the wealth report 2009

Knight Frank

Citi Private Bank

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PROPERTY: TRACKING PRICES IN THE WORLD'S PRIME RESIDENTIAL LOCATIONS
ASSETS: HOW THE MARKETS FOR CLASSIC CARS, WINE AND ART ARE FARING
INTERVIEW: CITY DESIGNER ALEJANDRO GUTIERREZ SHARES HIS VISIONARY IDEAS
OPINION: MONEY ISN'T EVERYTHING, SAYS PHILOSOPHER ALAIN DE BOTTON

PHOTOGRAPH: Richard Powers (richardpowers.co.uk)

wealth ***n***

1. a large amount of money or possessions.

2. Econ. all goods and services with monetary value.

3. an abundance or great profusion: a wealth of gifts.

4. Arch. wellbeing or prosperity.

Contents

Notes and definitions: HNWI is an acronym for 'high net worth individual', a person whose investible assets, excluding their principal residence, total between $1m and $10m. An UHNWI (ultra high net worth individual) is a person whose investible assets, excluding primary residence, are valued at between $10m and $100m plus. The term 'prime property' equates to the most desirable, and normally most expensive, property in a defined location. Commonly, but not exclusively, prime property markets are areas where demand has a significant international bias. Exchange rates: unless otherwise stated these were calculated using the rate on 2 January 2009. *The Wealth Report 2009* Attitudes Survey: the participants of the survey comprised 60 Citi Private Bank wealth managers around the world, representing around 2,000 HNWIs. Survey conducted between 1 December 2008 and 31 January 2009. Written and edited by Andrew Shirley and Liam Bailey, Knight Frank LLP. **For research and press enquiries:** Liam Bailey, Knight Frank LLP, 55 Baker Street, London W1U 8AN; +44 (0)20 7629 8171

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Edward Lucas

Lucas has been covering Russia and Eastern Europe since 1986 for the likes of *The Independent*, BBC and most recently, *The Economist*, for which he was the Moscow Bureau Chief from 1998 to 2002 and is now Central and Eastern Europe Correspondent. His book, *The New Cold War: How the Kremlin Menaces both Russia and the West*, was published in February last year.

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Katherine Vaughan

After reading English at Brasenose College, Oxford, Vaughan spent 10 years working at *The Spectator*, where she was Strategic Director, and later at international art magazine, *Apollo*, as Associate Publisher. She is now a freelance writer specialising in luxury brands.

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Alain de Botton

Born in Zurich, Switzerland in 1969, de Botton now lives in London. A writer of essayistic books that have been described as giving a philosophy of everyday life, de Botton also helps to run the School of Life in London, which is dedicated to a new vision of education. His next book, *The Pleasures and Sorrows of Work*, will be published later this year.

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Welcome to the 2009 edition of *The Wealth Report*, the third such collaboration between Knight Frank and Citi Private Bank.

Over the past 12 months the economic outlook has become even more uncertain. Most of the developed world is now in recession, and even the emerging economies have been forced to pause for breath. Every commentator accepts 2009 will be tough. Our Attitudes Survey (page 12) indicates clearly that HNWIs will look to protect their wealth from the ravages of the downturn with an emphasis firmly on security and transparency rather than risk.

The tangible nature of property means it is well placed to benefit from this shift in emphasis, and there are signs that some mature prime property markets, such as London and New York, have readjusted to price levels that offer good value for purchasers. For some emerging markets, the rollercoaster ride looks set to continue. A full analysis of prime global markets is included on page 26, and we recommend 10 locations and sectors that offer potential for growth on page 23.

As property is just one aspect of wealth, we have expanded the scope of *The Wealth Report* by including an investigation into the performance of alternative assets, from art and cars to wine (page 36), and an assessment of the state of the philanthropy sector (page 16). Influential thinkers, such as Alain de Botton (page 20), also share their views on how the world will adjust to life post credit crunch.

We hope you enjoy reading the report.

Patrick Ramsay
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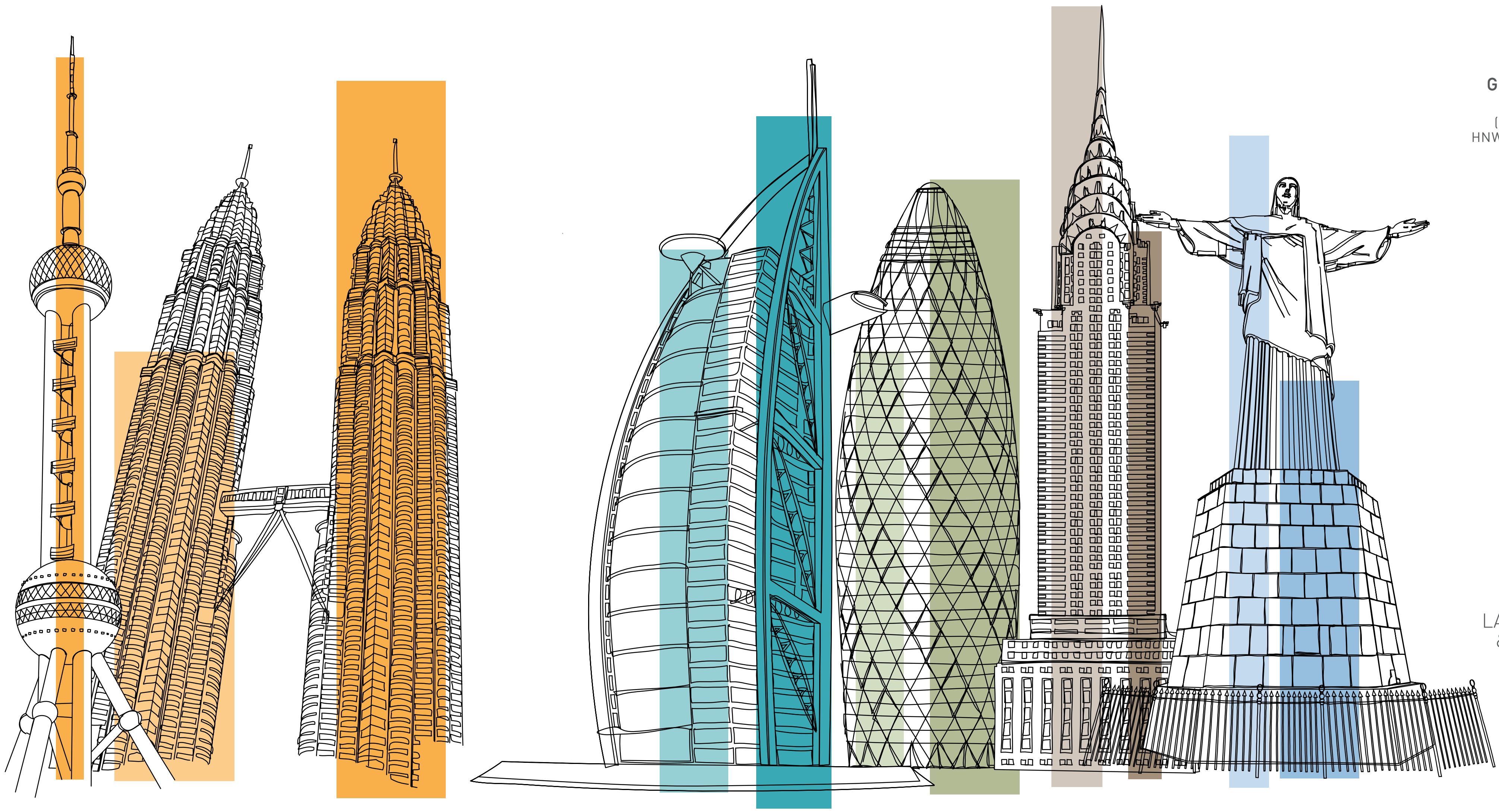
STATUS REPORT

CRUNCH TIME

What impact has the global economic downturn had on the fortunes of the world's super rich? **Sebastian Dovey**, of Scorpio Partnership, sets out his view

ILLUSTRATION BY NICK REDDYHOFF



GLOBAL WEALTH DISTRIBUTION

(% of total number of HNWIs by region, 2008*)

25% ASIA PACIFIC

3% MIDDLE EAST & AFRICA

28% EUROPE

37% NORTH AMERICA

7% LATIN AMERICA & CARIBBEAN

*Source: Scorpio Partnership

Wealthy investors across the world have been as shocked by the severity of the current financial crisis as the average investor. To a degree, many super wealthy have fared slightly better, as their professional advisers will have been able to forecast the storm and they would have moved into a more defensive asset allocation as much as 12 months ago. However, the big question on everyone's mind is how long the current economic conditions will last – and here even the super wealthy do not have the answer.

