in different countries. China is a popular country for this type of study (He et al., 2011; Hui & Chan, 2014; Jiang et al., 1998; Kuang, Zhou, & Zhang, 2011). Hui and Chan (2014) used a panel regression model to investigate the factors affecting FDI in China's real estate market in recent years. They have analysed the trend of entry mode and regions of investment from foreign real estate enterprises, through incorporating a new explanatory variable to test the difference between FDI in real estate in the coastal and other areas in China. Their findings showed that coastal areas are still the favourable investment spots for foreign investors. Hui and Chan (2014) shared the same findings in earlier research conducted by He et al. (2011). He et al. (2011) commented that China has been disproportionately agglomerated in the coastal regions and some inland provinces along the Yangtze River. Their research findings indicated that there is a significant spatial autocorrelation in the provincial distribution of foreign direct real estate investment. The findings also implied that foreign investors in China's real estate industry stress returns to capital while appreciating the conducive

institutions when choosing locations. He et al. (2011) have used the Tobit model, to conduct the analysis of this research. Kuang et al.'s (2011) research constructed a partial equilibrium of housing flow market to investigate the impact of foreign investment upon house prices. Despite that the theoretical model demonstrated that the inflow of foreign investment resulted in the appreciation of house prices, the empirical results illustrated that the foreign investment had a trivial impact on the house prices. In addition, the paper found that the household income rather than development cost was the most important factor influencing the urban housing prices. The other findings of the study were that interest rate policy is nearly invalid, the housing prices in bigger cities are more prone to increase and the substituting effect between rental market and ownership market is weak. He and Zhu (2010) have conducted additional research analysing the spatial patterns and determinants of FDI in real estate development in 35 major Chinese cities during 2002–2008. Using fixed effect on panel regression analysis, their results indicated that both local demand and demand generated by foreigners for real estate has attracted foreign real estate developers (He & Zhu, 2010).

Jung et al. (2013) researched into the FREI pattern of Ho Chi Minh City in Vietnam. The aim of Jung et al.'s (2013) paper was to understand the dynamics of foreign developers, the types of properties that were being created, the location of the investments and the differences in development strategies adopted by foreign developers in comparison to their domestic counterparts. The analysis method for Jung et al.'s (2013) project was to conduct a series of spatial analyses including sieve mapping, histogram analysis, factor analysis and logistic regression on the data and statistics of the apartment projects in the area. Furthermore, case studies and interviews with relevant stakeholders were also conducted, in order to understand the dynamics among foreign and domestic developers, also allowing the identification of the regularities in the patterns of foreign developments. Nguyen (2011) conducted research on FREI in Vietnam. Nguyen (2011) identified one of the main determinants of Vietnam's high economic growth for more than two decades has been its capability to attract FDI. Despite FDI contributing to economic growth through increasing manufacturing exports, creating employment and enhancing total factor productivity, this paper also argued that FDI into the country's real estate and construction sectors stimulated by the property market bubble has contributed to macroeconomic instability. This paper concluded that more government measures should be introduced in order to enhance its supervision and encourage FDI into labour intensive manufacturing sectors.

Rogers et al.'s (2015) research analysed the cultural, housing and inter-governmental politics of individual foreign investment in the Australian real estate market. The focus of Rogers et al.'s (2015) research was on identifying the Chinese investors' influence on the Australian housing affordability problem, especially in Sydney and Melbourne. The paper adopted a mainly qualitative approach. The authors drew on interviews, real estate websites and media data to demonstrate how the Australian housing system and Chinese and Australian actors enabled Chinese investment in Australian real estate. This study concluded that contemporary global real estate relations have complicated the politics of Asian real estate investment in Anglo-sphere countries.

Rodríguez and Bustillo (2010) used time series data from 1990 to 2007 to develop a model of FREI for Spain. This research concluded that relevant determinants on the Spanish real estate markets are from the demand side and also from financial considerations, such as gross domestic product (GDP) per capita, expected capital gains, travel costs, tourism

agglomeration and housing prices. Therefore, these factors are considered as relevant factors explaining FREI.

