INSIDE
RealtyTrac shapes much of the debate around foreclosures, and not always without controversy
BARBARA KIVIAT, ON THE HOUSING-DATA TRACKER

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Gathering storm
After 15 years of growth, London faces an abrupt downturn

BANKING

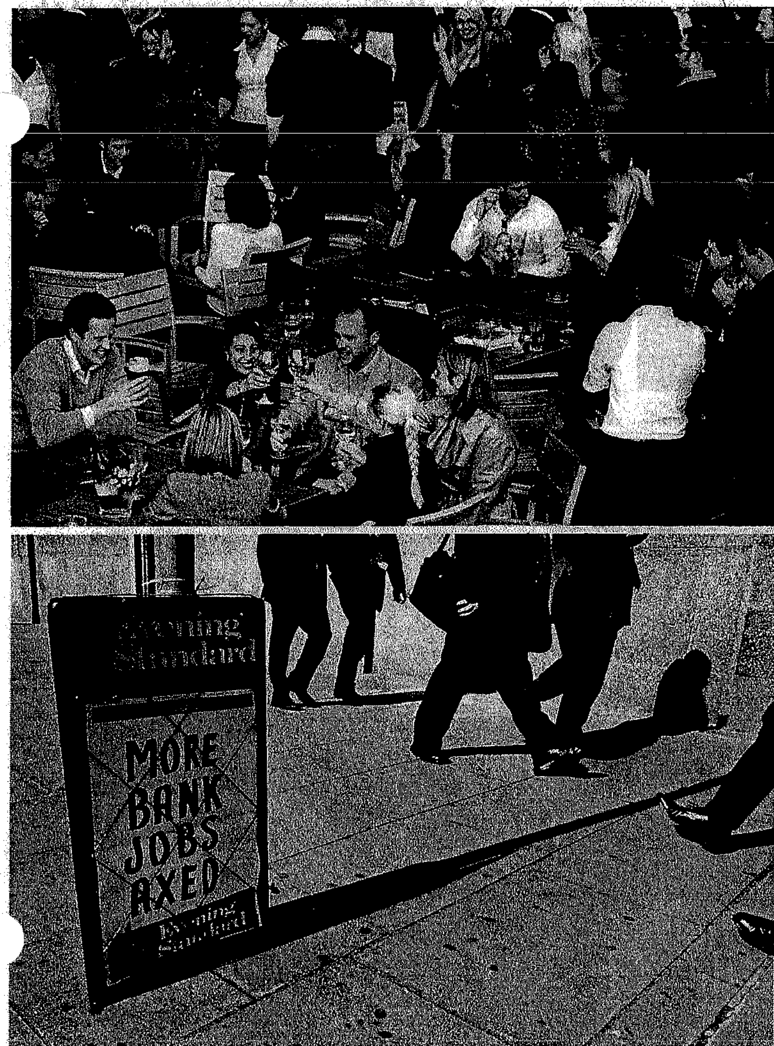
London Falling. Fueled by a finance boom, the city was a magnet for money and talent. Now a darker era looms

BY PETER GUMBEL

WHEN THE 4,500 PEOPLE WHO USED TO work for Lehman Brothers in London showed up at the investment bank's plush office on Canary Wharf on Sept. 15, only to be told that the firm was out of business that they should look for another job, some of them did what any number of their colleagues around town have been doing for years: they threw a party. On the equity-trading floor, the internal p.a. system known as the "hoot" blared out the R.E.M. song "It's the End of the World As We Know It." And then, after collecting their personal possessions, dozens of the Lehmanites crossed the concourse to the pub just opposite, All Bar One, where they drowned their sorrows in style. "People were spending five or six hundred pounds on champagne," recalls a bartender.

