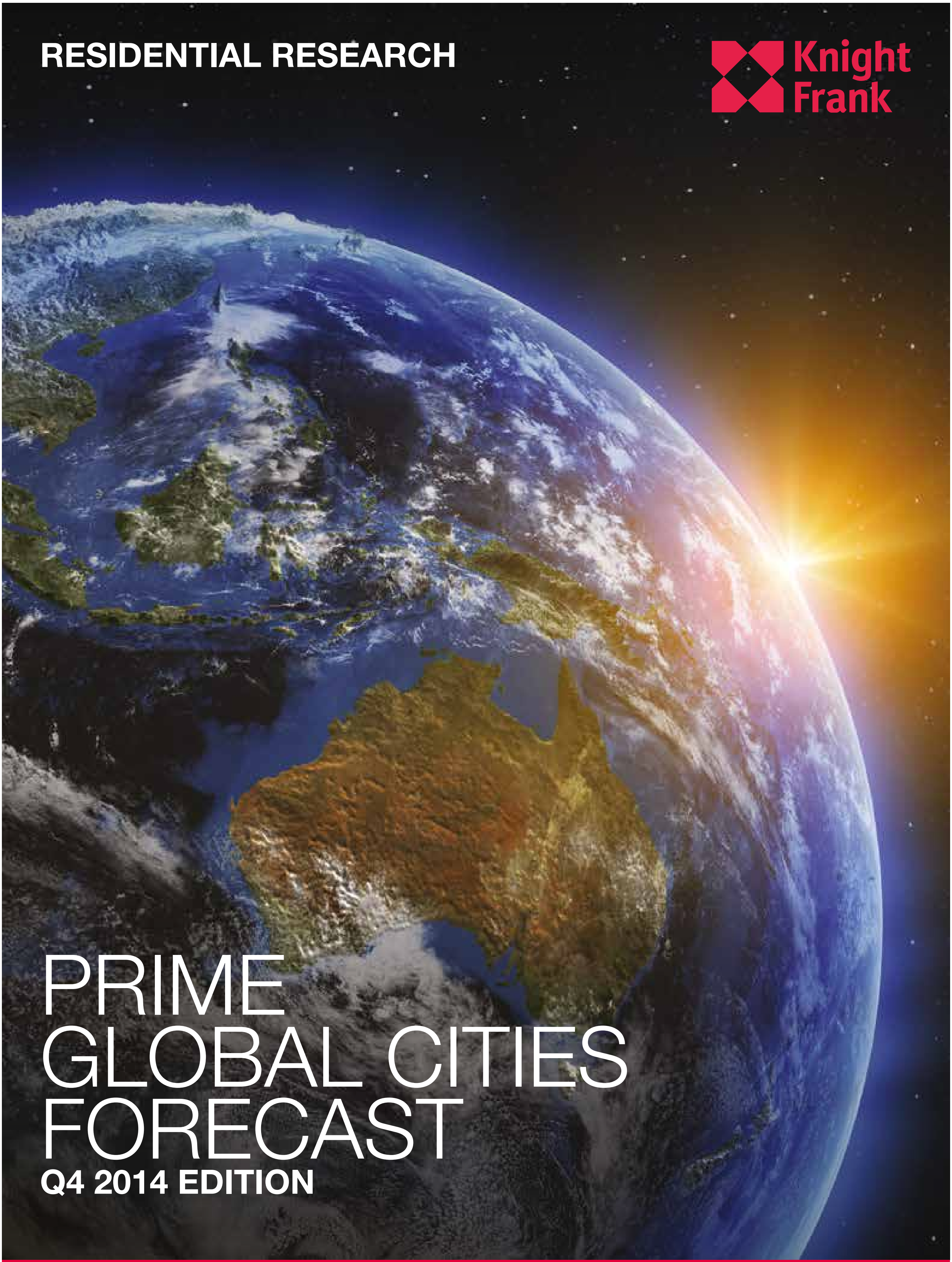
RESIDENTIAL RESEARCH



# PRIME GLOBAL CITIES FORECAST

## Q4 2014 EDITION

2015 PRIME FORECAST | MEASURING RISK | CITY BY CITY SNAPSHOT

# NEW YORK BACK ON TOP

Luxury residential markets face a diverse range of challenges and opportunities in 2015. Now that stimulus measures have all but disappeared in the US and the UK all eyes are on Europe and Japan and the extent to which they could halt the tentative global recovery, explains Kate Everett-Allen.