Kim et al. (2015) explored the characteristics of the foreign buyers of housing in Seoul, South Korea and their favourable property locations in this city. This research analysed the housing transaction data and the location of ethnic communities. This paper concluded that foreign housing investment in Seoul is closely associated with overseas Koreans rather than immigration. The location of foreign owned houses is linked to the geography of ethnic clusters as well as in areas where high potential investment returns are perceived. Foreign housing investment has the potential to strengthen long-term settlements of foreigners, and to encourage the emergence of “global villages”.

Gholipour (2013) investigated the distribution of foreign investment among different Malaysian States. The research indicated that some larger States, such as Kuala Lumpur, Selangor, Penang and Johor, have a higher level of foreign investment. This research used panel regression analysis and a Generalized Method of Moments approach to analyse the data of 14 Malaysian States over a period of 7 years, from 2004 to 2010. The statistical results showed that tourism agglomeration, well-being of the local people, foreign investments in other sectors, religious diversity and minimum property purchase price are important determinants of foreign investment in residential properties.

Despite FREI being a popular topic and extensive research being conducted in this area, there is not yet any academic research which focuses on investigating FREI in UK, or more specifically London real estate. The aim of this research is to fill this gap.

### **3.2 Impacts of FREI in real estate market of the host location**

There are mixed impacts on foreign investment to the host country. The impact of FREI is particularly significant in emerging markets (Jung et al., 2013). Horner and Swarbrooke (2004) stated the potential economic benefits in the host cities when FREI happened are: (1) bringing new life to the rural communities which suffer depopulation; (2) making local services viable, such as food shops, transport, restaurants and sporting facilities; (3) generating income for local entrepreneurs from the spending by the foreign owners; (4) generating property taxes paid to the local government; (5) generating profits from land owned by local people and (6) creating jobs and income for local builders and craftsmen. Moreover, foreign investments can contribute significantly to the rapid globalisation of metropolises and facilitates changing the scene of urban development qualitatively. Fung, Jeng, and Liu (2010) argued that investment in the real estate sector by domestic and foreign investors is a major driver of economic growth, by stimulating the demand for many other industries such as electronics, machinery, steel and architecture.

The growth of FREI is not without negative impacts to the host communities. Horner and Swarbrooke (2004) identified the negative impacts such as local people feeling like outsiders in their home community and being priced out of the local markets. This is how the press portrays the situation in London, that foreign investment has driven up the property prices and made it beyond affordable for the native Londoners (see Section 2.1).

It is not always the case that foreign investors have dominant comparative advantages to the local investors. Jung et al. (2013) stated the common reasons explaining foreign companies' inability to penetrate the markets as compared to their domestic counterparts. Foreign companies may have more sophisticated construction techniques and access to

finance, but domestic property construction companies have the advantage of possessing a better understanding of the local residential culture, lifestyle and climate conditions, etc. They are also more competitive in terms of cost reduction, having a strong business network and a familiarity with the local legal process. Therefore, the tension between foreign and domestic construction companies is more likely to be conspicuous in the market of property construction. However, the tension between local and foreign investors may not be too intense for purely property investment activities as the significance of local knowledge has become relatively less important.

In conclusion, the impact of foreign investment in the local market varies and it is largely dependent on the circumstances of individual countries. The research findings and discussion section of the paper will address the impact of FREI in the UK and in particular the London residential property market. Please see Table 1 for a summary of literature on FREI.

**Table 1.** Summary of literature on foreign real estate investment.

Source of data	Variables	Significance on foreign real estate investment
<i>Influence of variables on foreign real estate investment</i>		
Hui and Chan (2014)	Coastal areas	Foreign real estate investment disproportionately agglomerated in the coastal regions
He et al. (2011)	Household income	A positive relationship between household income and the level of foreign real estate investment
He et al. (2011)	Interest rate	Interest rate does not have much impact on the level of foreign real estate investment as it is unlikely foreign investors require finance from the country which they invest in
He and Zhu (2010)	Property demand	Local property demand and demand generated by foreigners for real estate has attracted foreign real estate developers
Nguyen (2011)	Economic growth	A positive relationship between economic growth and the capacity to attract foreign direct investment
Rogers et al. (2015)	Political environment	Contemporary global real estate relations have complicated the politics of Asian real estate investment in Anglo-sphere countries
Rodríguez and Bustillo (2010)	Economic indicators	A positive relationship between economic indicators and the level of foreign real estate investment
Kim et al. (2015)	Location of ethnic communities	Higher level of foreign real estate investment from certain ethnic groups of investors in the same location which has same cluster of communities from the same ethnic background
Gholipour (2013)	Social factors	A positive relationship between social factors and the level of foreign real estate investment
Source of data	Types of impact market	Description of the impact
<i>Impacts of FREI in real estate market on the host location</i>		
Horner and Swarbrooke (2004)	Generate economic benefits	Enhance local economy
Horner and Swarbrooke (2004)	Negative impacts	Making the locals feel outside of their community
Jung et al. (2013)	Competition/tension	Tension between foreign and domestic construction companies