It was a fitting end to what has been a remarkably bubbly period for London. Over the past decade and a half, ever since its last protracted downturn, the British capital has transformed itself into Europe's indispensable financial center. Leaving Frankfurt and Paris in the dust and encouraged by the policies of Gordon Brown, the current British Prime Minister,

Photographs for TIME by Tom Stoddart—Reportage/Getty



Good times and bad *Experts predict that at least 110,000 people will lose their jobs by 2010*

it has become a magnet for people, jobs and investment from around the world. The big U.S. banks made London their international hub, and the major banks of continental Europe moved much of their trading and investment-banking operations there. About 70% of international bonds, one-third of the world's foreign exchange and almost half the total volume of international equities are traded in London—more even than in New York City, its only remaining rival as the world's financial capital. Hedge funds piled into Mayfair on the heels of private-equity players. Any self-respecting Russian oligarch has a Knightsbridge mansion, sends his kids to élite private schools and has listed his company on the London Stock Exchange.

All this activity has made the City—the square mile around St. Paul's Cathedral that is the heart of the old financial district, plus the gleaming towers of the new financial district in the docklands area—a powerful motor not just for London but also for British prosperity. In 2007 financial services accounted for 10.1% of the U.K.'s gross domestic product, up from 5.5% in 2001. Add in professional services linked to finance, such as accounting, law and management consulting, and the total rises to 14%. And that's for Britain as a whole. For London, finance has been even more important: it accounts for almost one-fifth of the city's total output, perhaps as much as one-third if professional services are included. That's far more than for even New York City, where financial services account for about 15% of its economy.

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But now the world is in the grips of a perilous market crunch, the boom is over, and tough times loom. The U.K.'s FTSE-100 stock index has nose-dived and is down about 35% in the past year. Two famous British banks have already imploded—Northern Rock and Bradford & Bingley. And after a dramatic plunge in the stock price of other banks, on Oct. 8 the British government announced an emergency $88 billion recapitalization package that includes partially nationalizing three other banks: Royal Bank of Scotland, HBOS and Lloyds TSB. The City has been through enough slumps to know what to expect next: layoffs, shrinking bonuses for those lucky enough to keep their jobs, and a new frugality regarding expense accounts. This will inevitably have repercussions on housing prices and also on goods and services that boomed along with the City. They range from fancy-restaurant meals to pricey vacations, bespoke suits and aromatherapy massages that the financiers and their legions of support staff could once readily afford.

The coming downturn is already shaping up as different from—and tougher than—some previous ones. That's because the financial crisis is taking place at the same time as a real estate downturn, a conjunction that is unusual; in the past, one has often followed the other, but it's rare for them to happen simultaneously. And the problems are being exacerbated by an explosion of household debt in Britain. Buoyed by rising property prices, households ratcheted up their borrowing to a massive 173% of disposable income, vs. 106% in 1995. That's way above even that paragon of profligacy, the U.S., where household debt amounts to 139% of income.

Oxford Economics, which advises the British government, expects 110,000 jobs to be cut in London between this year and 2010—although if the credit crunch is protracted, that number could rise to almost 150,000 next year alone. Real estate is already reeling. Plans for two huge new skyscrapers in the City have been shelved, and the price of prime houses in central London has dropped 12% so far in 2008, according to the real estate firm Savills, while sales volume is down 50% in some areas like Clapham and Fulham.

As the gloom descends, a question is starting to make the rounds—one that London hasn't really asked itself before: Has London become too reliant on a single industry, putting all its eggs into one volatile basket? "Obviously people see it as a risk, and if there's a prolonged downturn, it will become an issue," says

Andrew Goodwin, a senior economist at Oxford Economics, who nonetheless believes that while "there is a concern about endency, financial services have done .il historically."

Move away from London, however, and you get a rather different perspective. Across the English Channel, Thierry Jacquillat, chairman of the Greater Paris Investment Agency, looks at what's happening in world financial markets and says, "The economy of Paris will resist the shock better than London. We're more diversified." And in Brussels, at the European Trade Union Institute, economist Andrew Watt draws some uncomfortable historical parallels. "There was some idea that the financial sector was immune," he says. "It's like pinning your hopes on anything, whether it's textiles in the north of England or the car industry around Birmingham. It expands for a while, and then it takes a nasty knock."

