RESIDENTIAL RESEARCH

Knight Frank

PRIME GLOBAL FORECAST

Q4 2013 EDITION

PRIME RESIDENTIAL CITY FORECASTS

RISKS AND OPPORTUNITIES

TRENDS AND INFLUENCES IN 2014

Stepping away from stimulus

The global response to the financial crisis has helped boost the prime global residential markets, the unwinding of stimulus poses some challenges, argues Liam Bailey, Knight Frank's Global Head of Residential Research.

Most global housing markets, especially the prime markets, have experienced two distinct phases since the start of the financial crisis.

The period between the market peak, in 2006/2007 and the beginning of the recovery in early 2009, saw prices tumble in most global markets, especially in the US and Europe – but also in Dubai, and several of the key Asian markets.

Even if downturns in markets like Singapore and Hong Kong were less pronounced in pricing terms, they were just as severe in terms of falling sales volumes.

With a few exceptions, global markets saw a difficult period, almost everywhere up to March 2009.

To understand why March 2009 was the turning point, we need to go back six months to 15 September 2008 – which was the day that Lehman's filed for bankruptcy.

Because, ironically, it was the size of the crisis that Lehman's collapse revealed, that hastened the revival in prime property markets, a trend we have seen over the past four years.

In late 2008 however, the resulting panic in financial markets. following the Lehman crash, led to a slashing of interest rates by policy makers and the beginning of quantitative easing.

This reduced the cost of finance, encouraging affluent buyers into the prime property markets.

And at the same time, the process of government asset purchases also reduced yields on alternative investments, and as a result, investors targeted tangible assets in safe haven markets.

So, all the ingredients were in place for the recovery in global residential markets, especially the prime markets. In cities like London, New York, Singapore and Hong Kong, the recovery has been very strong, with several years of positive price growth.

While most of Europe has struggled, this is by no means the whole story. Austrian and German prime city markets have seen their strongest growth for decades, and markets like Munich are seen by investors as part of this "safe haven" grouping.

Complications

The problem for governments is that their solutions to the financial crisis have had unintended consequences. Quantitative easing has had a global impact, but this impact has not been evenly spread.

In Asia the volume of cheap money has been such that governments have begun intervening in property markets. The weight of money leaving China, and landing in markets like Hong Kong and Singapore has led to a political reaction.

If you are a non-resident and you want to buy in Hong Kong or Singapore, you are facing significantly increased levels of stamp duty. Within China, maximum loan-to-value rates have been capped in key cities. Even in London, stamp duty has been raised in the past two years.

The reality is, in many cases the changes to property taxation, is more a case of bringing benign rules into line with global norms, which is certainly the case in London.

Also these rule changes are generally not a one-way street. With interest rates potentially rising in 2014, and markets in Hong Kong and Singapore already slowing, there is a real chance that some cooling measures could be lifted next year.

Similarly in Europe, the French President Monsieur Hollande is beginning to row back on some of his interventions, for example he is easing some rules around CGT exemption for non-residents.

It is unlikely that the key global markets will be closed for investors.

Aside from political issues, there are a number of further considerations we ought to consider.

The Eurozone crisis is subdued, but has not been solved. Interestingly, the crisis phase for the Eurozone in 2010 and 2011, while having a negative impact on the global economy, led to considerable demand for prime property.

"With a few exceptions, global markets saw a difficult period, almost everywhere up to March 2009."

In a similar vein, geopolitical risks are rising, in the Middle East, but also now in the South China Sea. There is no doubt that these have the potential to hit global economic growth, but once again they have the potential to increase the demand for safe haven assets.

Probably, the biggest issue we need to watch is the unwinding of quantitative easing.

There is no question that asset pricing will come under pressure. But the question is essentially down to timing – if this happens quickly the property market would see values and sales volumes come under pressure. But there is significant pressure on governments to extend the unwinding period, to ensure that economic growth and income growth can support prices.