Inevitably, the next question is: when will be the right time to get back into the market in terms of investing? At the end of 2008, I was with a family in Singapore who felt that the risk of being slightly early to the market was going to be worth taking in the first quarter of 2009. They also freely acknowledged that they were basing this assessment on a hunch rather than any mathematical certainties.

Global wealth distribution remained broadly static last year following a period of strong growth in emerging markets. As the credit crunch and recession unfold, the distribution will remain the same globally, although in absolute terms the number of HNWIs will inevitably fall, as most individuals have experienced, on average, a fall in total wealth of between 20% and 40%.

Investors will have to begin to accept risk again if they wish to recover some of their wealth, but the crucial matter remains identifying the right time to get back into the market and, more specifically, identifying the right asset classes in which to participate. Here, we expect many of the super rich to lead the way, as they are often at the frontier of wealth creation.

Predicting where wealth creation will recover first is almost impossible, as the rules of making money are undergoing complete revision due to the turmoil. My best guess is that the mature economies that are supported heavily by government intervention and a strong currency will recover more quickly. In particular, we would look to European countries. But there are also certain emerging markets, such as South Africa, which have not been as substantively affected and may show green shoots of recovery earlier.

In terms of wealth management, the world's super rich, particularly in Europe, are beginning to seek investment opportunities, and while they acknowledge they might not be getting it exactly right in terms of market timing, they know an opportunity when they see one. One investor suggested to me in Geneva recently that "the best thing to do when you fall off your 'investment bike' is to get right back on it". Private equity and real estate are asset classes of particular interest.

But the credit crunch has fundamentally changed wealth management. This is a critical issue. We are now in a new era of wealth re-creation, and the role of the financial institutions is under intense review. Investors now look at financial institutions in a totally different light. There is a loss of confidence that the institutions are as mighty as they claim.

> *"Both buyers and sellers have to re-engage with the concept of responsible and realistic investing"*

Indeed, in my view, we have shifted into a new world order for wealth management where clients will actively seek out independent advice and recognise this as a value solution. Strange though this may sound, I think this is going to be a good thing in the long run. Both buyers and sellers have to re-engage with the concept of responsible and realistic investing.

At the moment, we are hearing of a greater appeal among clients toward direct investment. The asset classes could be private equity, real estate and even venture capital. Critically, the clients want to know what it is that they are buying, the provenance of the opportunity and also have a greater influence in the outcome. During the last 12 months they have learnt that they do not like the sense of helplessness that comes with being swept along in the market crises. This is being demonstrated in the property market. Despite the slowdown in property investment interest en masse, there are some specialist super rich investors who are now beginning to deploy capital in new property ventures.

We can expect some big changes in the year ahead: clients will want to take much greater control of their wealth matters. This is perfectly reasonable. In many ways, I am very excited about this market condition. For over a decade I have been calling for change in the industry, with greater respect toward the process of offering advice and building a client-centric focus.

Behind this call is a driving passion to see the customer – of whatever level of fortune – being better served in financial services. While I did not realise it would require a cataclysm to bring about the change and for the industry to hear my calls, it is here now, so let us just get on with it. It is time for change. And it is time for a new agenda.

Sebastian Dovey is Managing Partner and Head of Consulting at Scorpio Partnership. www.scorpiopartnership.com

Q & A

CRISIS TALKS

In January, Knight Frank hosted a panel of leading experts from the worlds of investment, property and wealth management in order to discuss the critical issues affecting the global economy. Here are the highlights

PORTRAITS BY ANNABEL MOELLER

THE PANEL

Philip Watson

Head of Investment Analysis and Advice Group, Citi Private Bank EMEA

Roger Orf

President and CEO of Citi Property Investors

Nick Burnell

Head of Rutley Capital Partners, the real estate private equity and investment management business of the Knight Frank Group

Dan Thomas

Property Correspondent for the *Financial Times*, with a beat that includes both UK and global markets

Graham Harvey

Senior Associate at Scorpio Partnership, a business strategy firm dedicated to the global wealth industry

How bad is the current recession compared with others you have experienced?

NICK BURNELL The most striking characteristic is its breadth, both internationally and across different sectors of the economy. Most economic downturns in the recent past have been more concentrated geographically and on particular industries. The widespread nature of the current one results from its root cause in the credit markets, which have turned off the tap after a sustained period of excessive liquidity. The effect of this has been a radical correction in the pricing of almost every asset class, as the disconnect between inflated pricing and fundamentals has been cruelly exposed.

ROGER ORF This is the worst recession in my working lifetime. It connotes profound change for the Anglo-Saxon business model. The model is based on leverage and consumption, and the model is broken. It will take three to five years to recover from this downturn.

Should banks and other financial institutions brace themselves for increased regulation in light of the failings exposed by the credit crunch, and would that help prevent a similar scenario in the future?

PHILIP WATSON Without doubt we will see change – the big question is what type. There is no question that momentum towards the establishment of tighter regulation is underway. Disparate regulation in the past, such as the imposition of leverage ratios, the risk weighting of assets and – even more fundamentally – the meaning of capital, has led to some confusion. This has led to differing scenarios emerging across geographies. Remedies, therefore, also differ. A transparent, globally coordinated and harmonised approach with adequate resourcing would better support today's global markets. Bank nationalisations, whether partial or complete, may serve to speed the process, too, though it is conceivable that immediate concerns, such as easing credit conditions, may in the short term lead to looser bank capital constraints.

GRAHAM HARVEY There will be regulatory change, as public and shareholder pressure on financial institutions, especially those partly or wholly owned by governments, intensifies. However, the ability of regulation to prevent another bear market is questionable. Indeed, intervention of states in markets has not led to a substantial resumption of lending so far, although it can be argued it prevented the collapse of the system entirely.

When will property prices stop falling and when will they start to pick up again?

RO I think prices will continue to fall for investment property in secondary and tertiary locations throughout 2009, but I think core property will reach the bottom this year. People will start buying this type of property because a current yield of 7% is much better than earning less than 1% in your bank account.

DAN THOMAS The UK housing market is likely to continue to come under pressure throughout 2009 but will hopefully stabilise in 2010 and start to see a relatively sound recovery in the years after. Never bet against further shocks to the system: the banking bailout has had no discernible effect on the supply of mortgages or lending criteria, and that showed no sign of changing in the first quarter of this year. Buying into an economic recession seems ill-advised, and all the indicators suggest this year will be tough, with climbing unemployment, economic contraction and issues around inflation.

People are worried that the recession could usher in a new era of global protectionism. Do you think that will happen, and what would be the consequences?

NB There is certainly a risk of this type of knee-jerk reaction. I happen to think, however, that the credit crisis will only be solved by concerted international action that will eventually occur on a properly coordinated basis. This approach will be fundamentally incompatible with the adoption by individual countries of strongly protectionist policies. Conversely, therefore, were a mood of strong protectionism to take root, then I think this would hamper efforts to restore the flow of international credit and greatly prolong the recession. I think we will see a little protectionism going on for domestic political reasons, but not at a level that will be critically dangerous.