#### 4. Research method

Fixed effects panel regression method was used as a data analysis approach for this paper. Panel regression is a popular data analysis method for FREI research (see Farzanegan & Fereidouni, 2014; Gholipour, 2013; Hui & Chan, 2014). Baltagi (2005) and Farzanegan and Fereidouni (2014) stated the advantage of panel data is that it gives more informative data, more variability, less co-linearity among the variables, more degree of freedom and more efficiency. With additional and more informative data, researchers can produce more reliable parameter estimates. Fixed effects regression enables control to be imposed on the omitted variables that differ between cases but are constant over time. As a result, it enables the use of the changes in the variables over time to estimate the effects of the independent variables on the dependent variable. Minitab was used to conduct data analysis of this paper.

This research has conducted analysis of two sets of data. Equation (1) considered explanatory variables including GDP, wage, property price, land price and interest rate. Equation (1) has used quarterly data from Q1 1987 to Q3 2015, giving a total of 115 observations. Equation (2) considered the five explanatory variables that were used in Equation (1) plus tourists data. Tourism has been identified as an important factor affecting FREI (Fereidouni & Masron, 2011; Gholipour, 2013; Hui & Chan, 2014; Rodríguez & Bustillo, 2010), but the quarterly tourism data is only available from Q1 2002 to Q3 2015 and the number of observations reduced to 55. Other research on this topic, such as Spain, demonstrates that tourists purchasing a second home is one of the main reasons leading to a high level of foreign investment. However, tourists purchasing property is not the main type of foreign property investment in the UK. The main purpose is for investment purposes, either for capital gain or as a long-term investment such as letting the properties out. It is less likely the case that tourists purchase a property as a second home in London for holiday purpose. This is another reason to conduct two analyses in this study with the aim to identify the impact of tourism on the data analysis. The observed quantities in terms of the explanatory variables in this paper are treated that as if they are not random, the analysis approach of this paper is classified as fixed effects. Please see Table 2 for information on the sources of data for variables and their expected effect on FREI. Please see the discussion on the identification of each variable as follows.

FREI is the dependent variable and it is measured at total investment level. The source of FREI data is from the Office of the National Statistics (ONS, 2016a). The sample size of FDI sector is of approximately 6000 UK businesses owning subsidiaries and branches in foreign countries (outward population) and 20,900 UK businesses, who themselves are subsidiaries or branches of a foreign company (inward population) and the components collected include earning, flows and positions. The FDI Survey is responsible for collecting financial data on assets and liabilities, relating to direct investment in the UK by enterprises

**Table 2.** Source of data for variables and their expected effect on foreign real estate investment.

Data	Source	Expected effect
FREI	Office for National Statistics [ONS] (2016a)	
GDP	Office for National Statistics [ONS] (2016b)	+
Wage	Office for National Statistics [ONS] (2016c)	-
House price	Nationwide (2016)	+
Land price	Savills (2015)	-
Interest rate	Bank of England (2016)	-
Tourists	VisitBritain (2016)	+

located abroad (inward FDI) and direct investment abroad by enterprises located in the UK (outward FDI). In either case the foreign investment must be at least 10% of the ordinary shares or voting power (ONS, 2017).