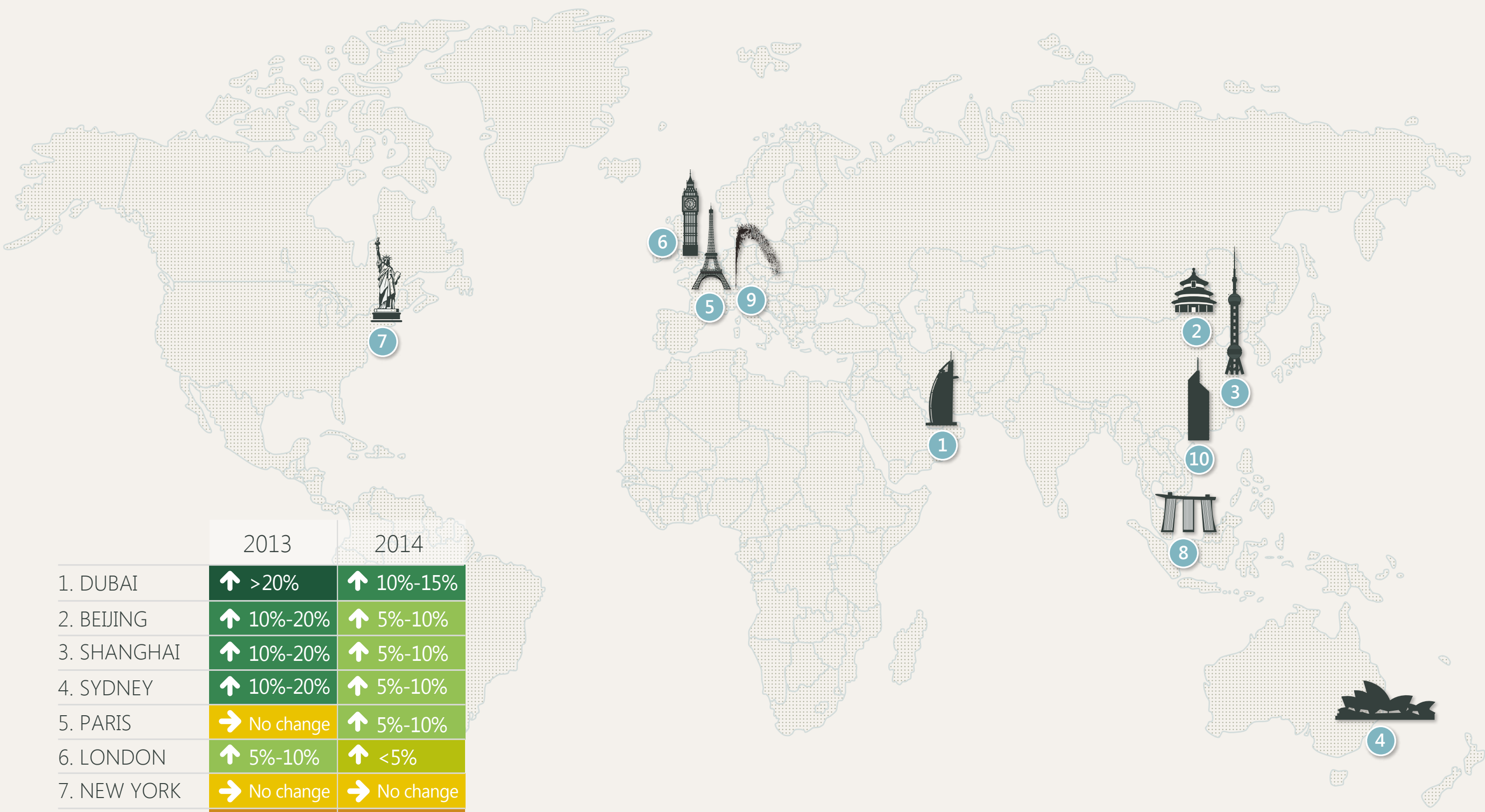
Investors have to consider these risks when making their investment decisions. However they also need to weigh opportunities for growth against these potential downside scenarios/risks.

For example the on-going growth of global wealth will see an additional 4,500 people with at least $30m to invest every year, joining the ranks of the super-wealthy; and these newly wealthy individuals will want to invest some of their wealth in prime property.

The relationship between prime residential markets and economic policy has become ever more entwined. The financial crisis led to policy responses which inflated prime property markets. As a result, attempts to manage prime markets have become more overtly political.

While the unwinding of quantitative easing poses short to medium term risks, in the longer term it should reduce the need for cooling measures in property markets.