"This is the worst recession in my working lifetime. It connotes profound change for the Anglo-Saxon business model"

GH It is likely that there will be protectionist movements in particular industries, especially those that take state funding, as shareholders with alternative agendas to the norm join the corporate arena. But trade will continue between states and companies with regional or global supply chains.

One minute we are worrying about inflation, then deflation, then inflation again. What is happening, and which should we fear the most?

PW Deflation is today's principal concern. Sharply deteriorating global growth, prompted by a large synchronous collapse in global trade, is reigniting financial distress. Declining wealth, high levels of uncertainty and financial disruptions have led to sharp declines in demand around the world.

Lower commodity prices and rapidly growing output gaps have led to rapidly declining levels of inflation in most countries. It is likely that attention will eventually turn towards central banks and authorities to ensure reflationary policy is controlled and does not spiral rapidly into heavily inflationary policy.

How would you rate government attempts to unlock the credit crunch, and will they work?

NB I would not rate them highly. The truth is the taxpayer does not have sufficient financial resources to rebuild the balance sheets of the major banks, and this has to be accepted by government and fresh policy developed accordingly. An examination of most banks' balance sheets reveals a large liability component in the shape of bonds. They should be obliged to convert these to equity in a manner akin to the recapitalisations by creditors seen in most other industries. The government should participate alongside to a restricted extent, perhaps only at a level necessary to protect depositors.

PW This is a difficult question to assess. There was no dress rehearsal for the crunch. Furthermore, governments responded in different ways and over differing lengths of time. In my opinion, the key issue here is how governments interact with their global counterparts to manage this international economic reality, while also managing their electorates' local fears and concerns.

EXPERT OPINION

WILL THE BEAR BUCKLE?

Russia has seen huge levels of wealth creation in recent years. Edward Lucas, a leading commentator on the country, evaluates what the global recession will now mean for its economy and super rich

ILLUSTRATION BY LUKE WILSON

Russia's economic performance over the past eight years has been astounding. Between Vladimir Putin becoming prime minister in 1999 and stepping down as president last year, GDP rose more than six times in nominal terms. Poverty halved – only a sixth of Russians live below the breadline, compared with one-third when he took office. Once a basket case, Russia became one of the largest economies in the world, paying off its debts and building up a $600 billion foreign currency reserve.

Yet look a bit more closely and the results are less impressive. Russia failed to diversify its economy. The number of small and medium-sized enterprises shrank. Reform in public service faltered. Plans for new roads, schools, hospitals and power stations were much-publicised but rarely completed. Corruption rocketed. As Boris Nemtsov and Vladimir Milov have pointed out in their seminal pamphlet, *Putin: The Bottom Line*, the results of the past eight years are actually rather feeble. The same point is made, from a different quarter, by Igor Yurgens, who runs a think tank close to the Russian president, Dmitri Medvedev.

So when the financial crisis hit Russia, the country was more fragile than it should have been, given the recent bonanza. The stock market has plunged by nearly three-quarters. The rouble – once a symbol of Russia's recovery from the 1998 economic crisis – has been steadily devaluing. Investors who hold Russian commercial debt are twitchy. Inflation is high and unemployment is rising. The rickety financial system has not collapsed, but it is in poor health. For many who have done well out of the past eight years, these are worrying times.

A sensible, wealthy Russian would typically diversify his assets and income streams: some would be inside Russia – perhaps in the company or job where he first made his fortune. Then there might be some property in London, plus a mix of blue-chip equities and government securities, with a few holdings in hedge funds and more exotic investments, perhaps with leveraged bets at brokers in Moscow or London.

For the truly unlucky, all those have gone sour at once. The brokers are demanding margin calls. Equities have plunged. Safe government debt yields almost nothing. Risky commercial debt is worth next to nothing. Worst of all, our sensible, wealthy Russian may be facing demands from friends and associates to repatriate some money to repay favours and help them out. For those scrambling for cash, one option might be to sell a prized property in London or New York. But the weakening residential property market means that these flats and houses, bought at the top of the market, may be worth considerably less.

The most likely solution is an uncomfortable one: thrift and patience. The bad thing about being rich is that you have expensive habits. The good thing is that you can always cut back on them in a downturn.

The bigger questions are about what the future holds. Firstly, will the current traumas and economic pain in Russia herald a future in which wealth is held more widely and more durably? Economic downturns have one good feature: they highlight the faults of badly managed businesses. That can give the well-managed competitor a chance to move in. For now, the story in Russia is of the politically motivated bailout. But over the economy as a whole, the downturn will see more bad businesses go bust than good ones – and that is an opportunity for the entrepreneurial class.

Secondly, will the business class in Russia develop a political voice? One of the startling features of opinion poll surveys over the past eight years has been the clash between Russians' appreciation of higher living standards and political stability, and their generally gloomy feelings about the nitty-gritty performance of the government. Is corruption getting better or worse? Worse, say the polls – and president Dmitri Medvedev agrees. Are elected representatives following their own interests or those of their voters? Their own. Are public services getting better or worse? Worse. And so on.

For anyone doing business in Russia, the costs of the overloaded infrastructure and predatory officialdom are burdensome and infuriating. Yet, so far the business world has preferred to keep its head down and enjoy the profits rather than complain about the costs. With the downturn, there is just a chance that this will change. The complaints of business – about tax rules, about bad roads and about silly regulations – are the foundation of political pluralism.

Thirdly, if the business people of Russia do demand a better deal, will the Kremlin actually pay attention to them? For now the arguments seem finely balanced, with people around Medvedev, such as the economist Igor Yurgens, saying that the time has come for more political and economic openness, and some people around Putin saying the opposite. On the outcome of that hangs the future of Russia's new middle class – and much else besides.

Edward Lucas is the Central and Eastern Europe Correspondent for *The Economist*.

Russia in figures...

$386bn
The nation's foreign currency reserves on 4 February, down by more than a third from their peak of $600bn in August 2008.

40%
The drop in value of the rouble in the six months to 4 February. The currency hit a historic low against the dollar at a few kopeks short of 41 roubles.

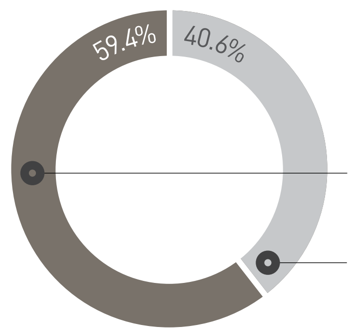
8.7%
The fall in industrial output in November 2008, compared with the previous year, according to figures published in December.

$42.8
The average price for Urals crude oil on global markets in January this year. The budget forecast an oil price of $70.

13.8%
The rate of inflation last November. One of the biggest macro-economic problems over the previous two years, inflation remains stubbornly high.

THE PUBLIC ATTITUDE TO BANKS DURING THE CRUNCH

A survey by the All-Russian Public Opinion Research Centre (VTsIOM), 'People and Banks Amid the Fianancial Crisis: What Should Depositors Do?', conducted in October 2008*



THE SAFEST WAY TO SAVE MONEY
(% of the total number of respondents)

PROPERTY	51%
GOLD AND JEWELLERY	19%
SBERBANK (RUSSIA'S LARGEST BANK)	17%
ROUBLES IN CASH	13%
SHARES OF COMPANIES	8%
FOREIGN CASH CURRENCY	7%

*The VTsIOM conducted the proactive nationwide survey among 1,600 respondents in 140 settlements in 42 regions, territories and republics of Russia in October 2008. The margin of error is within 3.4%.