TO SEE HOW FINANCE HAS RESHAPED the British capital, take a trip to Greenwich—about 3½ miles (6 km) downstream from Tower Bridge—home to the Royal Observatory, which dates back to 1675. It's the birthplace of Greenwich Mean Time, but for years the area was as well known for its mean streets: 19 Green-ch neighborhoods rank among the most prived in England.

But these days, coexisting with the urban blight are plenty of new, well-heeled residents in new, well-appointed residences: bankers and others who work at Canary Wharf, the docklands development where Barclays, Morgan Stanley, Credit Suisse and many others have their offices. Greenwich is just a short hop from the wharf, thanks to the Docklands Light Railway. Liam Bailey, head of residential research at the real estate firm Knight Frank, says the gentrification started a decade or so ago and has accelerated in the past five years. Knight Frank is currently offering one-bedroom apartments with river views there starting at about $500,000 apiece.

Local businesses blossomed with this growth, but they are now seeing the swoon. At one end of Greenwich's High Street is the Green Baby store, which sells Earth Friendly Baby organic chamomile shampoo and diaper balm made from sweet-almond oil and shea butter. A short walk away is the Greenwich Park Bar & Grill, where a burger made from "Kobe" beef raised on a farm in north Wales will set you back $33. At the Nevada Street Deli, which ves up smoky cheese from County rk and freshly made poached-salmon sandwiches, owner Laura Heap says she's already noticed a downturn in business. "I get a lot of local moms, and they're spending less," she says. "Whereas they used to buy their eggs and bread, now they're just buying a cup of tea." Heap, who opened the shop less than a year ago, has dropped her prices 25% and let some staff go. She remains upbeat about the future, but with Canary Wharf on her doorstep, she concedes, "I do feel a slight wave of fear."

She has every reason to be scared, because financial services have a record of retrenching fast in a crisis. And the business in some sectors has evaporated. The volume of mergers and acquisitions, for example, is down about two-thirds from its peak in 2006, while the public stock offerings that made the London Stock Exchange an international shooting star have fizzled. Given the role played by arcane financial engineering in triggering the current crisis—the troubles at AIG, for example, stem largely from its freewheeling London financial-products division—the future looks especially bleak for people working in structured finance and complex derivatives. No surprise, then, that HSBC, Citigroup, Credit Suisse and others have started cutting staff.

The Alternative Investment Market (AIM) is a good example of how London got so big in the first place and how it's starting to pay the price. Launched in the mid-'90s as part of the London Stock Exchange, this market for small companies deliberately set out to cut to an absolute minimum the paperwork for listing firms. There's no need, say, for bulky official prospectuses before a stock is listed on AIM, and the market is overseen not by official regulators but by brokerage firms called nomads, which are responsible for the new issues. For years, AIM was a fabulous growth story, attracting more than 2,500 companies from around the globe. But in the first eight months of this year, only 85 companies listed on AIM, compared with 201 in the same period a year ago—and almost twice as many have dropped off it. "Capacity is massively down," says Tom Nicholls, a partner at the London law firm LG who specializes in matters related to AIM. So are the nomads—their number has dropped from 80 to 69.

All of this amounts to a particularly tricky issue for a man who has played a key role in the City's growth: Prime Minister Brown. In the 10 years when he was Chancellor of the Exchequer, his support for financial services was especially notable because his Labour Party had a history of antagonism with the City. Brown sought to convince the financial community that New Labour would be pro-business, pro-enterprise, noninterventionist and keen to cosset the rich, believing their wealth

By the Numbers. London's wealth has been driven by its success in finance

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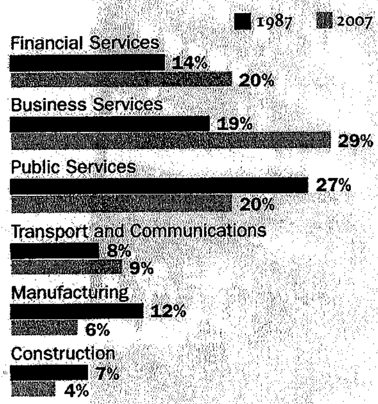
FINANCIAL CAPITAL

