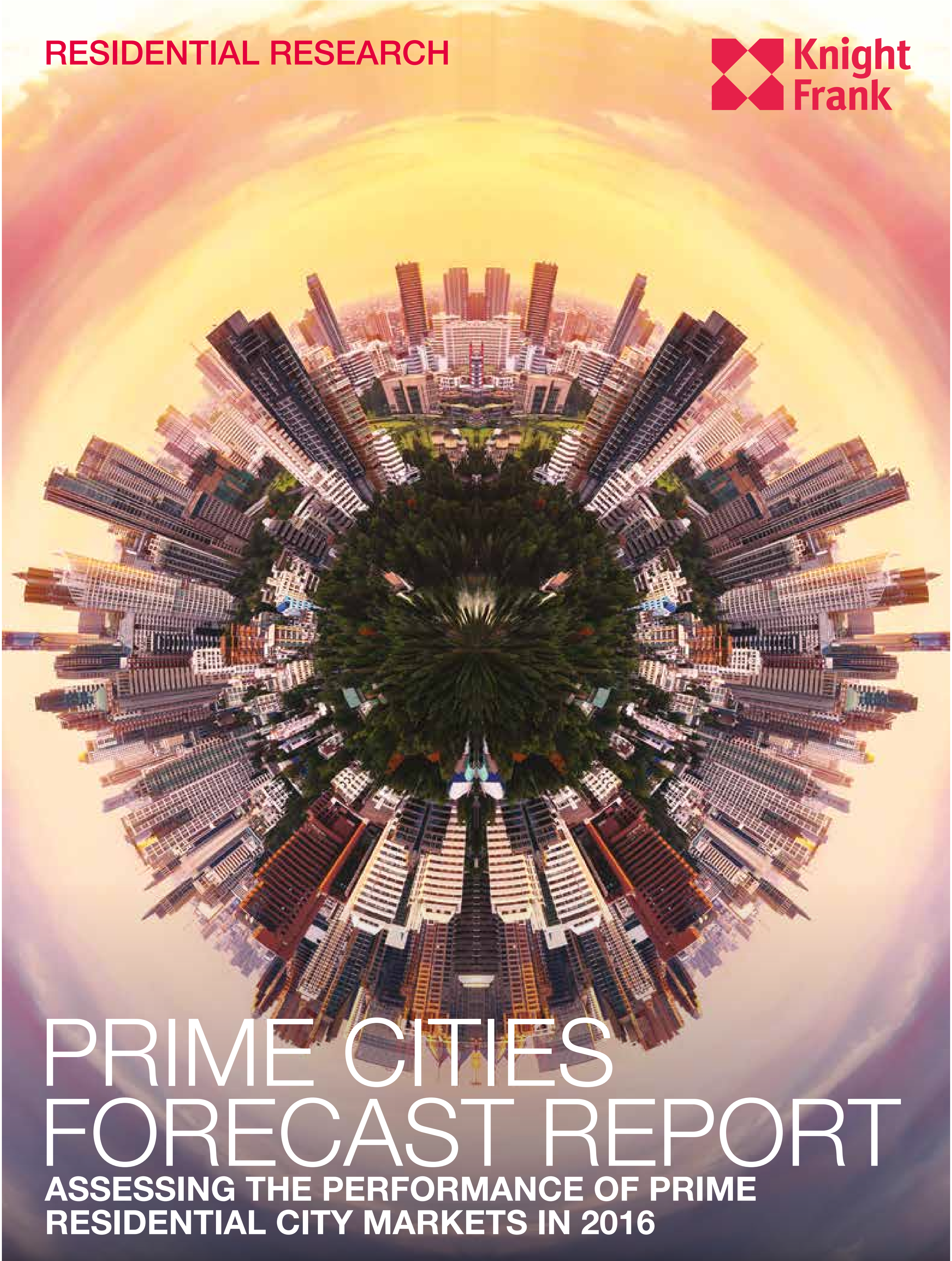

RESIDENTIAL RESEARCH

PRIME CITIES FORECAST REPORT

ASSESSING THE PERFORMANCE OF PRIME RESIDENTIAL CITY MARKETS IN 2016

MARKET OUTLOOK | 2016 FORECAST | RISK MONITOR

HIGHLIGHTS

Sydney is forecast to see the strongest prime price growth in 2016, rising by 10% year-on-year

Three cities are expected to see prime prices decline in 2016; Hong Kong, Singapore and Paris

Hong Kong (-5%) is forecast to overtake Singapore (-3.3%) in 2016 as the weakest-performing luxury residential market

Our Risk Monitor shows that further US rate rises and worsening geopolitical tension are considered the greatest risks to prime residential markets globally in 2016

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OVERVIEW

As we enter a new era of rising interest rates, greater regulation and potentially lower returns, which city's prime residential market will outperform?