PHOTOGRAPHY: Richard Powers

RESEARCH

CHANGING FORTUNES

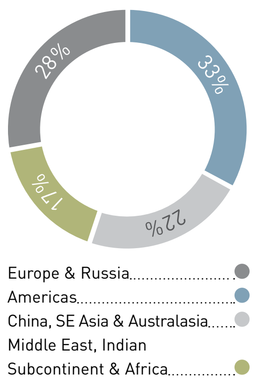
The results from *The Wealth Report*'s HNWI Attitudes Survey provide a unique window on how the credit crunch is affecting the behaviour and attitudes of the wealthy towards their property and investment portfolios. Knight Frank's **Andrew Shirley** analyses the numbers

It's tempting to assume that wealth insulates HNWIs from the day-to-day worries associated with economic downturns. Surely, when you are worth millions or even billions, it doesn't matter if stock markets fall a bit or your house is worth less than you paid for it. However, according to the results from *The Wealth Report*'s Attitudes Survey, which was completed by a global spread of Citi Private Bank's wealth managers acting for almost 2,000 of the world's richest people, that is not the case. The wealthy have the same preoccupations and concerns as everybody else. If anything, they keep an even closer eye on their investments and react more quickly when markets start to change.

ASSET DISTRIBUTION

There has already been a substantial shift in asset distribution among the rich, who appear to have taken decisive action to mitigate risk and protect their wealth (see bar chart on page 14). Although the creation of fortunes is often associated with risk and daring decisions, safety first seems to be the mantra in times of economic turbulence, with both transparency and stability highly valued. Based on this survey, almost 90% of HNWIs have either decreased or substantially decreased their exposure to equities, while virtually all have moved away from hedge funds. A small proportion, 7%, feels confident enough to have increased their exposure to equities.

SURVEY DISTRIBUTION



Bank accounts have been the biggest beneficiary from the flight away from stock market volatility – almost 60% of those represented by our survey have substantially increased the amount they have on deposit. The perceived safety of the bond markets is reflected by the fact that 67.8% of respondents have increased their exposure to this kind of investment. But uncertainty about the ability of even national governments to repay increasing levels of debt could explain why 14.3% of people have decided to reduce their exposure to bonds.

PROPERTY AS AN INVESTMENT

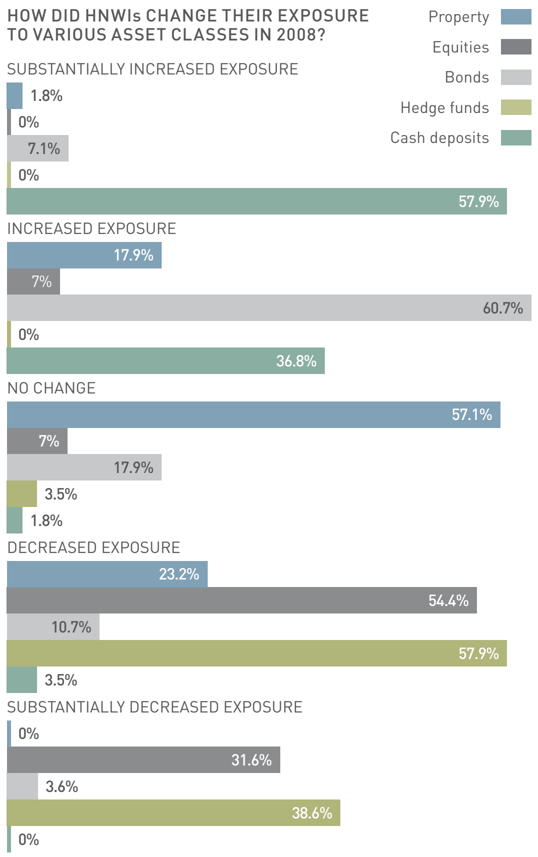
When looking at bricks and mortar as an investment class, the picture becomes less clear. The majority of HNWIs appear to be sitting on the fence at the moment, with 57.1% making no change to their property portfolios, although over 90% have seen their property portfolios decrease in value during the credit crunch, with about a third of those hit by a substantial decrease (see the graphs on page 14).

The illiquid nature of property probably goes some way towards explaining this lack of action. While an entire portfolio of stocks and shares can be sold with just a few taps on a keyboard, it is more difficult – and sometimes almost impossible – during an economic downturn to sell property quickly. Many investors also acknowledge the long-term nature of property investment: even if values fall your asset is unlikely to disappear completely. Despite this, a significant number of HNWIs have either increased or reduced their exposure, with a very small percentage increasing it substantially.

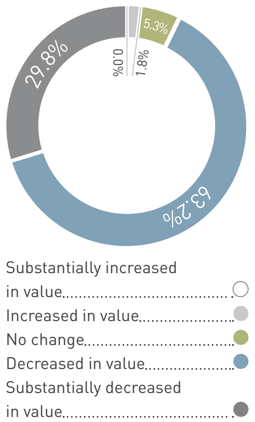
This ambivalence is probably a reflection of the diversity of the property market and the attitude of the wealthy towards it. While stock markets around the world have all been heading one way only, property markets have not reacted homogeneously. As our PIRI survey on page 26 confirms, performance has varied widely. In those areas where values dropped fastest and furthest, canny HNWI investors are sensing the bottom of the downturn is imminent and are slowly reinvesting.

Experienced investors realise we are firmly into the bargain-hunting stage of the property cycle, especially in the commercial and newbuild sectors. A number of survey respondents said their clients were actively looking to take advantage of distressed sales to cheaply acquire stable assets with good yields. Many fortunes have been property-based and a large proportion of the HNWI community has a passion for property ownership. According to our survey, property accounts on average for 30% of their asset portfolios. But even this enthusiasm has »

HOW DID HNWIs CHANGE THEIR EXPOSURE TO VARIOUS ASSET CLASSES IN 2008?



HOW HAVE HNWI PROPERTY PORTFOLIOS FARED DURING THE CREDIT CRUNCH? (Q4 2007 to Q4 2008)



been dented by recent events. Although the attitude of almost 60% has either remained unchanged or become more positive towards property as an investment since the credit crunch, that still leaves a significant number who now have a more negative outlook. It may be that these are relatively new or over-geared investors who have only invested in rising property markets and whose confidence has been knocked by the realisation that not even bull runs with seemingly boundless energy can carry going on for ever.

FUTURE EXPOSURE TO PROPERTY CLASSES

Looking to the future (see bar chart, opposite page), our survey reveals that property is set to play a major role in HNWIs' investment strategies, but the tough lessons learnt during the credit crunch mean the focus will remain firmly on tangible and transparent assets. Residential property is easily understood by everybody. We all know what we expect a house or apartment to provide – warmth, security, comfort and prestige. Expectations and emphasis will, of course, vary dramatically depending on circumstance, but the concept is uniformly shared by most societies around the world and the vast majority of its population will occupy a dwelling in one form or another. This common ground and empathy help explain why over half our survey sample is likely to increase its exposure to residential property over the next one or two years.

Within this timescale, most commentators are also predicting that prices will start to stabilise, bringing some certainty to the market. By nature, many investors fear buying an asset that has further to depreciate in value, but by waiting for the bottom of the market they also risk missing out on the best opportunities. These will already have been snapped up by those prepared to take more risks.

Commercial property is also set to grow in popularity, with just under half of HNWIs showing their understanding of the market by planning to increase their investments in this area. This sector has been particularly hard hit by the recession, and is arguably well placed to offer growth potential in the near future for the shrewd investor. Quality stock in the best locations with good clients has probably been devalued too much and this is reflected in some very tempting yields for those with funds to spend now. But investing in commercial property does generally require a more in-depth understanding of specific industries and markets to minimise risk. Perhaps acknowledging this, over 20% of our sample is planning to cut its exposure to the sector.

Not all property investments are man-made and agricultural land has received much attention over the past few years. Despite the press headlines, our survey suggests farmland is still viewed as a specialist long-term investment, with almost three-quarters of investors having no intention of buying or selling land in the short to medium term.

Real Estate Investment Trusts (REITs) have suffered horribly during the credit crunch. With the market for new homes stagnant, cash flows have all but dried up for developers and construction firms, sending their stock into freefall. Although nearly 20% of HNWIs feel bullish enough about a future recovery to recognise some value in this kind of investment, 27.5% are less confident and plan to scale back their exposure. (See page 25 to get the expert view on REITs.)