The source of the city's economic strength has shifted over 20 years



Source: Oxford Economics

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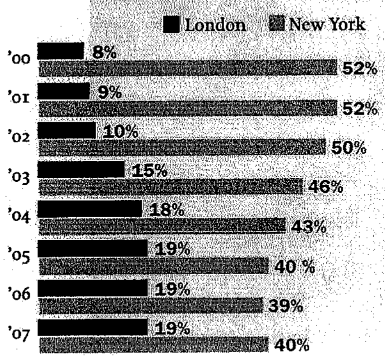
ASSET MANAGEMENT

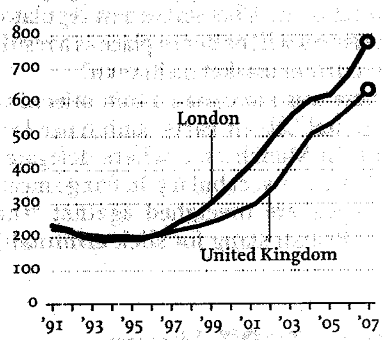
London has eaten into New York City's share of the global hedge-fund market



Source: IFSL estimates

HOT HOUSING

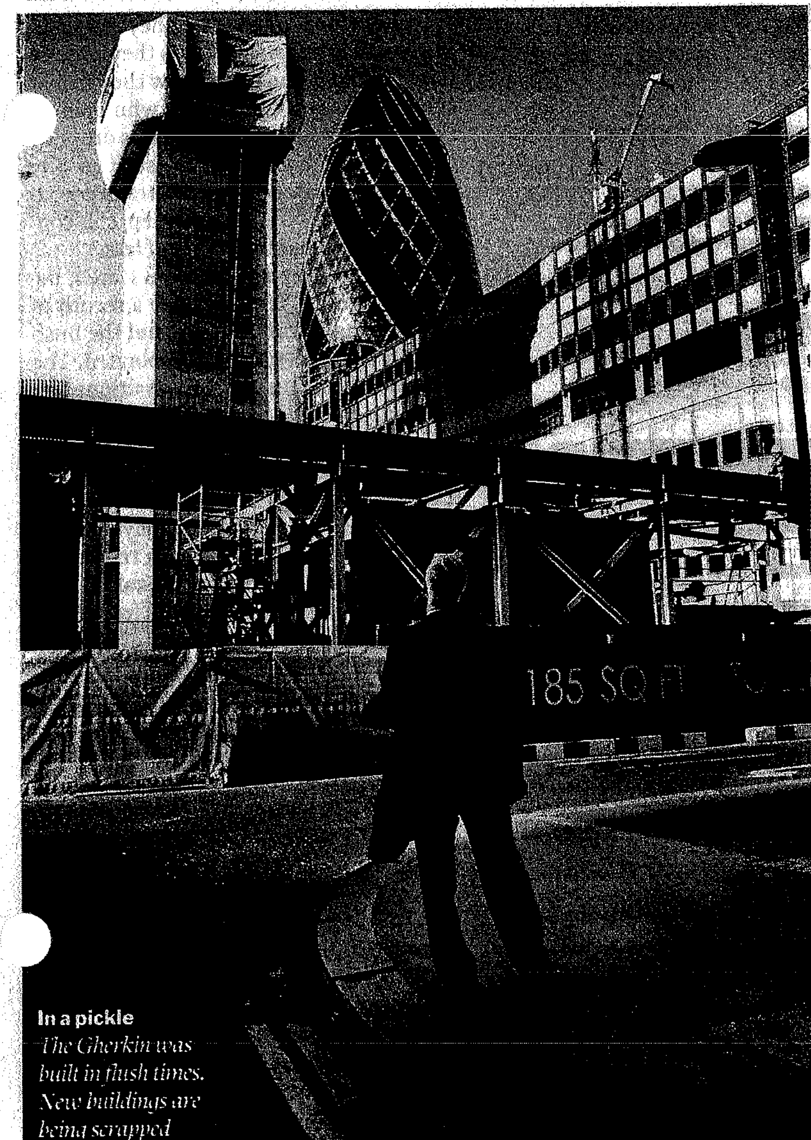
The property-price index rose faster in London than in the rest of the U.K.