Residential markets in the world's leading cities are well-positioned to benefit from both the peaks and troughs of the global economy.

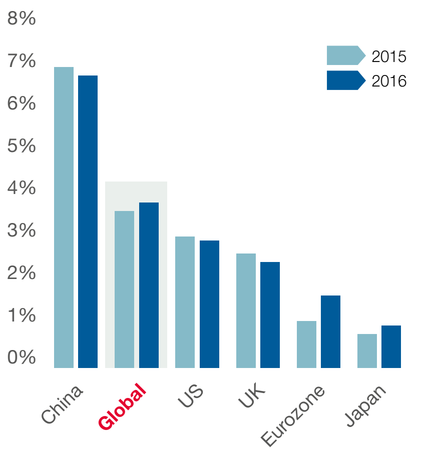
In times of crisis the world's wealthy look to shelter their capital in safe haven assets. In times of economic growth, there is an expanding pool of wealth looking for its slice of prime property in the best cities.

Since 2009 a number of the key housing markets worldwide have been supported by government stimulus measures. The slow withdrawal of such initiatives in markets such as the UK and the US, along with the potential relaxation of cooling measures in Hong Kong and Singapore, could mean that 2015 sees a more level playing field for the world's top luxury housing markets.

According to the OECD, the eurozone poses the greatest risk to prosperity and "may have fallen into a persistent stagnation trap."

The UK and the US are expected to be the key engines of growth as the eurozone and Japan trail behind. But there is an improving picture overall with the global economy forecast to grow

FIGURE 1
**Forecast GDP growth**
Annual % change




**Source:** OECD

by 3.3% this year, 3.7% in 2015 and by 3.9% in 2016 (figure 1).

The eurozone crisis has not been resolved and geopolitical risks are rising, in the Middle East, but also now in Ukraine and parts of West Africa. Aside from their potential impact on oil supply and global economic stability, these risks may also increase demand for safe haven assets as seen in 2009.

## 2015 forecast: New York and Sydney on top

We first published our city-by-city prime forecast as part of Knight Frank's inaugural Global Cities Report but for some cities (Geneva, Paris, Singapore and Dubai) our forecast has become marginally more negative over the last quarter.

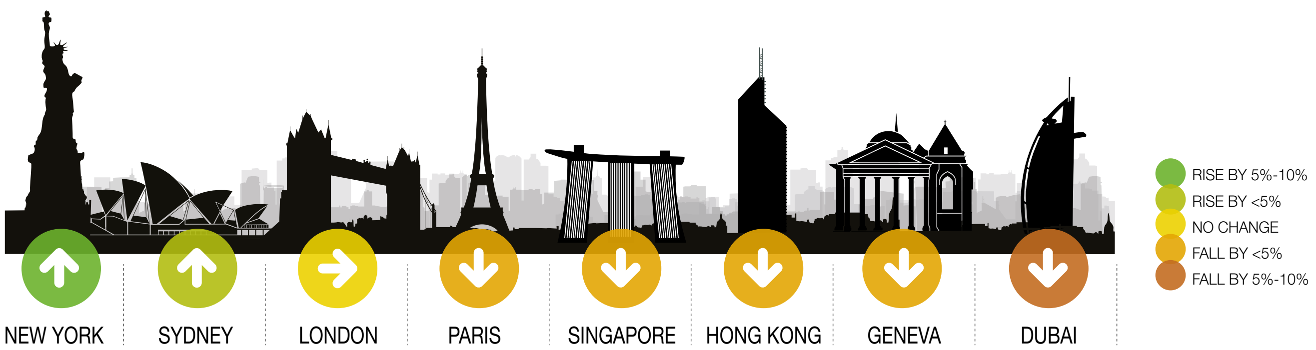
Of the eight cities included in our forecast we expect two to experience prices gains, one to see prices remain stable and five to see prices decline.