ATTITUDES TO WHERE WE LIVE

Judging by the results of the survey, HNWIs are not losing too much sleep about any drop in the value of where they actually live (see chart at top of page). Only 5.3% are very concerned about any fall, with 31.6% not worried at all. This is likely to be because primary and secondary residences account for a much smaller proportion of HNWIs' total wealth than the majority of the population, whose homes may well be their only real asset of value. According to last year's Attitudes Survey, primary residences made up 13% of HNWIs' wealth portfolios, with secondary residences taking a further 8%. If anything, the fall in values is perceived as an opportunity rather than a threat, with some seeing it as an opportunity to buy more cheaply. Not everybody feels immune, though, with a number admitting they might have to sell some property.

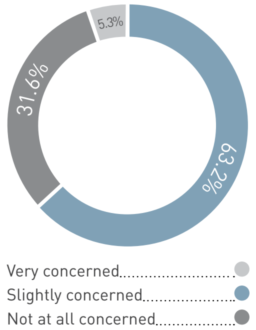
Most, though, seem content with their existing primary residences, with just over a quarter prepared to improve their existing dwelling rather than move (see chart, left). Only 7% are expected to take advantage of falling prices by upsizing. It may be that even the rich are nervous about displays of ostentation and affluence during a severe recession, or it could be that even international globetrotters value the stability and familiarity of somewhere they can expect to call home for the foreseeable future.

If we look at how the credit crunch could affect the ownership of secondary residences (see chart, left), we can see both concerns and opportunities reflected in the survey responses, but maintaining the status quo seems to be the majority position for nearly 63% of HNWIs. Just over 14% of the sample is predicted to go bargain-hunting during the downturn and add to their tally of secondary residences, while 23.2% may reduce the number of houses they have around the world. Some of these sales may be forced, but it is more likely to be a reflection of a more considered and less flamboyant approach to life in these recessionary times.

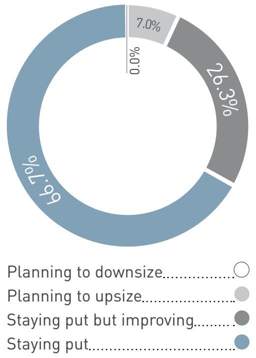
What overall conclusions can we draw from the survey responses? First and foremost it appears that HNWIs still regard property as a crucial part of their investment portfolios and have more confidence in it than other more ephemeral investments. Secondly, the majority of them are by and large happy with the houses they live in and have no plans to either retrench or expand their property collections because of the credit crunch.

The results show that when times get tough even the wealthy take the view that you should only invest in things that you understand. Property: we can see it, we can touch it, and we still all want it.

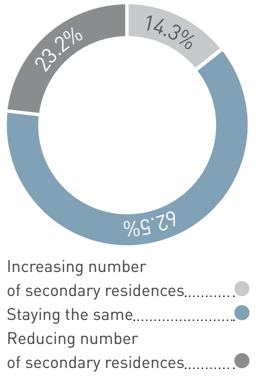
HOW CONCERNED ARE HNWIs ABOUT A DROP IN VALUE OF THEIR PRIMARY OR SECONDARY RESIDENCES?



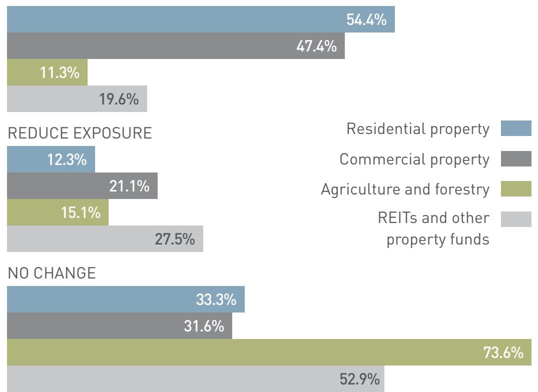
INTENTIONS FOR PRIMARY RESIDENCE AS RESULT OF CREDIT CRUNCH

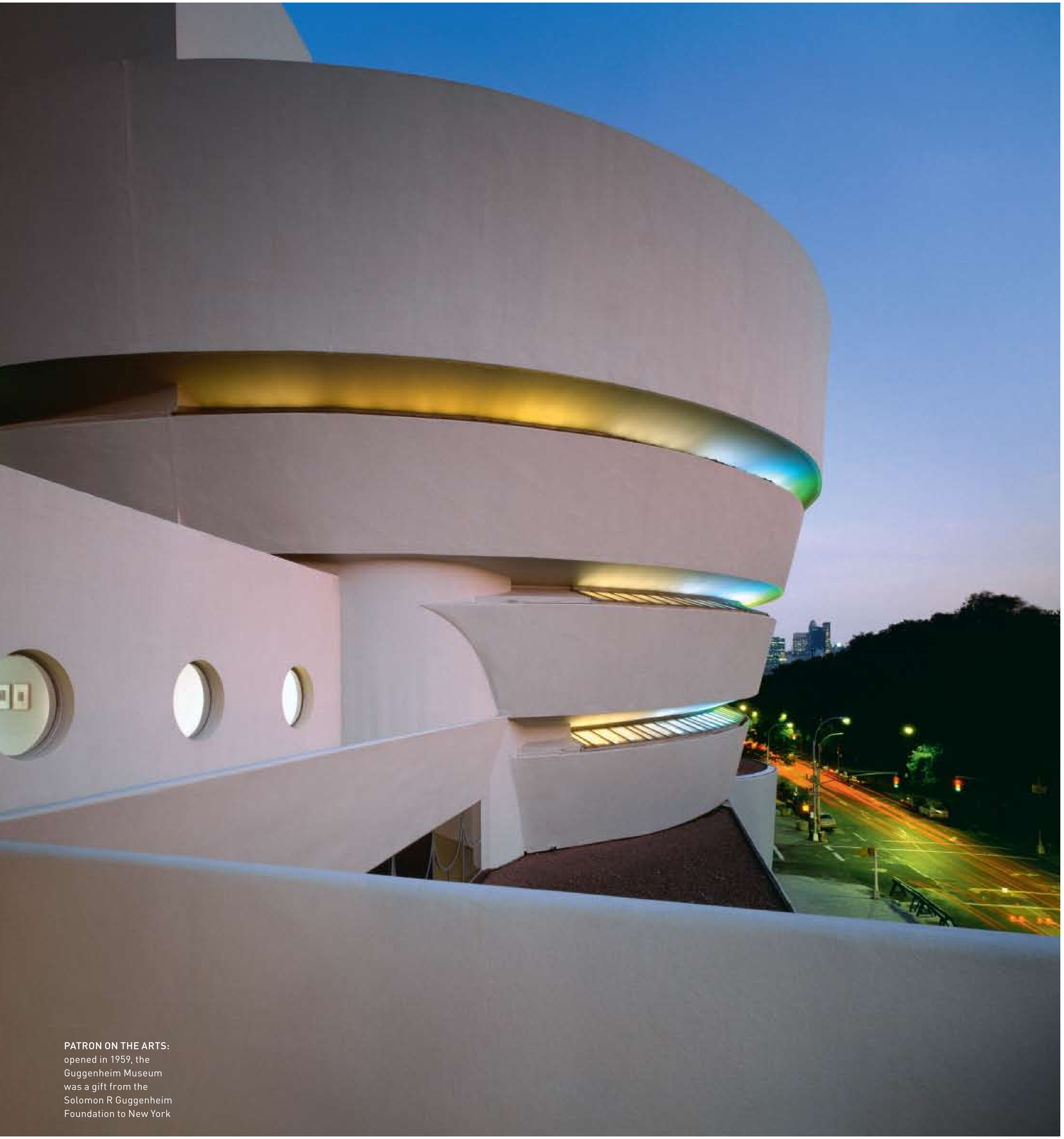


INTENTIONS FOR SECOND HOMES AS RESULT OF CREDIT CRUNCH



HOW HNWIs PLAN TO CHANGE THEIR EXPOSURE TO SPECIFIC CLASSES OF PROPERTY IN THE NEXT 1-2 YEARS





PATRON ON THE ARTS: opened in 1959, the Guggenheim Museum was a gift from the Solomon R Guggenheim Foundation to New York

PHOTOGRAPHY: David M Heald/SRGF, New York

Just giving

A sense of burden, responsibility and enduring legacy motivate many of the world's great philanthropists. Jon Neale *investigates the rise of charitable giving and the impact of the downturn*

Over the past decade, wealth has been amassed on an unprecedented scale, creating a huge number of wealthy individuals across the world and making many of the rich even richer. This process has driven the emergence of new categories of luxury goods and services aimed at this wealthy elite. But, compared to the rise in luxury spending, the growth of giving among HNWIs has received little attention.

