RESIDENTIAL RESEARCH

PRIME GLOBAL RESIDENTIAL FORECAST

Q4 2012 Edition

Knight Frank

HIGHLIGHTS

- In 2013, we expect prime residential prices across the 14 cities included in our forecast to rise by 2.5% on average, with Moscow, Miami and Dubai being the strongest performers.
- A sharp slowdown in the global economy is the highest risk for the world's prime residential markets closely followed by government cooling measures.
- However, the current economic uncertainty is also considered a key driver of demand in prime cities as HNWIs seek the shelter of 'safe-haven' investments.
- Supply, or the lack of it, will be a key determinant of price performance in cities such as New York, Moscow and Miami in 2013.
- We envisage that government-imposed regulatory measures will keep a lid on price growth in Asia in 2013 but the west-east shift in the economic balance of power suggests more promising prospects in the medium term.

PRIME NUMBERS

Luxury homes in key cities worldwide have emerged as a new international currency. The fragility of the global economy has promoted luxury bricks and mortar to the status of 'safe-haven' amongst the world's wealthy. How did we arrive at this point and what does 2013 hold? Kate Everett-Allen examines current market conditions:

"In 2013 we expect currency movements will have an increasing bearing on the flow of wealth from city to city."

Kate Everett-Allen, International Residential Research

Since Lehman Brother's collapse the world's luxury markets have come full circle. The global downturn meant luxury prices tumbled as market confidence ebbed away but within 12 months key markets such as London, Hong Kong and Shanghai were rallying once more recording prime quarterly price growth of 5.5%, 5.6% and 9.8% respectively.

In 2006 Knight Frank established the Prime Global Cities Index to measure the performance of luxury housing markets in some of the world's most important city markets. The index now stands 18.7% above its financial crisis low in Q2 2009. But it is the speed of the re-bound that is impressive, by Q1 2010 the index had regained its pre-crisis high.

Prime property has done more than just weather the economic storm and outperform its mainstream counterparts, it has prospered as a direct result of the uncertain economic climate. The protracted Eurozone debt debacle, the geopolitical tensions surrounding the Arab Spring and the absence of alternative strong-performing asset classes have heightened its appeal.

But aside from the climate of uncertainty, the rapid transition from 'crisis' to 'safe haven' was assisted by low interest rates, the preference amongst HNWIs for accessible and transparent markets and the unprecedented scale of wealth creation that was simultaneously occurring in the world's developing economies.

Between 2006 and 2011 the number of centa-millionaires (those with disposable assets of $100m+) increased by 29% globally. The number of centa-millionaires in Latin America, South-East Asia and South-Central Asia rose by 67%, 80% and 200% respectively over the same period.

Cross-border investment flows have risen significantly as HNWIs in these emerging markets have looked beyond their national boundaries for double-digit annual returns. Miami has delivered for wealthy Brazilian, Venezuelan and Argentinian buyers while Dubai is the location of choice for an increasing number of Indian and Iranian HNWIs.

What will be trending in 2013?

In our 2012 Forecast we envisaged there would be three global trends that would be increasingly influential on the world's luxury residential markets; wealth creation, the growth of 'safe-haven' investments and the widening gap between East and West.

In 2013 we expect a continuation of the same trends but currency movements will have an increasing bearing on the flow of wealth from city to city. Prime prices in New York have slipped 2.6% since 2008 but taking currency movements into account this translates into a 17.6% discount for Chinese buyers.

GLOBAL HOTSPOTS

Luxury housing markets are an amalgam of numerous sub-markets, some often amounting to only a few key streets or developments. We asked our network of global research teams for their view as to which areas or price brackets they think will be their strongest performers in 2013.

Figure 1
Markets to watch

	Submarket	Why?
Paris	Properties below €1.3m	Less expensive homes are not covered by wealth taxes
Geneva	Old Town of Geneva	Buyers are returning to the market as pricing becomes more realistic
Miami	Waterfront single family properties	Continued demand from overseas buyers
London	Bayswater, Farringdon and Fitzrovia	Impact of Crossrail
New York	Midtown, Upper East Side, Upper West Side	New developments are targeting these areas
Dubai	Palm Jumeriah, Emirate Hills	Limited supply of luxury homes is pushing prices higher
Monaco	Carre D'Or, Fontvieille, Saint Romain	New developments, such as Tour Odeon, are expected to attract buyers as they near completion

Source: Knight Frank Residential Research

To see the full list of the markets and price brackets we are tipping for growth in 2013 please visit our news and blog site Global Briefing

The search for unique "trophy" homes will gather pace in 2013 due in part to the increasingly high standard of new projects. Tall towers in the main gateway cities are already capturing the attention of an expanding number of HNWIs and we expect this trend to intensify.

