

RESIDENTIAL RESEARCH



GLOBAL OPPORTUNITIES REPORT

ASSESSING VALUE IN HOUSING
MARKETS WORLDWIDE **2014**

MAINSTREAM MARKETS:
OVER OR UNDERVALUED?

PRIME SECOND HOMES: IDENTIFYING
BUYING OPPORTUNITIES

ASSESSING RISK: TO
BUY OR NOT TO BUY?

INTRODUCTION



“The upturn in the global economy, albeit gradual, has meant for some home ownership, or even the acquisition of a second home, is back on the agenda again for the first time since 2008.”

KATE EVERETT-ALLEN
International Residential Research

With the global economy displaying green shoots, buyers – both in mainstream housing markets and second home hotspots – are looking closely at which markets offer real value.

Already in 2014 there has been a steady stream of positive indicators for global housing markets. Lending criteria is being relaxed, interest rates in Europe, the US and the UK look set to remain at historical lows at least until 2015, employment is picking up and buyer confidence is strengthening.

This upturn in the global economy, albeit gradual, has meant for some home ownership, or even the acquisition of a second home, is back on the agenda again for the first time since 2008.

Below and on page 3 we look at how **mainstream housing markets** at a national level compare, what stage they are at in terms of their property cycles and which housing markets are considered over or undervalued.

On pages 4-5 we examine the opportunities emerging in **key second home destinations** across Europe and the Caribbean. We highlight those locations

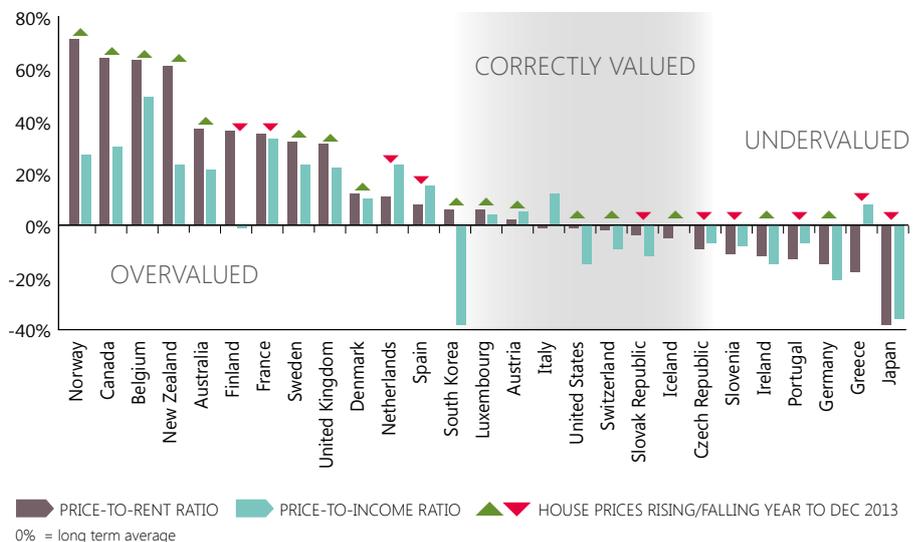
that have seen some of the largest price falls in peak-to-trough terms since the financial crisis, and assess which markets now represent good buying opportunities.

We have also examined the issues that, given the economic climate, are weighing most on the minds of buyers. From currency fluctuations to purchase costs, from tax hikes to oversupplied markets; we look at the potential risks (upside and downside) that deserve close consideration.

Mainstream: seeking value

In figure 1 we have compared mainstream housing markets across 27 countries, assessing how prices are performing in relation to rents and incomes. The axis at 0 represents a position where a market is valued in line with its long-term average. A column above the line shows there is an imbalance with house prices surging ahead

FIGURE 1
Mainstream markets: Overvalued or undervalued?*
Percent over- or undervalued relative to long-term average of mainstream housing market



Source: Macrobond, OECD *Based on OECD calculations using house price movements to Q4 2012.

of rents or incomes. A column close to the line suggests the market is balanced, and displaying a sustainable level of growth. A column below the line signals the market is undervalued with rental and/or income growth outpacing house prices.

At present, 15 of the 27 countries we have tracked are above their long-term average both in terms of price-to-rent as well as price-to-income ratios. Interestingly, if the same exercise had been carried out at the height of the financial crisis in 2008 more than 20 countries would have been in this bracket.

Those markets in which prices and rents look to be balanced include the United States, Italy, Austria, Iceland and Luxembourg.