New York is back on top with luxury prices across Manhattan expected to accelerate by 5% to 10% over the course of 2015 (figure 2). Strengthening foreign interest (from Chinese, British, Russian and Latin American buyers) as well as improving economic indicators are behind our positive outlook.

Sydney is also on the radar of foreign buyers but here limited luxury supply is pushing prices higher, we forecast by up to 5% in 2015.

Dubai sits at the bottom of our forecast but even here prime prices are only expected to slip by 5% to 10%. Limited supply and a growing appetite from Indian purchasers should cushion the market.

FIGURE 2
**2015 Prime residential forecast**
Annual % change




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

FIGURE 3

## Measuring future supply, demand and sales... Forecast change in 2015

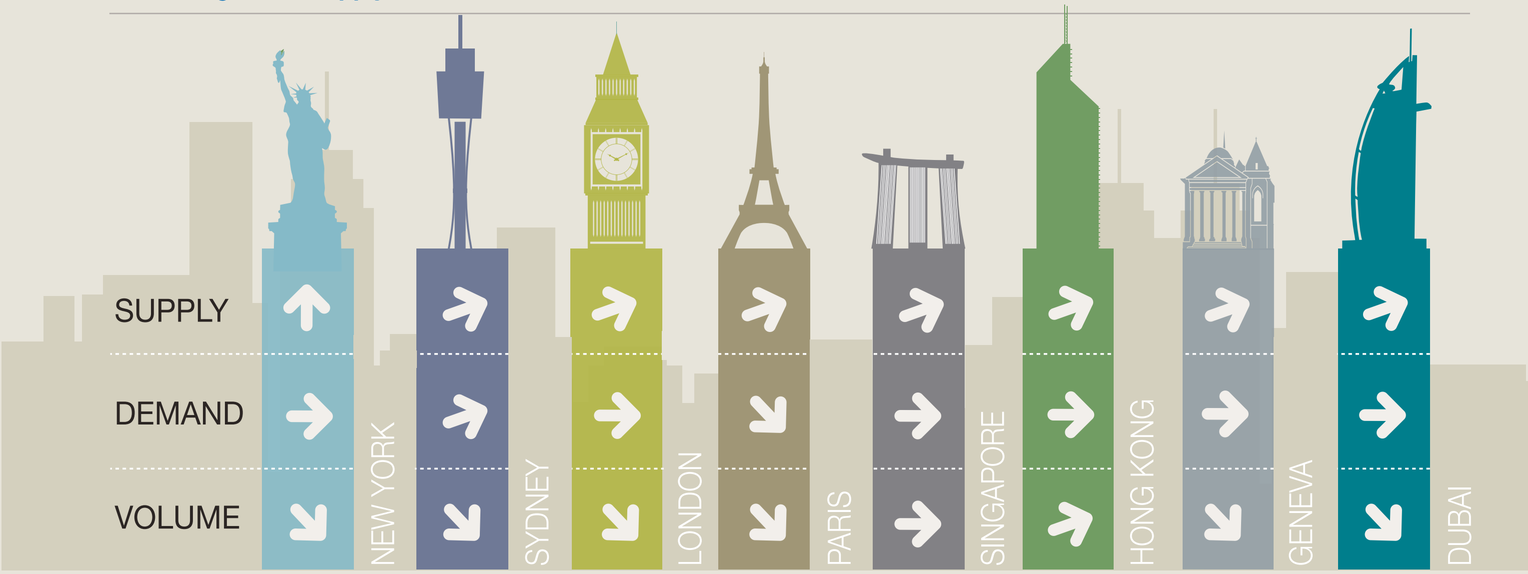



FIGURE 4

## Top of the class...

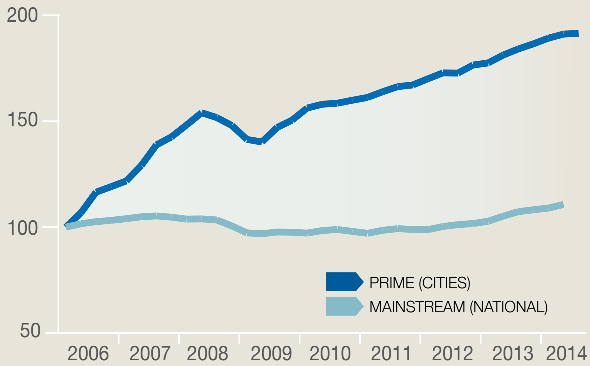
Submarkets expected to outperform their wider luxury market

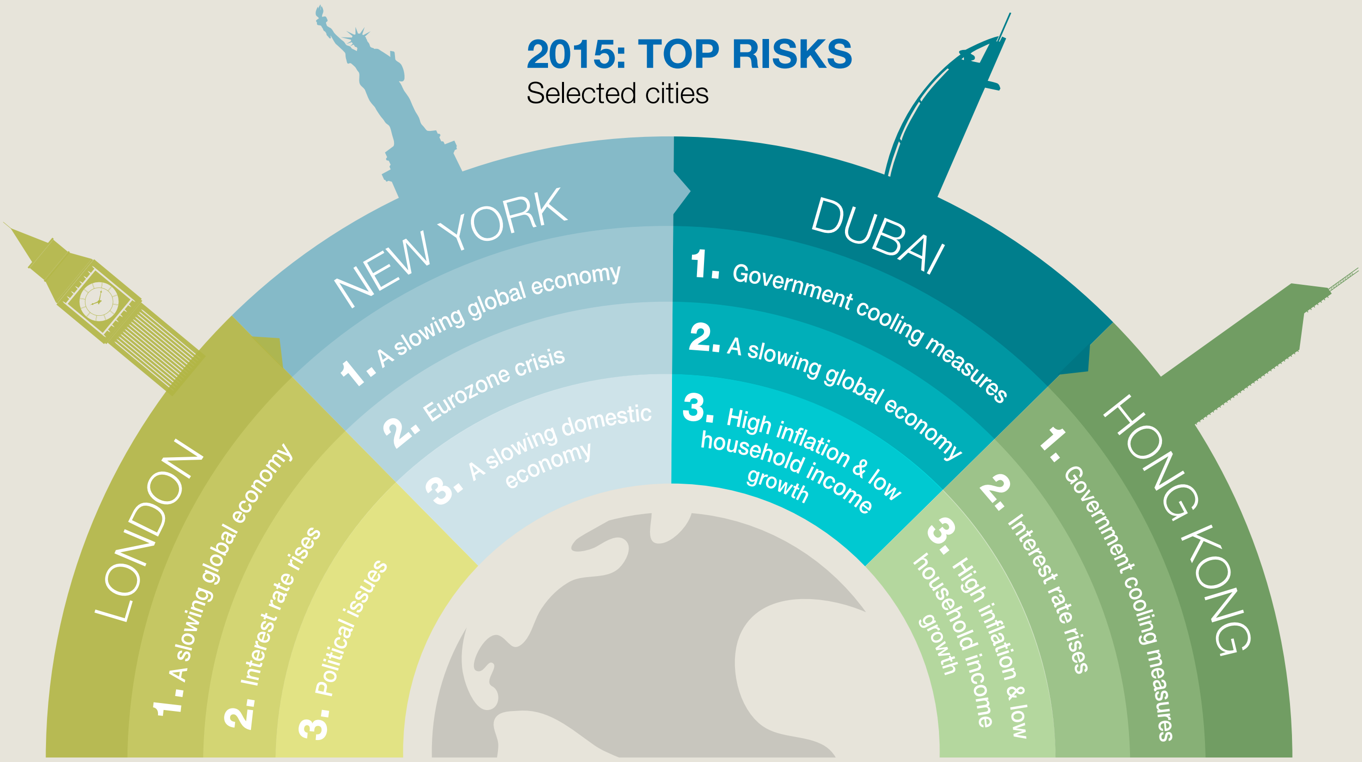
- **New York:** Downtown
- **Sydney:** Eastern suburbs and Lower North Shore
- **London:** Bayswater, Fitzrovia, Midtown. New developments around the City and Fringe area such as Shoreditch
- **Paris:** Core levels between €650,000 and €1,300,000 will continue to outperform
- **Singapore:** Mid-tier market in the city fringe
- **Hong Kong:** Peak, Island South and Mid-Levels
- **Geneva:** Cologny, Collonge-Bellerive
- **Dubai:** Emirates Hills, Palm Jumeriah