According to *The Chronicle of Philanthropy*, a record $15.5bn-plus was donated by the 50 most generous US philanthropists in 2008 – a 112% increase on the previous year. This is backed up by the results of *The Wealth Report*'s Attitudes Survey (page 12). Of the wealth managers we questioned, 80% said charitable giving had increased over recent years, with 29% of HNWIs involved in philanthropic activities. Most (64%) opted to channel it through specialist funds or foundations.

The individuals who set up institutions that give to good causes are a diverse set of people. They are more likely than in the past to have made money themselves and, thanks to the massive growth of the financial services industries, they are younger than ever before. Almost half our survey respondents said people were beginning to consider large-scale giving at an earlier age.

Attitudes towards wealth and giving are also changing. Susan Mackenzie, Director of advisory service Philanthropy UK, says: "There is definitely a difference in the underlying demographic as we move from inherited wealth to self-creation. In 1989, three-quarters of *The Sunday Times* Rich List had inherited their wealth; now three-quarters are self-made. The UK is increasingly like the US with new wealth from entrepreneurs and the City."

As our case studies on page 18 show, the attitude of donors has changed over time as well. No longer are people happy just to give money to a cause – increasingly they want to see it being used to allow people to change their life chances for the better. Mackenzie believes the underlying reasons for giving have not changed. These, she says, are "belief in a cause, personal experience, and a desire to help schools and hospitals that have helped family members". She does notice some other changes, however. "It's often inspiring how humble people are. They want to feel like partners in the process. People are becoming far more involved, and far more creative in the ways their foundation gives."

Musa Okwonga, a director at the London-based Institute for Philanthropy, explains that givers have certain characteristics. "People are more likely to be philanthropists if they have been through higher education or are part of a church. Generally, they tend to identify with one of the main political parties, read a daily broadsheet and are over 35." ››

LOOKING UP: the skylight at The Guggenheim, which was designed by Frank Lloyd Wright

CASE STUDIES

Peter Munk

Businessman and Developer

Peter Munk is an example of how personal experiences are often the most important philanthropic drivers. Munk arrived penniless in Canada in the 1940s, after his family fled Nazi-occupied Hungary. He subsequently became one of Canada's richest men, building Barrick Gold into the world's largest gold mining operation.

Munk's charitable foundation is worth more than $150m and he says he is proudest of the contribution he has made to Toronto, the city that took in his destitute family. The Peter Munk Cardiac Centre is now the best of its kind in Canada, treating around 17,000 patients a year and, through an impressive research programme, developing innovative treatments. His interest here has a personal element too – the hospital helped his mother survive a cardiac arrest.

Munk likes to combine business with philanthropy. He is currently developing Porto Montenegro, a 650-berth marina that will be the largest home for super yachts in the Mediterranean. But behind the glitz, he is aiming to leave a legacy of investment through educational and training programmes that will help the former Yugoslav republic prosper in the future.

Gerald Ronson

Chief Executive, Heron International

Gerald Ronson is one of the UK's most successful entrepreneurs and property developers. In 1956, he founded Heron Group, now called Heron International. Its current projects include the 220m Heron Tower in Bishopsgate in the City and the Heron, a 284-apartment residential tower near the Barbican.

Ronson's public image may be that of a hard-nosed, no-nonsense businessman, but he donates 20% of his time to good causes and raises over £5m a year for charities.

"The Gerald Ronson Foundation gives a seven-figure sum to help the underprivileged in education and welfare, although I probably raise four or five times that for the other charities I help with," says Ronson, whose faith plays a big role in his philanthropic activities. "I have been involved in many causes, from the Prince's Trust and the Natural History Museum, to cancer research. I have been involved all my life and shall be even at 70, predominantly in charities helping the underprivileged. I believe if the good Lord blesses you with the ability to make money, then you have the responsibility to put it back into the community."

"People are more likely to be philanthropists if they have been through higher education or are part of a church"

At the most elite level, though, philanthropy becomes very different – and the phenomenon of the 'family office' emerges. "These are quite opaque, perhaps a bit like hedge funds in the sense that very few people, until recently, knew they existed or understood what they did," explains Okwonga. "They manage the investments and trusts – and philanthropic activities – of a single wealthy family, or sometimes a number of families. In the US, in particular, there is a whole industry devoted to advising family offices on giving."

As the results of our Attitudes Survey show, nearly 66% of wealth advisers believe the economic downturn has reversed the trend towards philanthropy among HNWIs. Large amounts of wealth have simply vanished over the past year and many HNWIs are not quite as rich as they thought they were a year or two ago.

Melanie Schnoll-Begun, Head of Citi Family Office Philanthropic Services, is convinced that the amount given in dollars will decline this year – particularly as the wealth of so many prominent US donors has been eroded by the equity markets, credit crisis and Madoff scandal. "Many prolific donors are going into wait-and-see mode," she says. "While they may be cutting back on their giving, they still want to keep their philanthropy vital and fulfilling. We're encouraging donors to give fewer but larger gifts. Doing so maximizes the effectiveness of charitable dollars. Also, we're urging them to use grant agreements. These outline how grant funds will be used, and what outcomes are expected. Finally, we're finding that some foundations are renegotiating the terms of pledges made, in terms of the amount and the term."

In one case, she adds, a foundation committed to giving out more than 5% of its corpus each year in perpetuity. In fact, it considered the 5% payout a floor not a ceiling. Until recently, it was able to make this distribution from its earning alone. Now that the return of its investments has dropped substantially, it is having to reconsider whether this is still feasible. In another case, a donor is considering dropping all payments for five years to one of its three core mission areas, or at least until the financial storms have passed.

However, Schnoll-Begun believes there's a silver lining as donors are becoming increasingly involved with their selected causes. According to our survey, the biggest area in which philanthropists need advice is not which causes to give to, but how to maximize the effect of their donations. "We will see the emergence of an alternative form of philanthropy, where donors are more involved and engaged in the programme. They will offer leadership and commitment. We are already witnessing a new wave of donors who will adopt a more hands-on approach. They are demanding more reporting and accountability than ever."

Schnoll-Begun remains convinced that donors are far more aware of issues today than in the past as a result of volunteering, social networking and the internet. There is also a lot more information on the work that non-profit organisations are doing. There is a danger, she says, that the effects of the recession could lead donors to concentrate their efforts in certain areas. An increasingly fragile Western economy could lead to philanthropists giving to domestic causes rather than global or developing world concerns.

Nevertheless, Barack Obama's presidency has brought a new wave of optimism to America and this may inspire a greater degree of philanthropy – although this may take the form of volunteerism, rather than financial resources, at least in the short term. Moreover, the new administration's attitude to areas, such as stem cell research and microfinance – including US-based microfinance – could spur new interest in these, hitherto, overlooked subjects.