Countries such as Greece, Spain, and Portugal where prices are still falling are likely to end up on the right of the chart as the gaps between the respective indicators narrow.

Germany and Japan, having missed out on the double-digit price growth observed in many developed economies in the early 2000's remain firmly in the 'undervalued' camp.

Belgium, Norway and Canada, where prices are still rising, represent those countries most at risk of a price correction, particularly if mortgage rates increase or incomes start

to slide. The price declines evident in much of Europe, the UK and the US post 2008 largely passed these countries by.

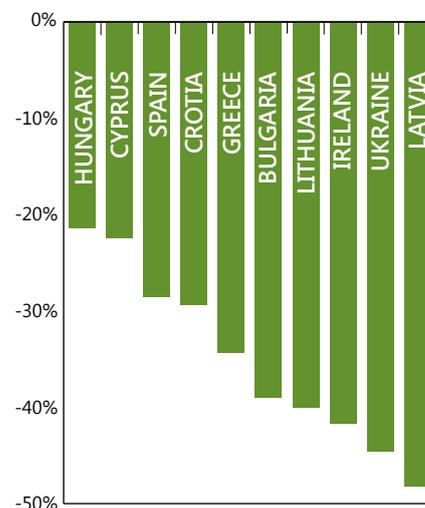
Mainstream prices in France and the Netherlands, while positioned in the 'over-valued' camp, are seeing the rate of decline slow suggesting they are further ahead in the property cycle than those to the left (figure 1).

While comparisons such as those in figure 1 offer valuable insight, it's important to note that they are based on national average income levels and national house prices which mask different city level dynamics.

In cities or local markets with a large amount of global and second home purchasers the ratio outcomes would be significantly different due to higher incomes and rents.

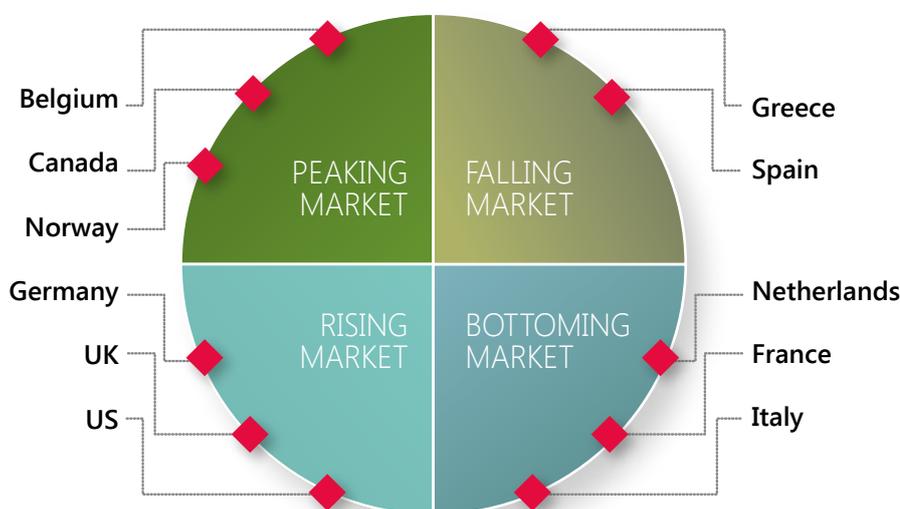
Mainstream housing markets do not function along the same lines as prime second home markets. Instead, these smaller, less mortgage-dependent luxury markets are driven by the flow of capital and the lifestyle choices of the world's wealthy, nonetheless they are also motivated by price. On the following pages we look at which second home destinations in Europe and the Caribbean have seen significant price discounts since 2008 and highlight which direction prime prices are currently headed.

FIGURE 3
Mainstream markets: largest fallers
Price change since Lehman's collapse



Source: Knight Frank Residential Research

FIGURE 2
Mainstream property market cycles
As at Q4 2013



Source: Knight Frank Residential Research

PRIME SECOND HOMES BUYING OPPORTUNITIES IN EUROPE AND THE CARIBBEAN

Knight Frank's International Team provide us with their views on prime second home markets that now represent 'value' opportunities compared to the pre-Lehman era.