In the coming year the world's wealthy will continue to micro-manage their property portfolios weighing up lifestyle gains against tax benefits and currency movements but central to most decisions will be price performance, both historic and forecast.

The forecast

Barring a collapse of the euro, the US toppling off its fiscal cliff or Asian protectionism being ramped up, the outlook for luxury homes in the world's key cities is one of quiet optimism.

The forecasts shown in the map below represent our view as to where we consider prime prices are headed in 2013; for comparison purposes we have also shown each city's actual price performance in the year to September 2012.

In 2013 we expect prime prices across the 14 cities surveyed to rise on average by 2.5%. In 2012 we predicted average price growth of 0.6%.

In 2013, we expect prices to rise or remain flat in eleven of the 14 cities included in our forecast.

Moscow is expected to record the strongest price growth of all 14 cities (we forecast annual growth of 10%) due to tight prime supply and the expected release of a number of super-prime projects.

Dubai provides another good news story; here we expect prices in the luxury villa market to rise by between 5% and 10% in 2013. The volume of enquiries from professionals re-locating from the UK and Asia is rising while the supply of high quality family homes is largely static.

We expect prices to fall in only three cities – Paris, Geneva and Shanghai – but in each case by less than 5%.

In Paris, the market has been sluggish in the second half of 2012 but we expect greater clarity to emerge in 2013 once President Hollande's austerity measures have bedded in. New development is still limited in markets such as Paris which may help sales absorptions in spite of political dampening measures.

Geneva has seen foreign demand fluctuate in 2012 and borrowing power has been affected by new lending legislation.

Shanghai meanwhile is set to see a continuation of the home purchase restrictions that came into force this year. This includes preventing single persons that are non-resident from buying property in the city.

In 2013 supply constraints are expected to be a determining factor for a number of cities. The shortage of top-end homes in Moscow and Miami is expected to support price growth. But in Monaco and New York although the lack of luxury homes is also evident there is not enough of an imbalance to drive prices significantly higher in 2013.

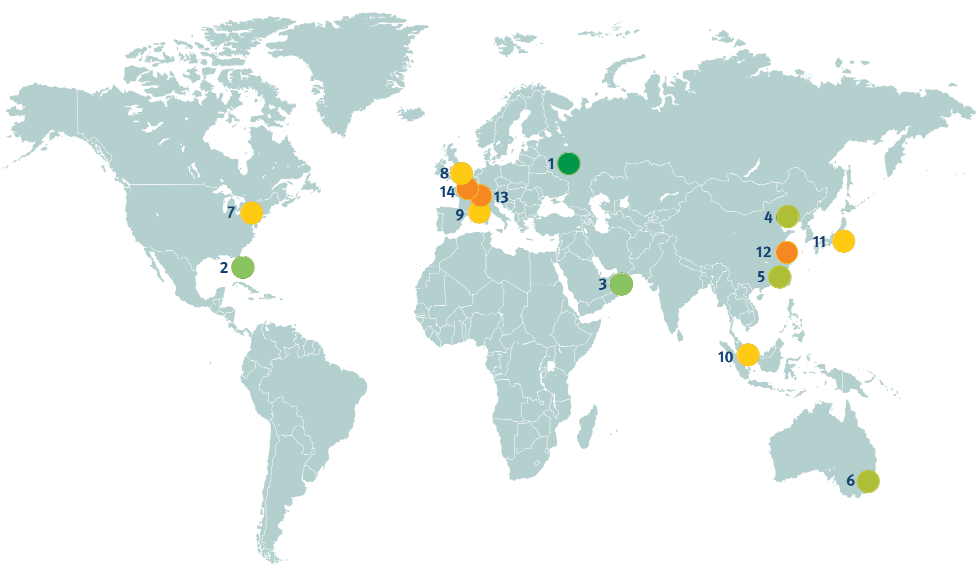
Mainstream housing market forecasts are arguably more straightforward than prime. By scrutinising key indicators such as house prices to income ratios, house prices to rent ratios, interest rates and disposable incomes it is possible to gauge levels of affordability. The prime market however operates according to a different set of dynamics.

Instead, hard-to-quantify factors such as lifestyle, market confidence and the ease with which HNWIs can exit a market are often the critical factors under consideration. The current situation in Asia where markets are increasingly being controlled by government regulatory measures also make it harder to take a true reading of a prime markets' capacity for growth.