Events in the world's two largest economies look set to dominate proceedings in 2016.

The scale of the slowdown in China and the speed of further US interest rate rises will determine the performance of property markets across developed and emerging markets alike over the next 12-18 months.

Last year we correctly anticipated that Sydney and New York would outperform in 2015 rising by 5%-10%.

Sydney has exceeded expectations, prime prices in the city look set to end 2015 15% higher.

At 5%, price growth in New York has been strong but mitigated to some extent by the strength of the US dollar which has curtailed foreign demand.

By the end of 2015, we expect the strongest and weakest performing prime markets to be separated by around 20 percentage points, in 2016 we forecast this figure will slip to 15 points as price growth converges, we set out our **full forecast on page 5.**

Whilst luxury price growth looks set to converge, monetary policy globally is likely to follow a divergent course.

The US and UK will be tightening monetary policy whilst the Eurozone, Japan and China are expected to either loosen policy further through additional stimulus measures or are likely to stick to the status quo in policy terms.

This year our **Risk Monitor on pages 3-4,** assesses the likelihood and impact of ten key scenarios on each of our cities.

As we take the pulse of city markets in December 2015, it is perhaps no surprise that the Fed's recent rate rise and the impact of terrorism/geopolitical tension on the world's top cities, are currently considered the highest risks to luxury city markets.

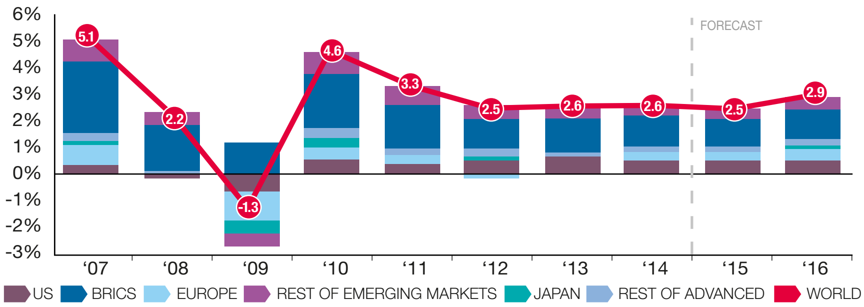
In previous years, the Eurozone and its potential break-up was the top threat to economic and property market stability but jitters over its demise have subsided as the ECB has announced an extension to its QE programme. Instead, emerging markets and the risk of potential deflationary cycles represent the major headwinds for the global economy.

For most cities, low income growth and a slowing domestic economy are considered the lowest risks to luxury markets.

There is a chance that the recent 0.25% US rate rise and resulting strong dollar could spark a new wave of safe haven capital flows from emerging markets to first tier luxury residential markets. However, with new supply in several markets expanding (Hong Kong, London, Miami, New York) we think it's unlikely we will see prices respond in the same way they did post-Lehman.

FIGURE 1

World GDP forecast Contributions to World GDP growth (y/y)



Source: Knight Frank Research / Macrobond

RISK MONITOR

Knight Frank's residential market Risk Monitor provides our latest assessment of key risks to the world's prime residential markets. Our risk score, out of a maximum 10, is based on two assessments, firstly our view of the likelihood of the described scenario occurring, and secondly the potential market impact. Both these elements are scored from one (low) to five (high), collectively contributing to our combined Risk Score out of ten. Our breakdown of each city's likelihood and impact risk score is available on request.