The first explanatory variable is GDP. This variable represents the market demand/size and it is a crucial factor for foreign investment. It is expected that when the local economy grows, more business opportunities are created for foreign investment and hence investors' confidence is boosted. Previous studies such as Cheng and Kwan (2000), Coughlin and Segev (2000), Dees (1998), Havrylchyk and Poncet (2007), Hui and Chan (2014), Ren and Pentecost (2007) and Sun, Tong, and Yu (2002) found that market size is a significant positive factor on FDI. As with most previous studies, this paper also used GDP per capita as the measure and it is expected to have a positive effect on FREI.

The second explanatory variable is wage. Labour cost is an important component of the total cost for many companies. Previous studies, such as Cheng and Kwan (2000), Coughlin and Segev (2000), Ren and Pentecost (2007) and Sun et al. (2002) found that a higher wage level imposed a negative impact on FDI. However, it is not a one-side view. Zhao and Zhu (2000) found a positive significant relationship between wage and FDI. Branstetter and Feenstra (1999) commented that multinational firms in China tend to pay a wage premium in order to attract high quality workers. However, the majority of previous studies dominantly found a negative relationship between wage level and FDI. Therefore, the assumption was made that wage has a negative effect on FREI in this study.

The third explanatory variable is the average house price for all houses. The previous studies had mixed results on the relationship between property prices and FREI. Bagchi-Sen (1995), He et al. (2011) and Zhu, Sim, and Zhang (2006) found that increasing property prices in a country enhance FREI of that country. On the other hand, Rodríguez and Bustillo (2010) found a long-run and negative relationship between property prices and FREI in Spain. As the positive relationship between property prices and the level of FREI was found in the majority of previous studies, the same assumption has been used in the current study.

The fourth explanatory variable is land price. The land value used in this paper is Savills's land index (Savills, 2015). As, if higher land cost increases the cost of foreign investors' investment in real estate, it is expected land price has a negative effect on FREI.

The fifth explanatory variable is interest rate. Interest rate is a proxy for financial cost. When the interest rate rises, the cost of borrowing money increases and it may hinder investment with FREI no exception. Farzanegan and Fereidouni (2014), He et al. (2011), Rodríguez and Bustillo (2010) and Zhao (2003) found that higher financing cost/ long-term interest rate had a negative effect on foreign investment in real estate. This paper used the Bank of England base rate as the measure for interest rate. As with previous research, it is expected that the interest rate has a negative effect on FREI.

The sixth explanatory variable for Equation (2) (see below) is tourists, which is the number of tourist arrivals in a year. Fereidouni and Al-mulali (2012) commented that international tourism allows potential investors to have first-hand experience of the host country's environment and to obtain information about the investment opportunities available. Rodríguez and Bustillo (2010) and Gholipour (2013) also stated that tourists have a positive impact on FDI in a country. Therefore, it is expected that tourists have a positive effect on FREI in this study.

Please see Table 2 for the information on the variables and their expected impact on FREI. The two panel data equations (Equations (1) and (2)) are listed as below and  $t$  stands for time period and  $e_t$  is an error term.

$$\begin{aligned} \ln FREI_{it} = & \alpha + \beta_1 \ln GDP_t + \beta_2 \ln WAGE_t + \beta_3 \ln PRICE_t \\ & + \beta_4 \ln LAND_t + \beta_1 \ln INTEREST_t + e_t \end{aligned} \quad (1)$$

$$\begin{aligned} \ln FREI_{it} = & \alpha + \beta_1 \ln GDP_t + \beta_2 \ln WAGE_t + \beta_3 \ln PRICE_t \\ & + \beta_4 \ln LAND_t + \beta_1 \ln INTEREST_t \\ & + \beta_1 TOURISTS_t + e_t \end{aligned} \quad (2)$$

In addition to the panel regression analysis, Pearson correlation analysis was also conducted to explore the statistical relationship between the dependent variable and explanatory variables.

## 5. Research findings and discussion

The Pearson correlation analysis showed that most explanatory variables have statistical significance and expected correlations with the dependent variable, FREI (see Table 3). GDP, wage and house price are statistically significant and with positive high Pearson's correlation coefficients of greater than .90 with FREI, indicating that better economic prospects have a positive correlation relationship with FREI. This finding supported Kuang et al.'s (2011) theoretical model which stated that the inflow of foreign investment will enhance housing prices. It is arguably a similar situation for the London property market. As mentioned in Section 2, the performance of the London real estate investment market is largely affected by the economic situation of other countries. If these countries are prosperous, they have more money to invest. Considering that London is a favourable foreign investment market with a favourable tax system and political stability, there is a distinct possibility that potential investors in these countries are more inclined to invest in London.