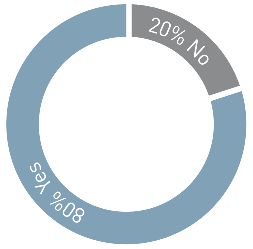
Looking further forward, Schnoll-Begun believes that philanthropy will continue to evolve and change. "There will be a new emphasis on the legacy of grandparents in wealthy families – the matriarchs and patriarchs. There is a need to educate young adults in the family's history, how the wealth was accumulated and the family's background before it had money."

While the next few years will present problems to the philanthropy industry, they will also provide new opportunities.

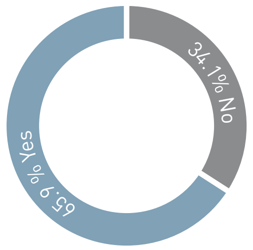
Jon Neale is Head of Development Research at Knight Frank.

ATTITUDES TO GIVING*

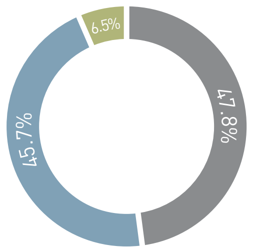
Prior to the credit crunch, had there been an increasing trend among HNWIs towards philanthropy?



If yes, do you think that the credit crunch has reversed that trend?



How do you think the age at which HNWIs start to think about philanthropic activities has changed over the last five years?



*Source: Attitudes Survey 2009

Is philanthropy always a good idea?

Liam Bailey

THE RAPID GROWTH OF PHILANTHROPY in recent years has encouraged a more critical examination of its impact. While giving is viewed as noble, there is no guarantee of its success. The $33.5bn Bill & Melinda Gates Foundation, for example, came under fire in 2006 for appearing to concentrate on technological solutions to global health problems rather than ensuring these solutions worked at local level. It has since worked hard to tackle this problem and the wider accusation of unaccountability.

There are undoubtedly problems within the sector, and the main charge is the ineffectual use of funds, including the duplication of effort and under-performance of the not-for-profit sector. Research from 2007 found that in the US there were 1.6m organisations employing nearly 9% of all workers. Many worked in the same fields, with little cooperation or sharing of resources.

An important criticism is that the sheer size of the mega foundations means they divert resources – labour, research spending and materials – towards their own areas of particular interest and take away effort from equally needy but less glamorous causes. However, this argument would seem to imply that governments and businesses have a monopoly on intelligent resource allocation – in the light of the sub-prime fallout and welfare spending failures across the developed world, this seems rather unfair.

There is little doubt that the wealthy may find it hard to dispose of their wealth effectively, but this difficulty ought not to dissuade them from the attempt. The significant potential offered by so-called 'smart philanthropy' ought to keep them focused on the potential outcomes.

Paul Brest and Hal Harvey's book, *Money Well Spent: A Strategic Guide to Smart Philanthropy*, suggests that rather than conflicting with government programmes, philanthropy is complementary. This should be the experimental sector, where more risky and longer-term solutions can be trialled before the public or business sectors implement them on a wider scale. Brest goes further by welcoming philanthropic failure. He argues that through failure lessons can be learnt and future improvements can evolve, and without the willingness to fail, the big advances that donors seek will not be achievable. It is hard to make money work effectively, but this challenge motivates the likes of Bill Gates and the countless other philanthropists. Their willingness to waste as well as to give money ought to be welcomed.

THINK TANK

Bonfire of the vanities

Recessions ask us to look past the value of our property and investment portfolios and consider some of the biggest questions of all, says influential philosopher ***Alain de Botton***

PORTRAIT BY HARRY BORDEN

The current economic crisis is forcing all of us to rethink nothing less than the meaning of life. In particular, it is prompting us to re-examine a key idea in our society: the connection between making money and being happy. Criticisms of consumer society have focused not only on the shortcomings and inadequacies of products but also, more fairly perhaps, on the distorted picture of our needs that ensues from the way these products are presented to us. They can appear essential, blessed with extraordinary powers to bestow happiness on us, because we understand neither their actual identities nor our own functioning.

A car advertisement will, for example, be careful to ignore aspects of our psychology and of the overall process of ownership that could spoil, or at least mitigate, our joy at coming to possess a featured vehicle. It will fail to mention our tendency to cease appreciating anything after owning it a short while. The quickest way to stop noticing something may be to buy it – just as the quickest way to stop appreciating a person may be to marry them. We are tempted to believe that certain achievements and possessions will guarantee us an enduring satisfaction. We are led to imagine ourselves scaling the steep sides of the cliff face of happiness to reach a wide, high plateau on which to continue our lives; we are not reminded that soon after reaching the summit we will be called down again into fresh lowlands of anxiety and desire.

Life seems a process of replacing one anxiety with another and one desire for another – which is not to say that we should never strive to overcome any anxieties or fulfil any desires, but that we should perhaps build into our strivings >>

THINKING THROUGH: the quickest way to stop appreciating something is to buy it, says de Botton

an awareness of the way our goals promise us levels of rest and resolution that they cannot, by definition, deliver. The car will quickly be absorbed and hardly be noticed – until the night a burglar does us the paradoxical service of breaking a window to steal the radio and reminds us, in the midst of the shattered glass, how much there was to be grateful for.

The advertisement stays quiet, too, about the weak capacity of all material goods to alter our levels of happiness, as compared with the overwhelming power of emotional events. The most elegant and accomplished of vehicles cannot bring us a fraction of the satisfaction of a relationship – just as it cannot be of any comfort whatever following a domestic argument or abandonment. At such moments, we may even resent a car's impassive efficiency and the methodical calculations of its onboard computer.

We are equally prone to misunderstand the attractions of certain careers, because so much of what they entail has been edited out, leaving only highlights it would be impossible not to admire. If we cannot stop envying, it is especially poignant that we should spend so much of our lives envying the wrong things.

"If we cannot stop envying, it is especially poignant that we should spend so much of our lives envying the wrong things"

The essence of the charge made against modern materialism is that it is guilty of a gigantic distortion of priorities, of elevating to the highest level of achievement a process of accumulation which should be only one of the many things determining the direction of our lives under a more truthful, more broadly defined conception of ourselves.

Incensed by the distortion of priorities, the 19th-century art critic John Ruskin excoriated Victorian Britons for being the most wealth-obsessed people in the history of the world. They were, he wrote, never far from a concern with who had what and from where.

But Ruskin made a confession. Contrary to expectations, he too was frantic to become wealthy. The thought of wealth preyed on his mind from breakfast till dinner. Yet he was only sarcastically toying with an ambiguity in the word 'wealth' to bring home more forcefully how far he felt his countrymen had strayed from virtue. For the dictionary tells us that wealth means not only, or historically even primarily, large amounts of money. It means an abundance of anything, from butterflies to books to smiles. Ruskin wished to be wealthy in kindness, curiosity, sensitivity, humility, godliness and intelligence – a set of virtues he referred to simply as 'life'.

In *Unto This Last*, first published in 1860, Ruskin entreated us to set aside our ordinary monetary conceptions of wealth and take up a life-based view, according to which the wealthiest people would no longer be merchants and landowners but those who most keenly felt wonder beneath the stars at night or were best able to interpret and alleviate the sufferings of others. "There is no wealth but life," he intoned. "Life, including all its powers of love, of joy and of admiration."

Ruskin was uttering the plain, childlike truths of the prophets – and when people did not guffaw, they listened. In a lecture on the centenary of Ruskin's birth, George Bernard Shaw proposed that the invective of Lenin and the indictments of Marx were, when compared with Ruskin's works, like the platitudes of a rural dean. Ruskin's political message to the cultured people of his day – the class to which he himself belonged – began and ended in this simple judgement: "You are a parcel of thieves."