FIGURE 5

## Mainstream markets recovering

Indexed, 100 = Q1 2006




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

# MEASURING RISK…

With the global economy stuttering and Europe yet to shake off its malaise, we highlights the top five risks facing the world's top luxury residential markets in 2015 and provide our view of where the key opportunities lie.

## 1 The removal of government stimulus

The most obvious manifestation of this trend will be interest rate rises. Prime city markets are shielded to some extent by the fact they tend to be more equity rich than the mainstream national markets they sit within. The counter to this advantage is that as yields rise on alternative investments, low yielding residential property could begin to appear less attractive as interest rates begin to rise from historic lows.

## 2 Currency instability

Predicting the next currency movement to shift investor flows into international property is not an easy task.

However, with the Federal Reserve likely to increase interest rates in 2015, and the ECB's move towards negative interest rates, the dollar is likely to rise – pointing to a stronger outlook for demand for prime residential property in the UK and Eurozone.

The most interesting development will be future movements of the Chinese Renminbi. The currency is still not fully exchangeable, but is likely to be in five years' time. Any potential devaluation would dampen investment outflows into global residential property – especially property priced in currencies with a hard dollar link – Hong Kong in particular.

## 3 Political intervention

So far political interventions in the world's residential property markets, through cooling measures and limits to market access, have been concentrated in Asia, in particular Hong Kong, Singapore and China. The rising level of cross-border investment is likely to contribute to further debates in other parts of the world in 2015 (Canada, Australia, Dubai) on the impact of foreign buyers on local residential market affordability and stability.

## 4 Economic reversal

While the immediate threat of a collapse of the euro has retreated, other risks have taken up the slack for those nervous about the economic underpinning of the world's key city housing markets.

With the target market for many prime residential developments becoming increasingly cross-border, a sharp reversal in the Chinese economy, is probably one of the highest risk issues facing the market. However, do not underestimate the impact of economic uncertainty as a boost for safe-haven markets (see No.3 of Opportuniti es).

## 5 Tax

Taxation of residential property has become an increasingly live issue, especially in Europe, as governments have tried to shift the burden of taxation towards wealth and asset holdings rather than income.

Ironically, taxation has also been used as a tool to reduce the impact of stimulus measures which have acted to push asset prices higher. The landscape in several countries for property taxation has undoubtedly become far less benign than it was pre-crisis, however outside of Hong Kong and Singapore; most changes have had a limited impact on demand.

# AND OPPORTUNITY…

## 1 New wealth in emerging markets

The growth in global wealth, especially from emerging markets, is set to power demand for residential investment property. The growth in Ultra High Net Worth populations (investors with more than US$30m in investable assets) is set to rise from nearly 168,000 to over 215,000 in the decade to 2023. While the ever popular global hubs are set to take the lion's share of this investment, we also think 2015 will see a growing appetite for alternative markets and more speculative plays from investors.