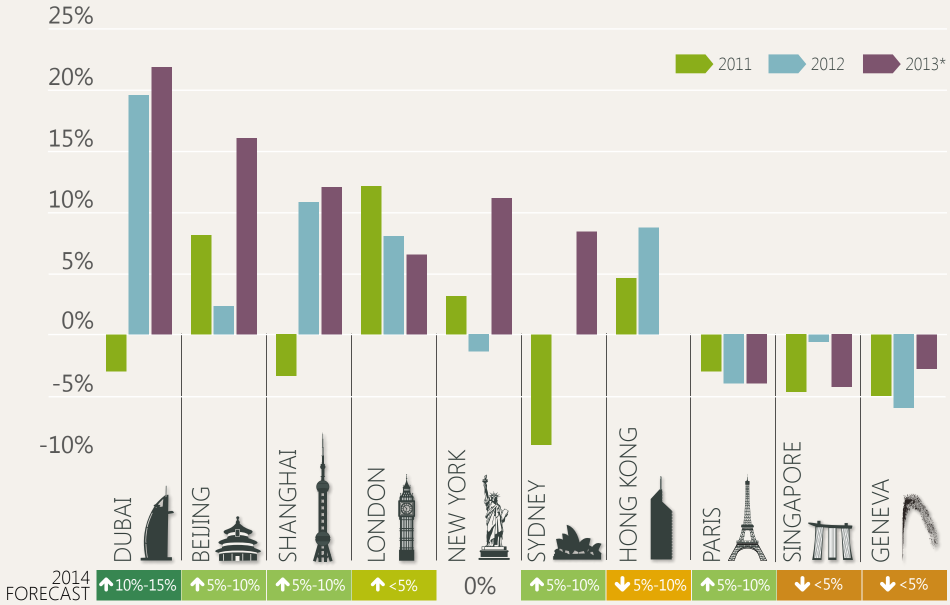
FIGURE 1 **Dubai on top**
Annual change in prime prices, 2013* v 2014**



	2013	2014
1. DUBAI	↑ >20%	↑ 10%-15%
2. BEIJING	↑ 10%-20%	↑ 5%-10%
3. SHANGHAI	↑ 10%-20%	↑ 5%-10%
4. SYDNEY	↑ 10%-20%	↑ 5%-10%
5. PARIS	→ No change	↑ 5%-10%
6. LONDON	↑ 5%-10%	↑ <5%
7. NEW YORK	→ No change	→ No change
8. SINGAPORE	↓ <5%	↓ <5%
9. GENEVA	↓ <5%	↓ <5%
10. HONG KONG	↓ <5%	↓ 5%-10%

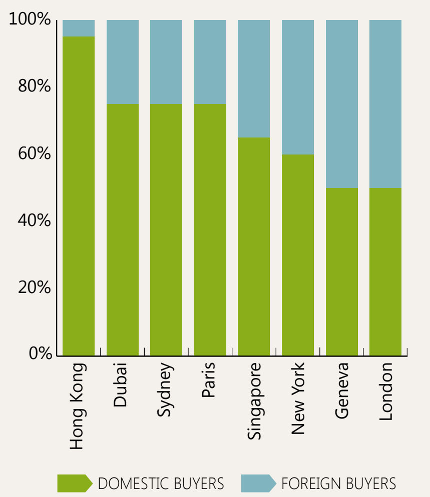
Source: Knight Frank Residential Research, Miller Samuel/Douglas Elliman

FIGURE 2 **Past, present and future**
Annual prime residential price performance (%)



Source: Knight Frank Residential Research, Miller Samuel/Douglas Elliman
* 2013 YTD

FIGURE 3
Measuring foreign demand
Prime residential buyers 2013: foreign v domestic (%)



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

RISKS AND OPPORTUNITIES...

Below we provide our view as to the main risks and opportunities that face four of the world's key luxury residential markets.

The Eurozone debt crisis is not the overriding concern that it was a year ago. Instead, rising interest rates and government intervention in the form of buyer restrictions now pose the greatest threat to luxury residential markets worldwide.

Opportunities in 2014 are focussed more on a local rather than a macro level. An improving local economy as well as the search for regional safe havens are considered the best means of boosting investment and driving inward capital flows.