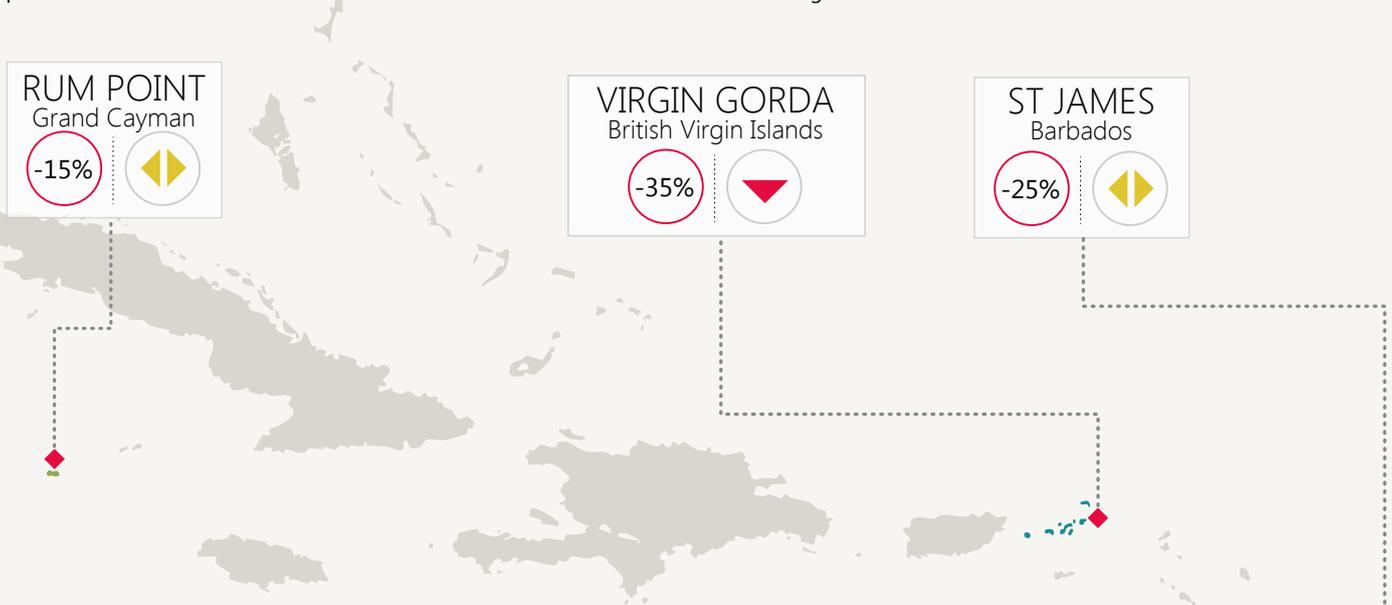
The infographic below illustrates the extent to which prices have fallen since Lehman's collapse in the third quarter of 2008. It also shows the direction of prime prices currently in 2014.

Some second home markets have been selected due to the scale of the price discounts now available. As the

arrows indicate, we are starting to see prices stabilise in a number of these markets.

Other locations, such as Montreux in Switzerland, have been selected not because of the reduction in prime prices but due to limited stock. Supply is also tight in Champel and the Gold Coast. Both markets suffer from a severe shortage

of stock which is now slowly easing, albeit marginally so, allowing some buyers an entry point into the market for the first time in several years. Lex Weber, the Swiss law which caps the number of second homes to 20% per commune, also means that competition amongst buyers will remain tight – whether purchasing as a Swiss or foreign resident.



EXPERT INSIGHT:

UMBRIA: "Prices have fallen further in Umbria than in neighbouring Tuscany although Umbria made gains on Tuscany before the recession."

Rupert Fawcett, Head of Italian sales

BARBADOS: "Prices and activity have fallen over the last six years but now buyers have seen the opportunity and in the past six months sales have risen."

Christian De Meillac, Head of Spain, Portugal and Caribbean sales

CAP D'ANTIBES: "The Cap has seen only a small number of

prime sales in the last few years. Recent transactions point to a fall of almost 30% in some cases, creating strong buying opportunities."

Mark Harvey, Head of French, Monaco and The Alps sales

CHAMONIX: Chamonix has seen good price growth over the last few years at the prime levels, balancing initial falls immediately post 2007/8."

Matthew Hodder-Williams, Head of Alps and SW France sales

SOUTH WEST FRANCE: "Falling prices, coupled with a growth of available stock on the market has meant that now is an excellent time to be looking in the south west of France."

Matthew Hodder-Williams, Head of Alps and SW France sales

SWITZERLAND: "The sheer lack of available stock coming into the market in the Swiss Riviera will naturally have a great effect on pricing in the coming years."

