RESIDENTIAL RESEARCH

US INSIGHT

Knight Frank

Five years on from the start of the US recession the country's prime residential markets are on the road to recovery despite a lukewarm economy and tight credit conditions. Foreign demand and shrinking stock levels have bolstered prices but there are challenges ahead. Kate Everett-Allen assesses current market conditions:

Key findings

Prime prices in Manhattan and Miami increased by 6.5% and 35.1% respectively in the two years to September

Foreign demand, the growing status of luxury homes as a 'safe haven' and for some, favourable exchange rates, have been key market drivers

The mainstream housing market recovery is also underway, prices are rising but the 'fiscal cliff' has the capacity to push the US back into recession

The volume of online US property searches undertaken by Brazilian, Australian and Italian buyers rose the most in 2012

Buyers from mainland China are searching for the highest-priced US luxury properties, priced on average at €11m

The fiscal cliff: mind the gap

The **'fiscal cliff'** represents the crunch point when tax benefits (introduced by Bush and extended by Obama) will expire and government spending cuts kick in. Combined, it represents a fiscal tightening of $626 billion. Dealt with expediently the US housing market could rally in the first quarter of 2013, left to drag and a period of volatility may ensue.

Another tipping point could be the **Dodd-Frank Act** which is due to be implemented in January. This new law will set new mortgage standards and define whether a mortgage is beyond the borrower's ability to pay.

"In 2009, 109 nationalities searched for US luxury homes on our Global Property Search website, in 2012 this figure jumped to 164."

Kate Everett-Allen, International Residential Research

2012 marked a turning point for the US housing market as it finally emerged from the sub-prime debacle. Following several false starts the numbers are now convincing. Vacancy rates and homes for sale are both at their lowest levels since 2005 while housing starts have increased 41.9% in the year to October.

These positives are being reflected in market performance. Mainstream prices posted their strongest gains for six years in the second quarter of 2012 (up 1.2% year-on-year) and luxury homes in cities such as Miami saw double-digit annual price growth (up 18%).

Historically low interest rates (0.25%) and the shrinking number of foreclosures were behind the upturn in the mainstream market. At the top-end, foreign demand, the growing status of luxury homes as a 'safe haven' for high net worth individuals (HNWIs) and for some, favourable exchange rates, were influential.

Despite the positive indicators, the housing market remains fragile and faces some hefty challenges. Its future momentum hinges on the government's handling of 'the fiscal cliff' and the outcome of the Dodd-Frank Act (see margin).

Luxury homes in Manhattan, The Hamptons, Miami and Los Angeles recorded price growth of 6.5%, -5.5%, 35.1% and 3.5% respectively in the last two years (figure 1). Miami's headline-grabbing growth is best explained by its emergence as an investment hub for Latin Americans seeking an accessible, developed and transparent market.

Foreign demand for luxury homes in the US has not only increased in volume but the origin of buyers has diversified. In 2009, 109 nationalities searched for US luxury homes on our Global Property Search website, in 2012 this figure jumped to 164 with Europe, Latin America and Asia now heavily represented.

Critical to the flow of foreign buyers has been the fluctuation in exchange rates. Figure 2 shows the performance of Manhattan's luxury market since Lehman Brother's collapse in late 2008. Prime prices have slipped by 2.6% over this period but taking currency movements into consideration the Swiss and Chinese have seen discounts of 11.1% and 17.6% respectively in real terms.

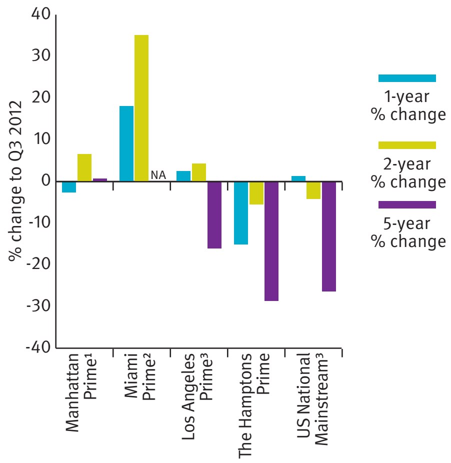
Ironically, while the prolonged nature of the Eurozone debt crisis could destabilise the US and wider global economy, a resolution to the crisis could dilute the 'safe haven' status of US luxury homes. However, given the current inertia in Europe, the shrinking supply of luxury "one-of-a-kind-homes" in the US and the poor-performing financial markets demand is likely to continue to outweigh supply.

The final quarter of 2012 may yet see a spike in sales, mirroring trends in 2010, as capital gains tax (CGT) is set to rise from 15% to 20% at the start of 2013 and vendors may race to complete sales.