Figure 2

Prime city residential price performance

City	Annual % change to Q3 2012 Actual	Annual % change 2013 Forecast
1. Moscow	↓ <5%	↑ 10%-20%
2. Miami	↑ 10%-20%	↑ 5%-10%
3. Dubai*	↑ 10%-20%	↑ 5%-10%
4. Beijing	↓ <5%	↑ <5%
5. Hong Kong	↑ 5%-10%	↑ <5%
6. Sydney	↓ <5%	↑ <5%
7. Manhattan	↓ <5%	→ no change
8. London	↑ 5%-10%	→ no change
9. Monaco	↓ <5%	→ no change
10. Singapore	↑ <5%	→ no change
11. Tokyo	↑ 5%-10%	→ no change
12. Shanghai	↓ <5%	↓ <5%
13. Geneva	↑ <5%	↓ <5%
14. Paris	↓ <5%	↓ <5%



*Based on villas only

Source: Knight Frank Residential Research, Miller Samuel Inc/Prudential Douglas Elliman, Sumitomo Mitsui Trust Research Institute

Figure 3

Risk analysis

Our forecast is based on assumptions made on global macro-economic outcomes. In this table we examine seven macro risks and their potential impact globally

Ranking	Risk	Downside scenario and impact
1 (Highest risk)	**A slowing global economy**	The global economy has essentially stalled since the second quarter of 2012. Consumers, businesses and investors are awaiting clear signals as to how key risks play out, from the US's fiscal cliff to the Eurozone debt crisis. A weakening global economy would limit wealth creation and dampen confidence. The pull of 'safe-haven' investments would lessen the impact in some markets.
2	**Government cooling measures**	The efforts on the part of mainly Asian governments to improve domestic affordability and avert a housing bubble have become increasingly wide-ranging and targeted at high-end properties (see figure 4). Regulatory measures such as higher stamp duty rates in Singapore have have already had a direct impact on the number of foreign buyers, a similar trend may now be seen in Hong Kong given its 15% Stamp Duty rate for foreign buyers.
3	**A slowing domestic economy**	The potential for a domestic recession, with the ensuing negative impact on employment and earnings growth, would have a direct and substantial impact on domestic housing markets, although the main effect would be felt in the mainstream rather than prime markets.
4	**Eurozone crisis**	If the Eurozone were to collapse all bets would be off and the global economy would enter a period of unchartered territory. Bank lending would be severely restricted and volatility would return to the world's financial markets would return. But some investors may view the tangible asset of luxury bricks and mortar as safe an investment as any at a time of immense turbulence.
5	**Interest rate rises**	With interest rates in much of Europe and the US at historical lows, this availability of credit has helped push prime prices higher. However, in some markets such as Miami cash purchases are increasingly common, minimising the influence of lending rates.
6	**Political / security concerns**	Those cities with a high degree of transparency, a strong legal system and relative political stability frequently see demand strengthen at times of geo-opolitical risk around the globe. The Arab Spring led to heightened interest in Dubai and Paris's luxury residential markets.
7 (Lowest risk)	**High inflation & low household income growth**	High inflation in parts of Asia has already pushed interest rates higher. This, together with lower incomes would have the effect of stifling demand but it would be more of a concern for mainstream than prime markets which are less exposed to credit availability.

Measuring risk

While the forecasts we have presented represent what we believe to be the most likely outcome for 2013, there remains a number of derailing factors which have the potential to knock our forecasts off course.

With no solution to the ongoing crisis in the Eurozone on the horizon, it is no surprise that both global and domestic economic factors remain the biggest risk to property prices in 2013.

While international locations such as Geneva, Monaco, Dubai and Hong Kong rank the slowing global economy as the biggest risk, there are more insular concerns surrounding the health of domestic economies in the growth cities of Kuala Lumpur, Mumbai, Ho Chi Minh City and Sydney.

Government intervention has become increasingly important both in mature real estate markets, such as London and Paris, but also in rapidly expanding ones, such as Singapore where the government has recently introduced tighter measures for foreign workers and placed restrictions on home loans. Figure 4 provides a ranking of the degree of risk posed by the main cooling measures.

Further regulatory controls in prime cities around the world, most notably a 15% additional stamp duty for foreign buyers in Hong Kong and an increase in stamp duty for homes worth over £2m in the UK, could have an impact at the very top end of the market.

Interestingly, given their proximity to the problem and wider concerns about the health of the global economy, not one of the European cities surveyed ranked the Eurozone crisis as the highest risk adding further weight to the idea that prime locations have benefitted from their 'safe haven' status and continue to attract investment against the backdrop of sovereign debt concerns and geo-political uncertainty.

However, the lack of available finance, shrinking job markets and low consumer confidence in the region could weaken demand, even at the luxury end of the market.

We have ranked interest rates, high inflation and low household income growth and the introduction of large scale housebuilding programmes as low risks for the majority of locations.