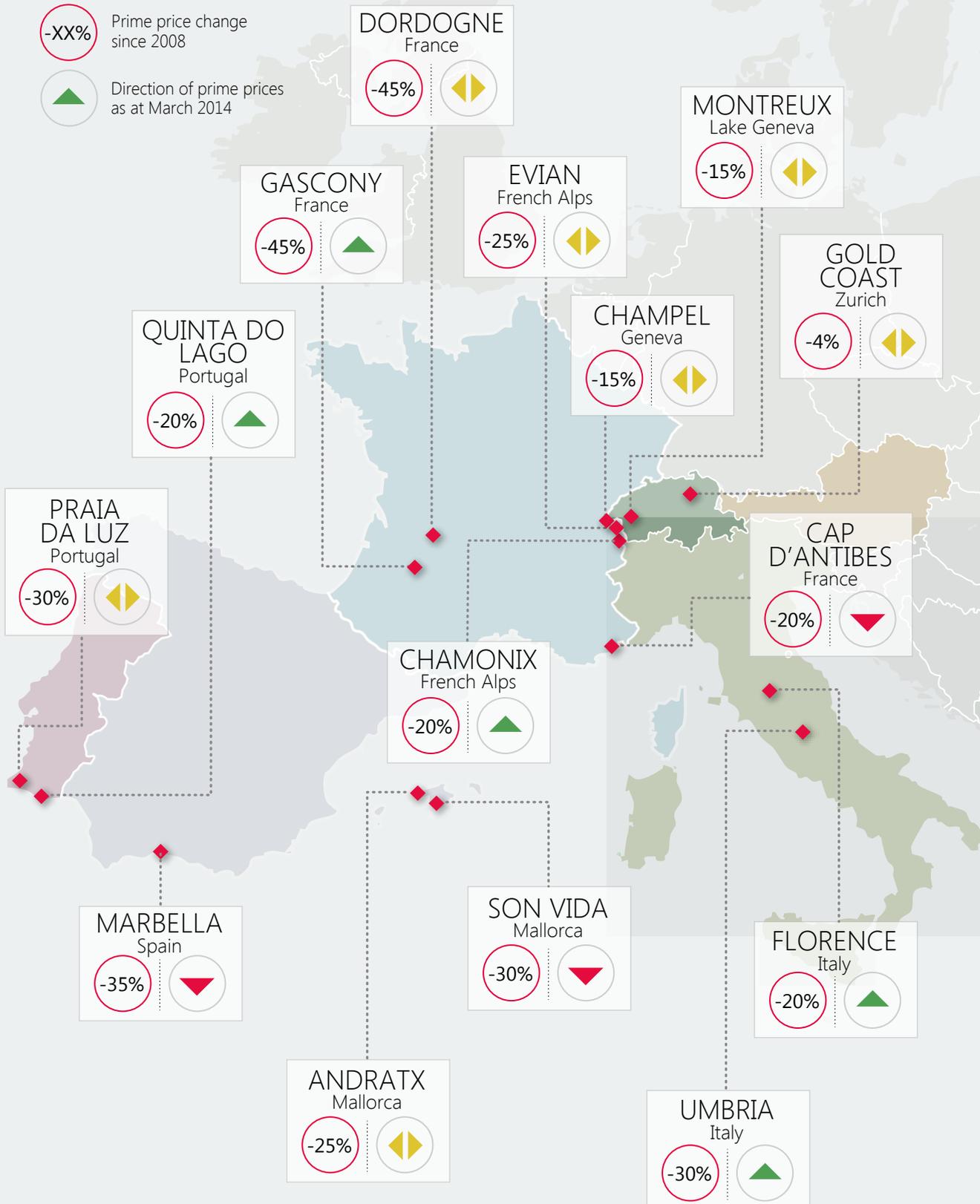
Alex Koch de Gooreynd, Switzerland and Austria sales

SIX YEARS ON...

What impact has the global financial crisis had on prime prices across some of Europe and the Caribbean's key second home destinations...

KEY

- Prime price change since 2008
- Direction of prime prices as at March 2014



Nationalities searching for properties in Europe's second-home hotspots*:

163
in 2009

212
in 2013

Source: Knight Frank Global Property Search
*France, Spain, Portugal, Italy & Switzerland

SECOND HOMES: ASSESSING RISK

Is now the time to buy? Below we outline some of the key considerations that prime second home buyers are weighing up.