FIGURE 4 RISKS FACING PRIME GLOBAL RESIDENTIAL MARKETS IN 2014

Ranked 1 to 7, with 1 representing the greatest risk

	EUROZONE DEBT CRISIS	END OF QE IN THE US	GEOPOLITICAL TENSIONS	A SLOWING LOCAL ECONOMY	BUYER RESTRICTIONS/ COOLING MEASURES	INTEREST RATE RISES	LIMITED NEW SUPPLY
London	4	5	7	6	2	1	3
New York	5	2	7	1	4	3	6
Dubai	1	3	2	7	4	5	6
Hong Kong	4	5	7	6	1	3	2

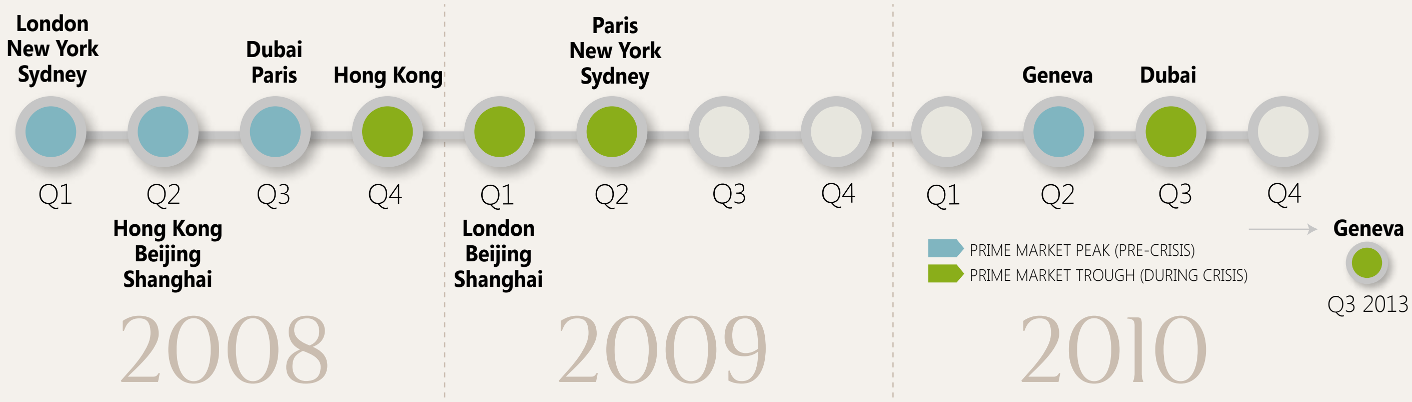
OPPORTUNITIES FOR PRIME GLOBAL RESIDENTIAL MARKETS IN 2014

Ranked 1 to 8, with 1 representing the greatest opportunity

	IMPROVING ECONOMIC CLIMATE IN THE EUROZONE	AN IMPROVING LOCAL ECONOMY	AN IMPROVING GLOBAL ECONOMY	SEARCH FOR REGIONAL SAFE HAVEN	BUYER INCENTIVES	A RELAXATION OF COOLING MEASURES	MORE RELAXED LENDING MEASURES	INCREASED LUXURY DEVELOPMENT
London	5	1	4	2	8	7	3	6
New York	2	1	4	3	7	8	6	5
Dubai	5	2	3	1	7	8	6	4
Hong Kong	5	1	4	3	2	8	7	6

Source: Knight Frank Residential Research

PEAKS AND TROUGHS: PRIME MARKET PRICE TRENDS DURING THE GLOBAL FINANCIAL CRISIS



MARKETS IN BRIEF...

Below we assess the key events and trends which will influence the performance of luxury residential markets in key cities around the world in 2014.

LONDON

Prime central London property has outperformed since 2009, but will begin to lose ground compared to the mainstream market over the next few years, while the UK's country house market will begin to strengthen.

Our view is that price growth will continue in prime central London in 2014, however we believe growth is likely to stall in 2015 due to market uncertainty in the run up to the UK general election. We do not expect the recent introduction of CGT for non-resident buyers to influence demand or pricing significantly.

NEW YORK

Demand is strengthening in New York's prime market but so too is supply. The majority of the new condo development is priced for the luxury end of the market. This is in sharp contrast to the wider market, which is seeing limited new development and will probably see tighter market conditions compared to the prime market.

Overall luxury prices are expected to stay largely flat due to expanding supply and some vendors pricing themselves out of the market.

Activity in the luxury sector will be strongest in the Midtown market in 2014 and demand from international buyers will remain at high levels.

Newly elected New York City Mayor de Blasio begins his term in 2014 and has not sounded as pro-real estate as his predecessor Mayor Bloomberg. However, it is not clear what the new mayor's ultimate policy stance will be.

HONG KONG

Prime residential prices in Hong Kong will fall in 2014 but the luxury end of the market will be better insulated than the city's wider housing market. Increased supply and the continuation of stringent cooling measures will be responsible for the reduction in prime prices. Supply in 2014 will focus on the New Territories, in particularly Tai Po, Tseung Kwan O and Yuen Long.