However, Kuang et al.'s (2011) empirical research findings showed that with a 1% increase of foreign investment, the housing price increases by .011%, which means the impact of foreign investment on house prices is trivial. Interest rates also showed an expected correlation relationship with FREI, having a statistically significant negative high Pearson's correlation coefficient of  $-.837$ . He et al. (2011) echoed this finding and they commented that foreign real estate investors avoided investing in provinces which have high financial costs. This can explain why there has been a relatively high level of foreign investment in recent years. The interest rate in the UK has been set at a historically low level, below 1%, since 2009.

**Table 3.** Pearson correlation between FREI and other explanatory variables.

Explanatory variables	Pearson correlation with FREI	Significance (2.tailed)
GDP	.983	.000
Wage	.979	.000
House price	.959	.000
Land price	.770	.000
Interest rate	-.837	.000
Tourists	-.901	.510

Land price and FREI did not show an expected Pearson correlation coefficient with FREI as it has a statistically significant positive value. One of the arguments for this situation relates to the demand and supply of the land, which is an essential element for property development, in London. The supply of land in London is limited, while the demand is high as it is the capital city. Therefore, there is an inelastic demand for land in London. As a result, the impact on the change in price has a less proportionate impact on its demand.

Despite the tourists variable showing a high expected value of negative Pearson correlation coefficient with FREI, it is not statistically significant. As mentioned in Section 4, the reason for foreign investors investing in the London real estate market is different from some other countries, e.g. Spain. The primary purpose for the foreign investors to purchase property in London is mainly for financial reasons, such as capital gain or use as long-term investment. They are less likely to purchase the property as holiday home. The incorporation of tourism as a variable has impact on the level of influence of other variables. The biggest impact after the incorporation of tourism as a factor is on interest rate as the statistical significance of this variable has changed from significant in Equation (1) to insignificant variable in Equation (2). The  $t$ -statistics has also reduced from  $-2.86$  to  $-1.31$ . It is difficult to identify a possible and logical explanation for this as there is no direct relationship between number of tourist and interest rate level. Also, as mentioned by He et al. (2011), there is trivial impact of interest rate on FREI.

Please see Table 3 for the Pearson correlation coefficient information.

At Equation (1), both  $R^2$  and  $R^2$  adjusted have high values of or exceeding .99. This indicates that the explanatory variables have a strong explanatory power on FREI. The value of  $F$ -statistic is not small but the  $p$ -value is very small and at a statistically significant level. The sign of the coefficients of the five explanatory variables are as expected. All explanatory variables are statistically significant, with four factors, GDP, wage, house price and land price at a statistically significant level of 1% while interest rate is at a statistically significant level of 5%.

The finding of Equation (1) has shared the similar finding with previous research such as Cheng and Kwan (2000), Gholipour (2013), He et al. (2011), Hui and Chan (2014), Kuang et al. (2011) and Rodríguez and Bustillo (2010). Kuang et al.'s (2011) empirical study finding research indicated that despite the interest rate being a well-known factor for FDI, the impact of interest rate policy on FDI is nearly invalid. This can be explained by the fact that the finance for FREI would likely have been obtained from their country of origin. Therefore, the change of the interest rate in the host country has very little impact on FREI's behaviour. However, the low interest rate in the UK since 2009 may be a contributory reason for having a high level of FREI. Rodríguez and Bustillo (2010) indicated GDP, expected increase in house prices, expected capital gains and travel costs are all relevant factors explaining and attracting FREI. Coughlin and Segev (2000) commented the economic size has a positive major determining impact on China's FDI while average wage has a negative impact on foreign investment. Gholipour (2013) also commented that the well-being of the local people, which can be measured in GDP, and the property prices, are important determinants for the level of FREI. The reasoning behind this argument is that the betterment of the well-being of local people will lead to a higher demand for properties leading to the situation that investing in these properties becomes more attractive.