Knight Frank's international property enquires have strengthened in the last two years. Prospective buyers are now researching their target markets in detail, weighing up the pros and cons of acquiring a second home. Below we outline some of the key considerations uppermost in the minds of prime buyers.

1. Global economy

Despite gaining momentum the global economic recovery is not yet secure. European government debt still totals €8.8trn (US debt stands at \$17.5trn/€12.7trn) and for some analysts, the Eurozone crisis still has some way to run. The US recovery, although it has gained traction, is still in its nascent stages and growth in the world's other economic powerhouse, China, is slowing.

Perhaps the biggest concern is the withdrawal of stimulus measures put in place to bolster housing markets and economies during the financial crisis. The speed with which the unwinding of quantitative easing is going to take place in the US will determine if and when interest rates start to rise and hence the future cost of finance. At present, policymakers are adopting a steady approach to ensure economic and income growth can support prices but all eyes are on the US Federal Reserve.

2. Finance

Interest rates are at historical lows (0.25% in the Eurozone and the US, 0.5% in the UK). The tight lending conditions in place since 2008 are beginning to be relaxed. The tapering of QE is one factor which may lead to rising finance costs. However, with the European Central Bank facing a strong euro, low inflation and falling liquidity in the

banking sector, there is still the chance of another small cut in the Eurozone's base rate.

3. Excess supply

Following six years of low sale volumes the number of second homes on the market in some locations remains high. For buyers this may be a positive development, providing a wider choice of properties and some room for negotiation on price. However, if it is planned as a short-term investment, focussing on quality and location will expedite a future sale.

Some excess supply may be absorbed by the new Golden Visa initiatives which offer residency to non-EU buyers in return for a capital investment or property purchase. Spain, Portugal, Greece and Cyprus have adopted such schemes but as yet there are few official statistics to confirm the extent to which Chinese and Russian buyers for example are signing up, see Knight Frank's [Wealth Report](#) for more details.

4. Purchase costs

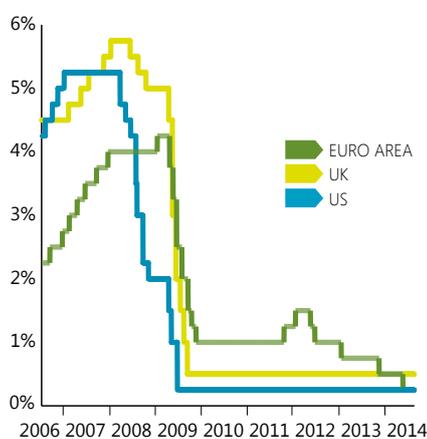
The cost of buying a home abroad varies significantly from country to country. A foreign buyer purchasing a home in Hong Kong for example would currently pay c.25% of the agreed property price in tax, legal and transfer fees. Purchase costs are significantly lower in Europe and the Caribbean at c.2%-5%. For a detailed breakdown see Knight Frank's [buyer guides](#).

5. Tax and austerity

The global recession put wealth firmly under the spotlight of policymakers and governments worldwide. The Eurozone's debt crisis further reinforced the need to cut spending and raise taxes.

Reaction came in many forms; from higher stamp duties (UK) to raising local property taxes (Italy) as well as social taxes and

FIGURE 4
Historically low interest rates



Source: Macrobond, BoE, Federal Reserve, ECB

the reintroduction of a wealth tax (France) but much of the rhetoric has now died down. In France for example, President Hollande’s tax changes have not proved as draconian as originally feared (see the [2014 France Insight](#)).

6. Future demand

The patterns of global wealth distribution are changing. There are currently 167,000 ultra-high net worth individuals (UHNWIs) globally, each with net assets of \$30m or more. There were nearly 5,000 new UHNWIs in 2013 alone.

The world’s emerging markets, despite a slight wobble in 2013, are set to be the real engines of growth in the coming decade (figure 5). The BRIC nations (Brazil, Russia, India and China) and the MINTs (Mexico, Indonesia, Nigeria and Turkey) will together produce an additional 12,175 new UHNWIs over the next ten years.

With restrictions on property purchases in much of Asia now in place, this new wealth is likely to look further afield – to the world’s top cities but also to the world’s most

established second home markets too, thereby strengthening demand.