The market has turned and entered a downward phase. Residential prices will decline in the coming few years, but significant corrections are not expected amid a low mortgage rate environment. The only uncertainty will be from the US – the possible tapering of QE3 and an interest-rate rise – but this is not expected until 2015 or 2016.

BEIJING

In China no further property market cooling measures were announced in the Third Plenary Session of the Central Committee held in November 2013. The current policies are temporarily suppressing demand by restricting home prices and purchase, but we expect the Central Government will tackle the bubble problem by introducing more long-term mechanisms, such as implementing a property tax, increasing land supply or regulating bank loan policies. We expect cash-rich developers, buoyed by issuing bonds and selling homes in 2013, to continue to acquire land in the core areas of China's first and second-tier cities at a fast rate in 2014.

SINGAPORE

Due to the existing cooling measures – in particular the hike in Additional Buyer's Stamp Duty, stricter limits on borrowing and the muted equity market performance – the high-end private residential market in Singapore will see prices decline by 1%-2% in the first half of 2014.

However, lower prices may lead to strengthening demand in the second half of the year, with prime residential properties in popular areas such as Districts 9 and 10 generating greater interest.

Singapore continues to be one of the favoured choices for property investment amongst high-net-worth individuals. Many value the country's stable economic fundamentals and political system, and its safe haven status in terms of cross-border liquidity, preservation of wealth and property ownership rights.

PARIS

Prime prices in Paris are at a similar level to where they were five years ago and an increasing number of foreign buyers are seeing value in the market.

We anticipate a softening of President Hollande's political rhetoric in 2014 and a gradual recovery in market confidence. Should the European Central Bank embark on a recapitalisation of the banks via quantitative easing this is likely to improve lending and potentially have a knock-on effect on the Euro's strength generating interest from non-Euro buyers.

SYDNEY

There is strong underlying demand for prime residential property in Sydney. The combination of low interest rates, a stable economy, demand from foreign buyers – particularly from South East Asia – and positive investor sentiment is driving demand.

Due to foreign ownership restrictions, foreign buyers tend to focus on purchasing new builds in Australia rather than established properties. As a result developers are trying to fast track new projects to take advantage of the currently strong market conditions. However, currently there remains a good level of supply for those looking within a 10km radius of Sydney's Central Business District.

GENEVA

Following two consecutive years of a decline in prime prices, we expect luxury prices will start to stabilise in Geneva in 2014 as buyer confidence improves on the back of more upbeat global economic indicators and a less critical debt situation across the Eurozone.

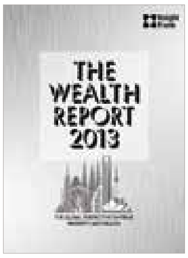
Concerns over the potential vote on the lump sum form of taxation, the final interpretation of the Lex Weber ruling and the vote on maximum pay in Switzerland each have the potential to curtail the strength of the recovery.

DUBAI

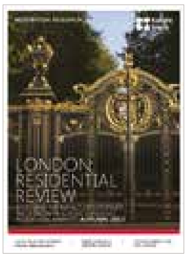
In the last quarter of 2013 Dubai has seen i) a doubling in the transfer fee to 4% ii) mortgage caps for both expatriates and nationals iii) Emaar, a part state-owned developer, banning real estate agents from selling on off-plan property before completion. All of this has come into play in order to ease residential price growth in the emirate, which so far this year has been running at a rate of 18-22% year-on-year.

Although there are signs that transaction volumes have fallen back since the introduction of these measures – which should dampen the quarterly rate of increase in the final three months of this year – we suspect that price growth will quicken again in the early part of 2014. After all, this week, it was announced that the emirate has been awarded the 2020 Expo. While the result was widely thought to be a foregone conclusion, home buyers have been showing signs of taking a “wait-and-see” approach – not surprising in view of the new cooling measures and the fact that prices are quickly approaching previous highs.

RECENT MARKET-LEADING RESEARCH PUBLICATIONS

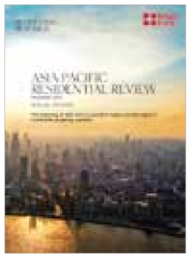


The Wealth Report 2013



London Review Autumn 2013

Dubai Prime Residential Review 2013



Asia-Pacific Residential Review November 2013

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