## 2 Improving economic fortunes

The weakest spot of the world economy has, for several years, been Europe, however the tentative improvements in economic fortunes there has fed into a belief that prices for property have hit a low point, and investor appetite has returned (strongly in markets such as Madrid and Dublin).

Aside from Europe, there are other markets where improving sentiment and growth is helping to drive market performance – India is a notable example. The arrival of Narendra Modi's new government has led to an increase in business confidence.

## 3 Continuation of safe haven trend

Despite some easing of the crisis conditions facing the global economy in recent years, the flow of wealth from economic or political crisis locations into 'safe-haven' markets is continuing.

In markets like London, Sydney and New York, these flows tend to reinforce demand for established market neighbourhoods, with buyers focusing on wealth preservation and looking for mature and stable markets.

## 4 Prices expected to reach their floor, attracting new investors

Key european markets, such as Dublin, Madrid, Rome and even Paris, have experienced a long period of declining values and weak demand, but we saw prices in the prime markets in Dublin turn up in 2012, followed by Madrid in 2013.

We expect to see a greater focus on opportunities in markets like Paris and Rome in 2015 which thus far have been largely overlooked by investors, nervous of political uncertainty, but which are increasingly offering good value when compared to neighbouring alternatives.

## 5 Infrastructure

Improving infrastructure, be it rail, road or air links, is increasingly a bellwether for developers and investors. The issue is understanding at what point to move in the development cycle, something we have been monitoring closely in our series of reports on London's Crossrail project and also in our Asia Pacific Residential Review.

# MARKETS IN BRIEF…

RISING STABLE FALLING
**Direction of prime prices in 2015**

What does 2015 have in store for the world's most exclusive residential markets and which events have the potential to knock them off course?

## LONDON

Next May's general election has dominated the fortunes of the prime central London sales market in 2014.

The prospect of a mansion tax has contributed towards slowing demand, though annual price growth has not deviated far from an average of 7.9% over the last two years.

Our view is that will change next year, when we forecast zero growth.

If the threat of a mansion tax recedes, some degree of recovery is likely in the second half of 2015, as pent-up demand is released. To what extent the tax would be absorbed by the market if introduced is currently difficult to assess given the lack of detail. Whatever the outcome of the election, our view is that growth will be less marked over the next five years than the last five, when prime central London's safe-haven appeal during the financial crisis contributed to a cumulative rise of 61%.

## NEW YORK

The two-pronged effect of strengthening international demand and improving economic indicators has helped push prime prices up by c.6.7% to date in 2014. We expect this trend to continue in 2015 with Chinese buyers likely to be increasingly active, particularly in light of the recent relaxation of visa terms.

Two issues developers are having to consider include the NYC government's plan to stipulate affordable housing mandates for developers and a proposal currently being considered by Mayor Bill de Blasio to apply additional taxes to pied-à-terre purchases.

Supply, particularly in the upper price bracket is strong with a number of new luxury developments planned for the Midtown market.

## HONG KONG

Due to high land prices and construction costs, development in Hong Kong has been focused on the mid to high end of the market in recent years.

According to the Hong Kong's Ratings and Valuations Department, the number of large units (100 sq m+) being completed will increase to 3,180 in 2015 from 1,210 in 2014. Mid-Levels West will see a number of these new luxury residential developments.

We expect The Peak, Island South and Mid-Levels to outperform Hong Kong's wider luxury residential market in 2015 as wealthy buyers target those areas.

Strict cooling measures in the form of higher stamp duties for non-residents and tight lending conditions remain in place. Prices may come under more downward pressure in 2015 as discussions of a potential rise in interest rates gather pace.

## SINGAPORE

Luxury residential prices in Singapore fell 10% in the year to September 2014. Foreign buyers have taken less interest in the market given the falling prices and overall weak sentiment on the property market. The Additional Buyer Stamp Duty, applicable at 15% of purchase price on foreign homebuyers, is one of the key reasons for the muted market demand, as foreign demand has typically provided higher support for this market segment.