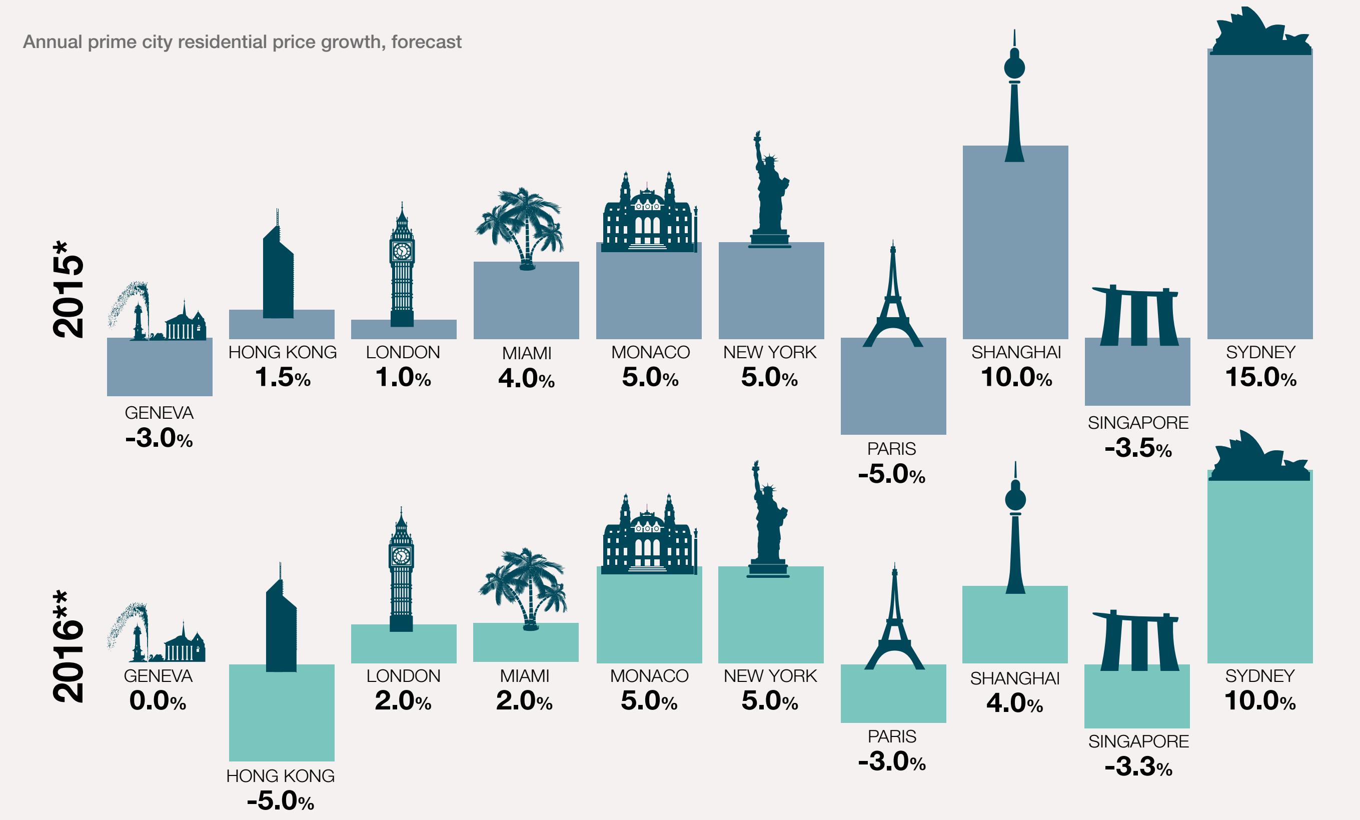
10 9 8 7 6 5 4 3 2 1

HIGHEST RISK … LOWEST RISK

RISK	SCENARIO	IMPACT	LONDON RISK SCORE	NEW YORK RISK SCORE	MIAMI RISK SCORE	PARIS RISK SCORE	MONACO RISK SCORE	GENEVA RISK SCORE	HONG KONG RISK SCORE	SINGAPORE RISK SCORE	SHANGHAI RISK SCORE	SYDNEY RISK SCORE
CHINA SLOWDOWN	Economic growth in China slows more than expected.	A hard landing for China's economy would lead to a slump in global commodity prices. A prolonged slow-down in growth would mean those emerging markets that have benefited from the Chinese-driven boom in commodity prices (large parts of Latin America, the Middle East and Africa) would see a knock-on impact. A prolonged deceleration in growth would have significant repercussions across the EU and the US as lower demand for goods starts to impact and exports fall.	6	6	4	6	5	4	6	6	7	7
US INTEREST RATE RISE	The Federal Reserve raises the US base rate more rapidly than expected.	With a 25bps rate rise now in place, the focus is on the pace of future rises by the Federal Reserve. Higher rates will lead to a surge in the US dollar, making US exports less competitive and could be unsettling following a protracted period of low rates. The US housing market will see a slowdown in sale volumes and more moderate price growth as affordability concerns pinch. Emerging markets will see capital outflows increase and funding costs raised further whilst those countries whose currency is pegged to the US dollar will see a reduction in foreign property demand.	5	8	7	6	6	5	7	8	7	6
WEAKNESS IN EMERGING MARKETS	Contrary to the IMF's view, emerging markets experience a prolonged period of slow growth.	The outlook for emerging markets remains challenging. The slowdown in China – for many years a key driver of economic growth in emerging markets across Asia, Africa, and Latin America – is likely to have a deep and long-lasting impact. Low global commodity prices, the beginnings of a global monetary tightening cycle and weak exports are taking their toll. Those countries with weak institutions, high political risk or exposure to lower commodity prices will present the greatest risks.	6	5	7	6	5	5	5	6	5	6
SLOWING DOMESTIC ECONOMY	The national economy is hit by weaker economic performance.	Several countries are at risk of weaker economic growth in 2016, Russia, Brazil, Italy and Japan among them, but most importantly China. This will stifle housing demand as wage growth will be minimal and buyer confidence weak. If government's opt to tackle deficits rather than re-invest in the economy or are caught in a deflationary cycle house price growth will slip into negative territory.	4	5	5	6	3	6	6	7	8	6
A SLOWING GLOBAL ECONOMY	Economic weakness leads to significantly lower global economic growth.	A key risk to future growth is potential renewed weakness in the global economy. Deflation and political turmoil in the Eurozone remain potent issues. Emerging markets, including China, have seen an economic reversal more recently, which could be reinforced by the withdrawl of monetary stimulus or the recent rate rise in the US.	5	7	8	6	6	6	6	6	6	6