For UK pensioners, the announcement in March’s Budget that they no longer need to buy a pension annuity may also influence future demand in second home destinations. British buyers’ affinity with bricks and mortar as an investment asset may lead some retirees to redirect their funds towards a retirement or investment property overseas. Estimates suggest the government’s initiative equates to an investment pot of as much as £120bn.

7. Currency play

The euro has outperformed the pound during most of the financial crisis, limiting any currency advantage for British buyers in Europe. However, this has not been the case for all currencies.

In Figure 6 we have assumed that prime prices across Europe’s second home markets declined on average by 30% since 2008. Due to currency fluctuations, buyers from Singapore and China have benefited from a further 10% reduction due to the strength

of the Renminbi and Singapore dollar against the euro.

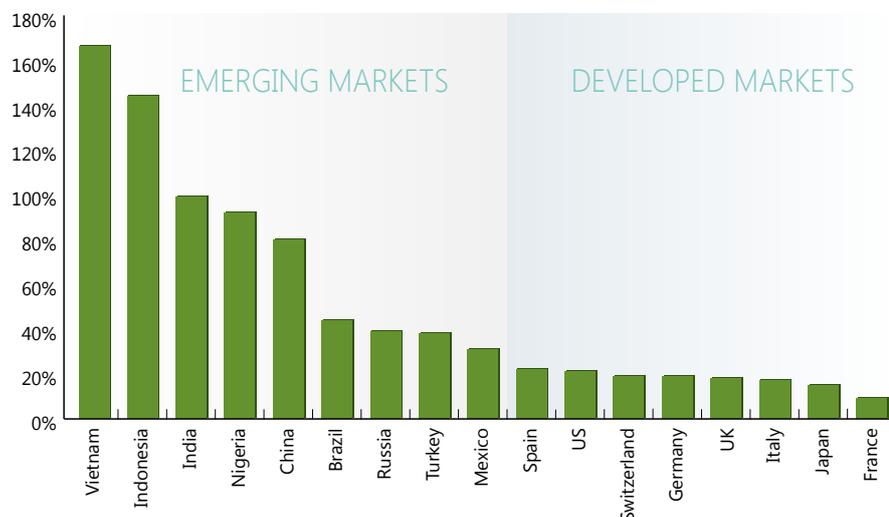
Despite the strength of the euro against the pound, some British buyers purchasing in France, Spain and Italy are mitigating this by keeping their pounds in cash and instead financing their acquisitions with euro debt using mortgages with no early redemption penalty. This allows them the option of clearing the outstanding mortgage once the pound has strengthened.

In the Caribbean, the US dollar is the main currency and US buyers comprise a large proportion of demand which largely negates the impact of any currency play. However, for British and Euro-denominated buyers they have experienced some small gains.

Lifestyle still paramount

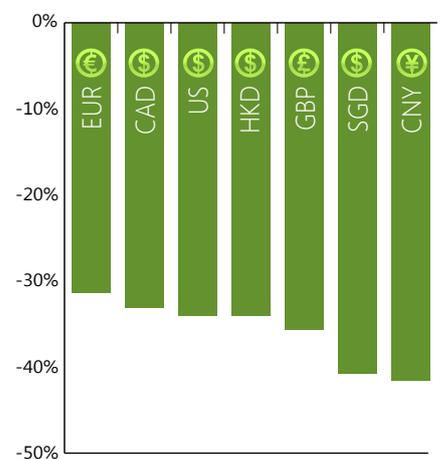
Although the political, economic and financial implications of buying a second home merit close consideration the final decision is often one based on lifestyle and/or changing family circumstances. For many buyers, a second home purchase often turns out to be an investment of passion rather than a number crunching exercise.

FIGURE 5
Worlds collide: new v old Forecast % change in UHNWIs by country, 2013-2023



Source: Wealthinsight * Individuals with net assets of \$30m+

FIGURE 6
Currency play
Effective discount of purchasing a property in the Eurozone according to buyer’s currency, 2008-2013



Source: Knight Frank Residential Research



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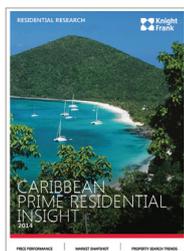
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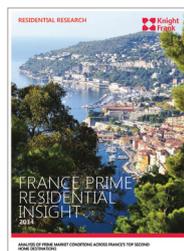
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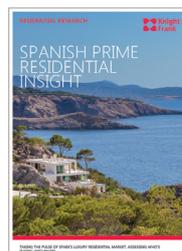
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