Figure 1

Prime v mainstream property price performance

% change to Q3 2012



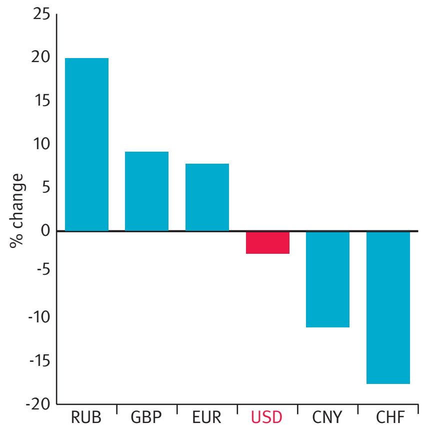
Source: Knight Frank Residential Research, Douglas Elliman/Miller Samuel, Case Shiller

[1] Luxury Co-ops and Condos [2] Luxury Condos
[3] Data to Q2 2012 (latest available)

Figure 2

Currency impact

Effective change in prime New York property prices, September 2012 compared to September 2008, due to price and currency movements



Source: Knight Frank Residential Research

Prime market snapshot

1. Manhattan

Prime prices in Manhattan ($3-$10m) stand 23% below their pre-crisis peak but the super-prime ($10m-$50m) and trophy markets ($50m+) have recovered well and now exceed their pre-crisis highs.

The health of Manhattan's luxury homes market has become defined by the supply of available properties. While demand has been relatively strong, supply has become the critical variable. However, at the top-end of the market there are a number of "copy-cat" listings that are not truly "trophy" and are artificially inflating supply levels.

Activity is currently strongest in Manhattan's prime neighbourhoods of Upper East Side, Upper West Side, Soho, West Village and Madison Square Park.

Hurricane Sandy is not expected to weaken prime prices given the current levels of tight supply but it is expected to lead to higher insurance premiums and construction costs.

2. The Hamptons

The volume of sales in The Hamptons is up year-on-year but prices are declining. Prime prices fell by 15.4% in the year to September but this was primarily due to the shift towards lower-end luxury sales. The sale of homes below $5m currently accounts for 63.4% of total sales.

The second home nature of The Hamptons is also partly responsible for the recent decline in prices as buyers have revised their budgets downwards.

Buyers in the prime market ($3m+) are largely split between international buyers (Russians, British and French) and Wall Street employees. With year-end bonuses on Wall Street expected to be lacklustre we envisage prime prices will remain largely flat in 2013.

3. Miami

The Miami market is starkly polarised with two very different markets coexisting; distressed properties on the one hand and luxury homes on the other. Foreign purchases – which analysts estimate make up a third of all sales in Miami and more than half of sales over $1m – are driving much of the sales activity.

Miami's prime market recorded price growth of 18% in the year to September. The increasingly 'global' city is attracting demand from a number of nationalities, in particular Brazilians, Venezuelans and Argentinians who are keen to invest in a transparent and developed market devoid of the political instability some are witnessing in their domestic markets. Most are cash buyers targeting South Beach and other waterfront locations. New Yorkers are also active in the market.

4. Aspen

Prime prices in areas such as Red Mountain and West End have remained largely flat in the year to September 2012 with $1,200-$1,600 per sq ft currently achievable for a typical prime property.

In 2011, the improvement in sales tailed off towards the end of the year, but 2012 has proved more consistent with the number of sales up 15% year-on-year. However, more peripheral markets such as Snowmass have not seen the same level of buyer confidence and activity as Aspen.

If recent trends continue into the 2012/13 season, we expect that international buyers from Brazil and Australia will help sustain the upturn in the Aspen market. Core Condos, West End homes and well-located, unique properties above $10m will continue to be the strongest performers.

5. Los Angeles

Prime prices in Los Angeles rose by 1% in the year to September but the most desirable locations such as Beverley Hills, Brentwood and Bel Air are seeing demand accelerate and prices increase.

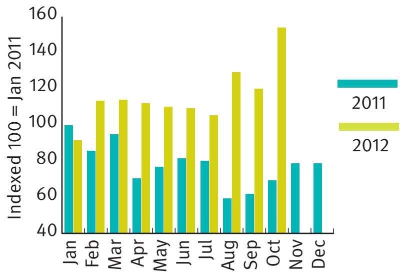
Demand is strongest in the west of the city and here sales volumes have improved and are back to pre-crisis levels. Sales volumes of homes priced at $2m and above increased by 11% in the year to March 2012 in Beverley Hills.

Notably absent since 2007 investors now account for c.20% of buyers in the luxury Los Angeles market. Interest in new-build homes has also strengthened.

Prime market trends

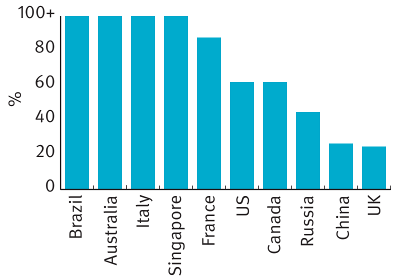
Knight Frank's Global Property Search website (GPS) receives up to 700,000 page views per month making it a unique barometer of the demand for prime international property. The following charts highlight the key trends in the prime US market.