LOW INCOME GROWTH	Low wage growth reduces housing demand and increases affordability concerns.	If the gap between house prices and incomes widens, the risk of policy intervention increases – either by the expansion of housing delivery or by curtailing investor activity. If on the other hand, wage growth impacts severely on sale volumes, as demand switches to the rental market, a price correction may result.	4	7	7	5	4	4	3	4	4	6
GEOPOLITICAL CRISIS/ INTERSTATE CONFLICT	Worsening geopolitical crises and/or terrorism starts to have a wider economic impact.	Tension in the Ukraine, the Syrian refugee crisis, along with the threat of terrorism and ongoing concerns in the Middle East all have the capacity to damage the global economic climate, disrupt world trade and unsettle investor and consumer confidence.	6	6	6	7	7	6	7	6	5	6
MARKET REGULATION	Policymakers embark on a range of measures (higher property costs or taxes, tighter mortgage regulation etc).	If more governments opt to regulate their housing markets, either to improve domestic affordability, quell speculative investment or as a means to boost revenue, the direction of capital flows will shift. Asia has been the focus of such measures in recent years and whilst no radical changes are expected in Hong Kong and Singapore the current measures in place look unlikely to be relaxed in the short to medium term.	7	5	5	6	5	8	7	7	4	6
CURRENCY RISK	Local currency strengthens against other currencies, is depegged from another or becomes unstable due to the break-up of a shared currency (e.g. Eurozone).	A further appreciation of the US dollar could pose balance sheet and funding risks for dollar debtors, especially in some emerging market economies, where foreign-currency corporate debt has increased substantially over the past few years.	4	7	8	6	6	7	7	5	5	5
SUSTAINED SLUMP IN OIL PRICES/ COMMODITY PRICES	Falling oil and commodity prices heighten deflationary pressures and lead to stock market volatility.	Oil supply is set to increase and demand weaken. The growth of the US shale industry is likely to limit the vigour of any oil price recovery. Add to this the fact that if, as expected, sanctions are lifted on the back of Iran's nuclear deal Iran is likely to ramp up its exports. On the demand side, the impact of China's economic boom is starting to fade and fast-rising consumption in parts of Asia and the Middle East is being offset by declining demand in the US and the EU. Should oil prices remain low, developed economies will benefit from a boost to consumer spending whilst in emerging markets, lower inflation will allow looser monetary policy.	6	5	6	6	5	7	5	5	4	7
AVERAGE RISK SCORE BY CITY			5.3	6.1	6.3	6.0	5.2	5.8	5.9	6.0	5.5	6.1

Source: Knight Frank Research, Douglas Elliman/Miller Samuel

THE FORECAST



Source: Knight Frank Research, Douglas Elliman/Miller Samuel
*Estimate, **Forecast

This year we have widened our forecast from eight to ten cities and provided an estimate of luxury price growth in 2015 as well as a forecast for 2016.