Source: Halifax Group

Capital in Crisis

For more of Tom Stoddart's photos of London's woes, go to time.com/london



In a pickle
The Gherkin was built in flush times. New buildings are being scrapped

would trickle down to the wider economy. Brown also championed a new governance system for financial services that he and other politicians like to refer to as "light-touch" regulation. In June 2007, just days before he replaced Tony Blair as Prime Minister, Brown gave a rousing speech at the traditional black-tie dinner in Mansion House, the residence of the lord mayor of the City, brashly predicting an "era that history will record as the beginning of a new golden age for the City of London."

It's been downhill ever since. First came the run on Northern Rock, the stricken bank that the government ended up nationalizing, whose near failure raised serious questions about the effectiveness of U.K. banking regulation. Then came a damaging political storm over the taxing of "non-doms"—wealthy foreigners who move to Britain and are taxed on their U.K. income only. Following last month's rescues of HBOS and Bradford & Bingley, the big question is, What sort of new regulatory measures will be put in place as a result of the current market meltdown?

There was more than a hint offered at the annual Labour Party conference last month in Manchester, where delegates adopted a new vocabulary. In fringe meetings, speakers inveighed against "the *spivs*" (British slang for slick criminals) who caused the mess, while union leaders and politicians raised cheers by bashing the rich. In his keynote speech, Brown talked of a new era that demands heavier regulation.

In June 2007, Brown predicted an era that history would record as a 'new golden age' for London. It's been downhill ever since

THIS ISN'T THE FIRST CRISIS LONDON HAS lived through, and it won't be the last. At the Guildhall, which is where the City administration is based, policy head Stuart Fraser talks about his 45 years of experience there and says, "You just have to sit it out. It recovers." But he acknowledges that "it's a painful process, and we are only at the beginning." The impact won't be felt across the board. Barring a financial cataclysm, London will retain its position as Europe's preeminent financial center. Some wealth management may migrate to Singapore or Dubai, rapidly emerging regional centers, and some of the back-office jobs that are cut may never return. "As in any business, there will be more pressure to take more support roles out of London, to Asia or just to cheaper places in Britain," says Owen Jelf, who heads the U.K. capital-markets practice at the consulting firm Accenture. But there is no place other than New York that boasts the combination of specially tailored office space and clustered expertise to challenge London's status. And even in the worst-case scenario, the London economy has one crutch that won't be knocked down: huge government spending ahead of the 2012 Olympic Games.

The bigger issue is whether the risk-taking, hard-charging, high-living times will give way to a quieter, duller, less profitable and far more regulated era—not so much a golden age as a golden cage. The debt-fueled days are almost certainly history. Jon Lloyd, joint head of LG's real estate practice, points out that the investment-banking mentality of the past few years—ever bigger fees for ever more complex transactions—has spread to all sorts of businesses, from law to real estate. He wonders if that's all about to change. "Will we as advisers fall back to where we were 10 to 15 years ago?" he asks. "The question is whether we are now entering a more frugal world."

Lloyd already knows the answer, and so do thousands of others who have thrived off the good times. Yes, London is heading for a fall. Yes, it will hurt. But he remains sure of one thing. "We've got a city we are proud of," he says. "There's a feeling that London is a good place, and that hasn't changed." In troubled times like these, a stiff upper lip may be just what's needed.

—WITH REPORTING BY EBEN HARRELL, CATHERINE MAYER AND ADAM SMITH/LONDON ■