Despite the limited number of new projects being developed, the existing unsold inventory of units in the high-end market stands at 9,469 as at Q3 2014, although it has declined slightly by 2% from the previous quarter. Property developers are facing looming pressures to offload their unsold units to avoid higher holding costs. One major property developer has recently hinted of 'likely fire sales' if market performance remain tepid for the long haul.

Given the quiet market, the government is not expected to introduce further cooling measures. Transaction volumes are likely to remain low at least for the next 6 months as potential buyers and investors monitor the market and await the relaxation of the existing cooling measures.

## PARIS

Political and economic headwinds have unsettled buyer sentiment in Paris in 2014. Further draconian taxes on foreign ownership from President Hollande remain the key threat to the luxury residential market.

Nonetheless, properties priced between €650,000 and €1.3m across Paris continue to sell well. This market segment is being fuelled by smaller investors looking to benefit from low interest rates, the growing availability of credit and strong rental demand.

Luxury prices in Paris remain very competitive compared to other key European cities and we expect investor interest to strengthen once the tax and economic climate is more benign.

## SYDNEY

Along with New York we expect Sydney to be one of the strongest performing luxury residential markets in 2015. Rising business confidence and an increasing sense of political stability is helping to attract interest from overseas. The weak Australian Dollar is adding to this momentum and also reviving interest from Australian ex-pats.

Low interest rates are forecast to remain steady with no change expected until mid to late 2015 and banks are keen to lend at competitive rates.

The House of Representatives Standing Committee on Economics has delivered its review into foreign investment in Australia's residential property market.


No additional restrictions have been placed on foreign purchasers buying in Australia but a list of recommendations have been made to ensure the rules are more rigorously enforced.

The Significant Investor Visa program that attracts high net worth individuals will be refined and a Premium Investor Visa will be introduced on 1 July 2015; a more expeditious pathway to permanent residency for those meeting a $15m threshold.

## GENEVA

Luxury prices in Geneva remained stubbornly high post-Lehman's collapse but vendors have slowly readjusted their expectations.

The vote on the lump sum form of taxation (Forfait Fiscal) added some uncertainty to the Geneva market in run up to the vote on 30 November. However, the decision not to abolish the 'forfait' tax is likely to add some renewed impetus to Geneva and the wider Swiss residential market.

The best-performing districts remain in the heart of Geneva's old town and along the banks of Lake Geneva including Cologny and Collonge-Bellerive.

Setting aside Geneva's benign tax environment, the city remains a target location for trading firms and families seeking a safer environment to educate their children. As a result, we are receiving a great deal of interest from the world's main areas of risk with safety the key driver rather than tax.

## DUBAI

At the end of 2013, the Dubai Land Department doubled the transfer fee to 4% and the UAE Central Bank introduced mortgage caps. As a result, a proportion of buyers face the prospect of much higher property purchase costs than they did 18 months ago.

Largely because of this, buyer sentiment has weakened notably. In annual terms, residential transaction volumes saw a double digit decline in the six months to September 2014. Also, in the third quarter of 2014 prime residential prices experienced their first quarterly fall (albeit of just 0.2%) in almost three years.

In the near-term, there is little to indicate that residential transaction volumes in the luxury segment will stage a strong recovery. However, a combination of healthy projected economic growth and the limited supply of new prime residential property, suggests that any further price falls in this segment next year will be moderate.

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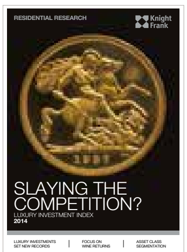


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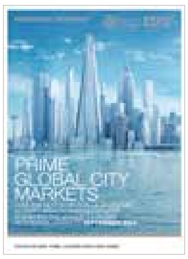


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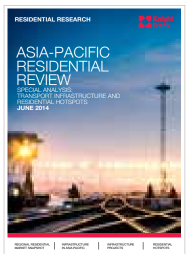


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