Figure 3
Monthly activity
Volume of property searches Jan 2011-Oct 2012



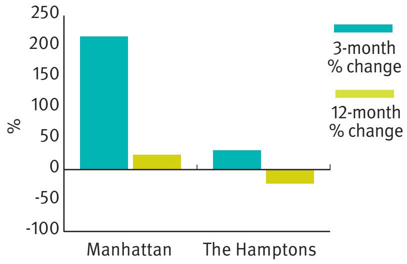
Online search activity has increased significantly in 2012. Searches peaked in spring 2011 but in 2012 September and October have generated the largest volume of searches to date. So far in 2012 there has been a 48% increase in search volumes year-on-year.

Figure 4
Who is searching for US property?
% change Jan-Oct 2012 versus Jan-Oct 2011



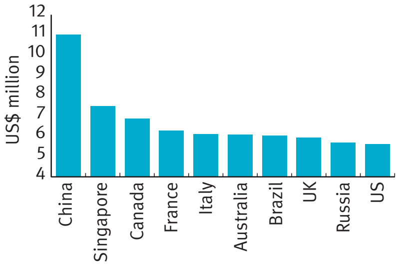
Demand for US property is increasingly global. The latest data shows those nationalities that are increasingly active in undertaking US property searches are not confined to one corner of the globe but instead emanate from Latin America (Brazil), Europe (Italy) and Asia Pacific (Singapore and Australia).

Figure 5
Change in search volumes by region
% change Jan-Oct 2012 versus Jan-Oct 2011



The volume of Manhattan property searches rose by 216% when comparing the three months to October 2012 with the same period a year earlier. The Hamptons also saw a rise over the same period but a fall of 21% when comparing searches in the year to October 2012 compared to the preceding year.

Figure 6
Average price searched by key nationalities
Jan to Oct 2012

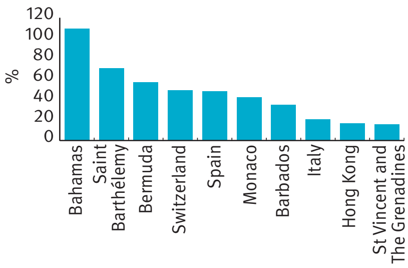


Mainland Chinese nationals searched for the highest-priced US properties (on average c. $11m) between January and October this year. The Singaporeans, who are next in the rankings, searched for properties closer to c. $7.5m. The US and Russian residents are, on average, searching for properties half the price of their counterparts in mainland China.

Figure 7
Property searches by region and price bracket
12 months to Jun 2012

Not only is the breakdown of searches by price brackets in Manhattan and The Hamptons largely the same but the price band are evenly split. In The Hamptons the $5-$15m price band is searched the most while in Manhattan most searches relate to the $15m+ bracket, but at 37.7% only marginally so.

Figure 8
Where are US luxury purchasers buying?
Change in search volumes for most popular countries, Jan-Oct 2012 v Jan-Oct 2011



The latest figures suggest that the Caribbean has retained its place as a perennial favourite with prime US buyers. Out of the top ten locations that have seen the largest increase in US web visits, (when comparing the first ten months of 2012 with the same period in 2011) five are Caribbean islands, the Bahamas seeing the largest increase.

Source: www.knightfrank.com/search

Table 1
Top nationalities buying prime property by city/region

Rank	New York	Miami	The Hamptons
1	US	US	US
2	Canadians	Brazilians	British
3	Chinese	Argentinians	French
4	Russians	Italians	Russians
5	Brazilians	Germans	Italians

Source: Knight Frank Residential Research

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US property highlights

NEW YORK
Manhattan

Location: The Residences, Fifth Avenue
Asking price: £1.35m-$32m

Local knowledge:

Where's prime? Tribeca, Upper East Side, Upper West Side, Soho

Top request: Views across Central Park

% of foreign buyers above €5m: 40%

Record sales price: $13,000 per sq ft

Up and coming areas: Midtown

International airport: John F. Kennedy (JFK), Newark (EWR)

LONG ISLAND
The Hamptons

Location: The Hamptons (near Westhampton Beach)
Asking price: $13.9m

Local knowledge:

Where's prime? East Hampton, Southampton, Bridgehampton, Sag Harbor, Sagaponack

Top request: A waterfront estate

% of foreign buyers above €5m: 20%

Record sales price: $60m

Up and coming areas: All established markets

International airport: John F. Kennedy (JFK)

MIAMI
Singer Island

Location: The Ritz-Carlton Residences, Singer Island
Asking price: $700,000-$10m

Local knowledge:

Where's prime? Miami Beach, Key Biscayne, Sunny Isles and Downtown Miami

Top request: Beachfront property with privacy

% of foreign buyers above €5m: 50%

Record sales price: $47m

Up and coming areas: Downtown

International airport: Miami International Airport (MIA)

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