Of the ten cities analysed in our forecast, only three are expected to see prime prices decline in 2016; Hong Kong, Singapore and Paris.

In both years, Sydney is expected to come out on top, although the pace of price growth is expected to slow from 15% year-on-year in 2015 to 10% in 2016. Australia's economic slowdown, weaker stock market performance in recent months and the introduction of foreign investment fees explain the lower rate of growth in 2016.

Only London, Paris, Geneva and Singapore are forecast to see stronger price growth (or a slower rate of decline) in 2016 than in 2015.

London's upturn is marginal, from 1% in 2015 to 2% in 2016. Higher transaction costs (a 3% increase in stamp duty for buy-to-let properties and second homes), political risk around the Mayoral election in May, and ongoing affordability concerns explain our muted forecast.

The recent terrorist attacks in Paris will undoubtedly affect buyer sentiment and will mean some buyers delay investments. With a Presidential Election less than 18 months away, however, we do not expect any radical shake up to the tax structure for foreign buyers and the city remains competitively priced compared to other top global cities.

Overall, prime prices across all ten cities are, on average, expected to have increased by approximately 3% in 2015 but average annual growth is forecast to slip to 1.7% in 2016. This confirms our view that lower returns will become the norm in the short to medium term.

Of the cities analysed, Hong Kong is forecast to overtake Singapore as the weakest-performing luxury residential market in 2016. A number of new developments are due to come to the market in 2016, this new supply coupled with a strengthening HK Dollar (pegged to the US Dollar) will see prime prices soften.

The price decline seen in Singapore's prime residential market is expected to persist at least until the end of 2016 following the government's assertion that it has no plans to relax its property market cooling measures. However, the drop in price of luxury properties has presented pockets of investment opportunities. We expect sale volumes to increase in 2016 and, due to the shrinking inventory of high-end homes, price falls within the prime sector will be less pronounced than those across the island as a whole.

In the current climate of heightened political tension and ongoing tax fluctuations, Monaco's status as a private and secure retreat continues to appeal to the world's wealthy. With supply severely constrained on the two-mile wide principality we forecast steady price growth of 5% in 2016 as demand and sales activity picks up.

The Geneva market, along with Switzerland as a whole, has been characterised by uncertainty in recent years. However, with the lump sum form of taxation now protected, a strong currency in place, the detail surrounding Lex Weber becoming clearer, and potential improvements to corporation tax in 2016, we expect enquiries from those seeking greater fiscal security to strengthen. The high stock levels will keep prices from rising over the next 12-18 months, hence our forecast of 0% growth in 2016, but more stable trading conditions seem likely in 2016 and beyond.

In 2015, the demand for New York's luxury homes cooled from the frenetic pace observed in 2013 and 2014 due to the strength of US dollar and weaker economic conditions worldwide, although it is not expected to impact price trends until 2017. With the US federal and presidential elections due in November 2016 both New York and Miami are likely to see buyers adopt a wait-and-see approach. In Miami's case, the performance of the dollar against key South American currencies and the euro will influence demand/capital flows.

FIGURE 2

Prime market: Measuring future supply, demand and sale volumes…

Source: Knight Frank Research

Knight Frank Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.

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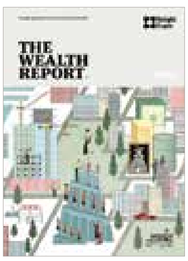

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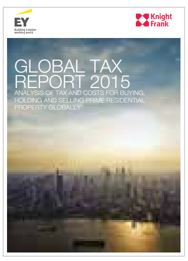

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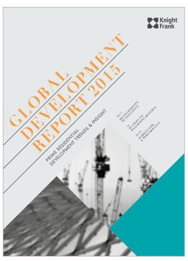

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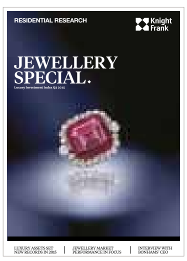

Luxury Investment Index - Q3 2015

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