Beyond the core risks examined above, there are countless factors such as currency fluctuations, tax changes and the revision

of planning rules which could change the patterns of demand and supply in the world's prime markets. But the fundamentals are likely to remain unaltered; the supply of luxury homes is tight in most cities and global demand is rising exponentially.

Asia Pacific focus

"In China (in 2013), we are more bullish about the stronger domestic "establishment" market of Beijing than the Shanghai market."

Nicholas Holt, Research Director, Asia Pacific

If the leading indicators of prime residential market performance are GDP growth and wealth creation, then at first glance, we could reasonably expect the Asia-Pacific markets to outperform the other regions of the world. This has not been the case in 2012, and the feeling is that this is unlikely to change in 2013. Nicholas Holt looks into the reasons why.

Push factors

Across much of Asia, 2012 has seen continued government interventions, aimed at mitigating the risk of asset bubbles and addressing concerns of affordability. These cooling measures have, however, dented demand for prime residential product in some markets, through limiting financing, introducing extra taxes for foreign buyers and penalties for disposing of the property within a certain time period. Many of these measures have targeted the high end residential market (loan to value ratios in Hong Kong are limited to 50% for properties over HK$10 million), but more often they have been introduced to penalise multiple home owners at the expense of first time buyers, which disproportionally impacts the prime residential markets.

Pull factors

At the same time that the market has become more difficult for some buyers, the attraction of prime property markets outside their domestic markets has continued to provide incentives to move their money abroad. With an increasingly mobile, educated and well-travelled class of property owners in the Asian region, the lifestyle choice of having a second home abroad, for personal or for children's educational use is proving to be one of the key narratives for HNW Asian buyers.

Given the lack of alternative investment options, property in so-called safe-haven cities around the world has become an attractive asset for Asian HNWIs. Domestic currencies that have strengthened against destination market currencies have also provided a currency play which has, in some cases, provided significant discounts in real terms.

Forecast

With the ongoing global west-east shift in the economic balance of power, there is no doubt that the prospects in the medium term for prime residential markets in the region are promising. Our forecasts show however, that given the protectionist measures introduced over the last 12 months in the Asian safe haven and lifestyle destinations of Singapore and Hong Kong, we expect fairly subdued price performances in these markets through 2013.

In China, we are more bullish about the stronger domestic "establishment" market of Beijing than the Shanghai market, which is more linked to the business performance of the financial capital of the country. Finally, Sydney, which is closed-off to foreign buyers except in the primary market, is expected to recover after a decrease in the number of motivated vendors with a stable market forecast for 2013.

Figure 4

Government Intervention

For those respondents that thought government cooling measures represented a high risk to their luxury markets, we asked them to rank which regulations they thought posed the greatest risk, the results are below:

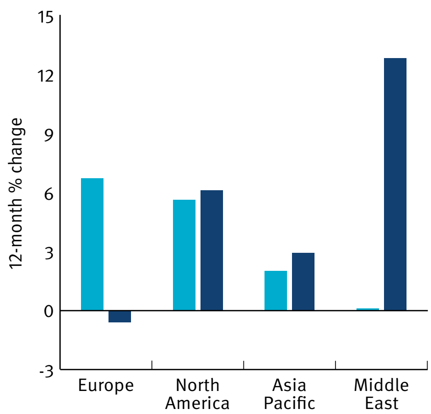
(Highest risk) 1	Shrinking mortgage availability
2	Restrictions on multiple ownership
3	Changes to CGT rules
4	Large-scale housebuilding programmes
5 (Lowest risk)	Stamp Duty increases

Source: Knight Frank Residential Research

Figure 5

Price performance of luxury homes by world region

Annual % change to Q3, 2011 vs 2012



Source: Knight Frank Residential Research

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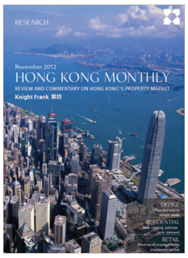
Recent market-leading research publications

The Wealth Report 2012

Asia Pacific Residential Report October 2012

Greater China Report Q3 2012



Hong Kong Monthly November 2012

London Residential Review Autumn 2012

Global Corporate Lettings Review 2012

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Residential Research

Liam Bailey
Global Head of Residential Research
T +44 (0)20 7861 5133
liam.bailey@knightfrank.com

Nicholas Holt
T +65 6228 7313
nicholas.holt@asia.knightfrank.com

Kate Everett-Allen
T +44 (0)20 7861 1513
kate.everett-allen@knightfrank.com

International Residential

Paddy Dring
Head of International Residential
T +44 (0)20 7861 1061
paddy.dring@knightfrank.com

James Price
T +44 (0)20 7861 1057
james.price@knightfrank.com

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