At Equation (2), both  $R^2$  and  $R^2$  adjusted are still at high values of exceeding .98. The  $p$ -value is also at a statistically significant level and the  $F$ -statistic is smaller than in Equation

(2). The sign for the first four explanatory variables are the same as expected but not for tourists. In Equation (2), it showed that tourists have negative relationship with FREI. Four out of six explanatory variables, which are GDP, wage, house price and land price, are at a significant level of 1%. The additional explanatory variable, tourists, is not at a statistically significant level. Also, with the addition of the tourists variable, the interest rate has also become a statistically insignificant variable.

Despite the impact of tourism on FREI being identified as statistically insignificant in both Pearson coefficient and panel regression analysis, it has a large negative coefficient value of  $-.901$  with FREI. This research finding disagreed with the finding of previous research (Gholipour & Masron, 2013; Rodríguez & Bustillo, 2010) which found that tourism agglomeration has a positive relationship with FREI level. Rodríguez and Bustillo (2010) interpreted the impact of tourism on FREI in Spain is their demand of housing services. This is not exactly the same circumstances as in the UK. As stated in Section 2 of this paper, the demand for properties in London is purely driven by the foreign investors' intention of obtaining financial gains through investment. Therefore, the tourists' impression or intention to buy properties in the UK may play less of a part in the decision-making process on purchasing properties.

The incorporation of tourists as an additional explanatory factor and also with reducing observations, from 115 to 55, has imposed impacts on the findings on the paper. Firstly, the  $R^2$  and  $R^2$  adjusted value has reduced slightly despite remaining at a high value. The  $F$ -statistic value has reduced substantially from 1227.63 to 610.68 while the  $p$ -value remains as .00, which means Equation (2) is a better fit than Equation (1) (Hui & Chan, 2014). The absolute value of the coefficient for GDP, wage, house price and land price has increased in Equation (2) but remains at a statistically significant level. On the other hand, the absolute value of interest rate has reduced and the  $p$ -value has become insignificant in Equation (2), which means the inclusion of tourists as an explanatory variable has changed the statistically significant impact of interest on FREI.

Please see Tables 4 and 5 for the result of the panel data regression for Equations (1) and (2), respectively.

In addition to the six explanatory variables which have been mentioned in this study, previous studies also stated that preferential government policy such as taxation and exchange rate (Cheng & Kwan, 2000; Ren & Pentecost, 2007). As mentioned in Section 2 of this paper, one of the reasons that the UK is a favourite for foreign investment is the exemption of CGT for foreign investors. However, the taxation policy was changed from 6 April 2015 and foreign investors now have to pay 20% in CGT, the same level as the local investors. Despite this, the FREI has continued to increase. The exchange rate of sterling has been low

**Table 4.** The estimation result of fixed effects panel regression analysis model (Equation (1)).

$R^2$	$R^2$ adjusted	$F$ -statistic	$p$ -value
.9908	.9900	1227.63	.000
Variable	Coefficient	$t$ -statistic	$p$ -value
GDP	.011724	12.85	.000
Wage	-3.44	-2.79	.007
House price	.00372	3.04	.004
Land price	-4.54	-2.86	.006
Interest rate	-25.4	-2.39	.020

Note: If Tourist data is not considered and have 115 observations from Q1 1987 to Q3 2015.

**Table 5.** The estimation result of fixed effects panel regression analysis model (Equation (2)).

$R^2$	$R^2$ adjusted	F-statistic	p-value
.9871	.9855	610.68	.000
Variable	Coefficient	t-statistic	p-value
GDP	.0118	9.01	.00
Wage	-3.85	-2.72	.009
House Price	.00459	3.06	.004
Land Price	-5.84	-2.87	.006
Interest Rate	-20.9	-1.31	.196
Tourists	-.0129	-1.59	.118

Note: If Tourist data is considered and have 55 observations only from Q1 2002 to Q3 2015.

which further added to the attraction of foreign investors to invest in the UK. According to the Office for National Statistics (ONS, 2016a), FREI increased .56% from Q2 2015 to Q3 2015 as compared to .25% from Q4 2014 to Q1 2015. These are the reasons stated in newspapers or professional reports for the popularity of London properties for investors.

There is also a social impact on the London residents as a result of the high demand for residential properties from foreign investors. The high demand for residential properties in London far outweighs the supply which cannot increase at the same pace, and has, therefore, pushed up the property prices. As stated in the Section 2, the level of increase in property prices in residential markets in London is substantially higher than the rest of the country. The ratio of the average price to average income was 4.6 in 2013 and it was 6.1 in Greater London (Green & Bentley, 2014). Therefore, it has created the situation where the local residents are being priced out of the market causing a chronic long-term shortage of residential accommodation. The shortage of affordable housing in London has become a key issue in government policies for years. Despite the government's direct intervention on it through policy development, such as initiatives suggested in Barker Reviews (2004, 2006), the housing shortage problem has remained unsolved.

## 6. Conclusion, limitations and suggestions for future research areas

This paper has established the situation of FREI in UK, with a particular focus in London. This paper has used Pearson coefficient analysis to identify the correlation relationship between the FREI and explanatory variables. The paper used panel regression analysis model to identify the relationship between FREI and a range of explanatory variables. Two regression analyses were conducted. Equation (1) considered the explanatory factors including GDP, wage, property price, land price and interest rate. The time series of the data was from Q1 1987 to Q3 2015 with 115 observations. Equation (2) considered tourists, as well as these five explanatory variables which were used in Equation (1). There are 55 observations for Equation (2) and the time period was from Q1 2002 to Q3 2015. The reasons for including these variables as they have been identified in the previous literature that they have significant impacts on FREI please see literature review section for further information.

Pearson coefficient analysis showed that FREI has a statistically significant correlation with GDP, wage, house price, land price and interest rate. FREI also has a positive relationship with all these explanatory variables except interest rate. This finding indicated that economic prosperity has a positive impact on FREI. The research findings of Equation (1) showed that all five explanatory variables are statistically significant and have an expected

impact on FREI, which are GDP and house price have a positive impact while wage, land price and interest rate have a negative impact. At Equation (2), all explanatory variables, apart from interest rate and tourists, are statistically significant. Tourists did not have an expected impact on FREI. In the previous studies, e.g. Rodríguez and Bustillo (2010) suggested that tourism should have a positive impact on FREI but the finding for this research is that the impact is negative. This is because the reason for having FREI in the UK is mainly for financial gain. This is different from Spain where tourists mainly purchase property as holiday homes.

This research is not without limitations. The first limitation is the size of observations. There were 115 observations in Equation (1) and it is at an acceptable level (Hui & Chan, 2014). However, there were only 55 observations in Equation (2). The second limitation is that this paper was not able to consider some explanatory variables which are particularly significant in the UK FREI market, such as taxation measures and exchange rate. The UK Government has just changed the taxation policy on foreign investment from the 6 April 2015 and there is not enough time series data to run sound statistical analysis. As for exchange rate, it is necessary to identify one type of foreign currency and track the changes of its exchange rate between this particular currency and sterling. As the change of currency will have substantial impact on the value of the property paid in sterling if the foreign investors purchase it by other currency. At the moment, the exchange rate for sterling is at a historical low level due to the impact of BREXIT; it will make foreign purchase of residential properties favourable as it would be cheaper as compared to few years ago. The last limitation is that the paper cannot reflect the accurate picture on the factors influencing FREI in the UK. Some of the explanatory variables used to conduct analysis in this paper, such as GDP, wage, interest rate and number of tourists are UK country-wide data while the house price and land price data are London-focus data. Therefore, this paper may not be most accurately reflect the FREI situation in London as two types of data, at country level and city level, are used in this study.

The first suggested future research area is to conduct the same analysis a few years later, after the new taxation policy for foreign investors have been implemented for some time. Also, it would be a good idea to identify the main foreign country investing in the UK and consider the trend of the exchange rate of this currency and sterling in the future analysis. One of the downsides for this suggested future research is that it will, to a certain extent, limit the applicability of the model as it will consider one type of currency only. The third suggested future research area is to conduct research which uses London focused data in order to more accurately review the picture in the most popular FREI city in the UK. One of the hindrances for conducting this London-specific FREI research is the availability of the regional level data. The final suggested future research area is to conduct empirical studies, such as questionnaire, interview or case studies in order to gain a deeper understanding of the situation of foreign investment in London and also the preference and behaviours of these investors.

## Disclosure statement

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