Ruskin wasn't alone in the opinion. Others hammered home identical criticisms of the way money appeared to have become the chief determinant of respect, something to wield as a sign of demonstrable goodness, and not merely one component – and perhaps not the most important – of a fulfilled life. "Never did people believe anything more firmly than nine Englishmen out of 10 at the present day believe that our greatness and welfare are proved by our being so very rich," lamented poet Matthew Arnold in *Culture and Anarchy* (1869).

Thomas Carlyle agreed, only more angrily. In *Midas* (1843), he asked, "This successful industry of England, with its plethoric wealth... which of us has it enriched?... We have sumptuous garnitures for our life, but have forgotten to live in the middle of them. Many men eat finer cookery, drink dearer liquors, but in the heart of them, what increase of blessedness is there? Are they better, beautifuller, stronger, braver? Are they even what they call 'happier'? We have profoundly forgotten everywhere that cash payment is not the sole relation of human beings."

Carlyle was not blind to the benefits of modern enterprise. But he could not accept a way of life in which what he termed "Mammon worship" subsumed the drive towards "blessedness" and "satisfaction" on "God's Earth".

Whatever our politics, recent events are making such voices ever harder to ignore.

Alain de Botton is author of *The Architecture of Happiness* (Pantheon). www.alaindebotton.com

PHOTOGRAPH: Vincent Starr

NEW HORIZONS

The recession has left few sectors undented, but even in turbulent times there are opportunities to be seized

Bricks and mortar still remain an attractive long-term investment, offering a sense of security that stock markets cannot provide in today's economic environment. Even cash deposits look out of favour, as investors question the safety of their money and banks slash interest rates. Here, experts at Knight Frank and Citi Private Bank reveal the worldwide locations and sectors that should make sound investments for the future.

PHOTOGRAPH: Narratives /Ignacio Izquierdo, richardpowers.co.uk, 4CornersImages.com

1 Up-and-coming prime London locations

Liam Bailey, Head of Residential Research, Knight Frank

"The weakness of sterling, combined with significant price falls, means London is very attractive to international buyers. Up-and-coming areas with additional growth potential include Fitzrovia, to the east of Marylebone. It may lack the historic and architectural integrity of areas further west but it makes up for this with a more varied selection of properties.

"Neighbouring Bloomsbury is already famous for its leafy appearance and elegant architecture, as well as the British Museum. Bedford Square is often cited as the best preserved of all London's Georgian squares. The vast regeneration programme planned for King's Cross is likely to make this area far more attractive to prime buyers. Already, the opening of the high-speed Eurostar link at St Pancras has vastly improved the image of the area." >>

2 US vacation and resort areas

Michael McPartland, Head of Residential Real Estate Lending, Citi Private Bank

"Over the next one to three years, I believe there will be opportunities in vacation and resort areas for real estate and investment vehicles like REITs [real estate investment trusts]. As values rise, these areas generally trail primary home regions, but they are also usually the first area to give back value when prices decline.

"The euphoria of the last few years led to a lot of over-building within the sector. The inventory exists, and much of it was created during a real estate bull cycle. This inventory will need to be reabsorbed, and the basic fundamentals remain that made these areas attractive to begin with. We are also beginning to see many experienced real estate funds acquiring properties. These funds are likely to begin to show profits over the next five years, assuming that the desire for inventory and capital constraints loosen."

3 Barbados

Georgina Richards, Caribbean Desk, Knight Frank

"The term 'flight to quality' is one being used above all others at present, and I do not think it is more applicable than in the Caribbean. We have seen increasing interest in up-and-coming islands, but over the last few months this has retracted to focus yet again on Barbados. Buyers appreciate its consistent track record, even in uncertain markets, thanks to a stable government, good infrastructure, a developed economy and accessibility.

"Virgin Atlantic is expanding its routes from Manchester to Barbados, property transfer tax has been reduced to 2.5% and foreign exchange controls have been lifted. I would invest in either a beachfront property or well-maintained themed development offering an array of facilities and security. Three-bedroom townhouses in a waterfront development in St James are available for $1.7m."

4 Moscow and regional Russian centres

Elena Norton, Russian and CIS Desk, Knight Frank

"Moscow is the place where everyone from Russia and the CIS would like a base. There is a lack of development opportunities in the inner city centre, and many developers have been affected by the crisis. I believe that in 12-18 months' time the shortage of quality stock will be really felt. Among regional cities, Kaliningrad and Astrakhan will be interesting for residential property investment due to their strategic locations as major sea ports on the Baltic and Black seas.

"I would definitely start looking for opportunities now, taking advantage of the global economic turmoil. The Moscow market will be the first to recover, with most growth towards the end of 2010. Here, $5m will buy an apartment that will hold its value and appreciate over the short and medium term. The level of regional investment will be about $1-2m."

5 Prime marina developments

James Price, Head of International Residential Development, Knight Frank

"Demand remains for high-quality property linked to desirable facilities, such as marina-based residential projects. Porto Montenegro (visualised below), a regenerated port on the Bay of Kotor, offers attractive surroundings and 650 berths, including 130 for boats over 30m."

6 Northern Tuscany, Lazio and Bordeaux

Paul Humphreys, European Desk, Knight Frank

"An improvement in infrastructure means that northern Tuscany in Italy is increasingly accessible and the area to the north of Lucca, the Garfagnana Valley, is undoubtedly well worth considering as an alternative to the more traditional areas in the south. The area to the north of Lazio also has potential, as a new international airport at Viterbo is scheduled for completion next year.

"In France, Bordeaux is undergoing something of a renaissance, and we are expecting to see increased Chinese interest in the area's vineyards following Hong Kong's abolition of import tax on wine. In all of these areas, an expenditure of between €500,000 and €2m will give buyers some excellent options to choose from. The growth period over which property should be purchased and held is at least five years."

7 Distressed US and UK property, plus emerging markets

Roger Orf, Head of International Investment, Citi Property Investors

"The US and the UK have an abundance of distressed real estate – in many cases distressed not because of the locations or tenants, but due to their capital structures. I believe there will be opportunities to buy debt on these properties at a deep discount to par in future years. There may not be growth for a number of years to come, but the high volume of distressed property will outweigh available capital, which should result in some attractive returns.

"Asian property continues to decline in value, but the underlying economies remain strong. Real estate historically has appreciated in tandem with a country's GDP. China and India are likely to economically outperform most countries and this presents an opportunity to buy assets cheaply as well as participate in these countries' strong ongoing underlying economic fundamentals."

8 Luxury penthouse apartments

Patrick Dring, Head of International Residential, Knight Frank

"Penthouse apartments in the best buildings in key city centres and resorts will retain their popularity. The wealthy are short of time and forever trying to simplify their lives, and fully managed lock-up-and-leave properties are ideal.

"If I were an investor, I'd start looking now and select at least two locations in different parts of the world and different currencies. If I were a lifestyle purchaser then clearly the location will be driven by factors other than pure investment returns. Different locations are in different stages of the property cycle right now, but Paris has displayed considerable resilience in recent years and is still benefiting from the Eurostar link to London. Monaco has seen some of the froth come off prices and London now looks good value. Buying property in these markets, which perform consistently well, will always make sense."

9 European REITs

Harry Stokes, Real Estate Analyst, Citi Investment Research EMEA

"The opacity of direct property values is reflected in the confusion and sharp write-downs of net asset value expectations in the quoted sector. For institutional investors, whose performance is benchmarked quarterly, property stocks are a risky selection at the moment. However, for private investors who take a longer-term view, some of the shares look interesting.

"Real estate is a long-term investment, and the introduction of REITs was intended to allow private investors the opportunity to access income streams of the direct market via liquid, quoted companies. The dividend yield of the European real estate sector is currently at a 50% premium to the wider market and should remain one of the more resilient, given index-linked or upwards-only rental growth."

10 Brazil

Nicholas Barnes, Head of International Residential Research, Knight Frank

"Although Brazil is a popular tourist destination, it remains in the emerging market category for second-home buyers. There are few developments of quality, though several are planned. Nonetheless, Brazil has considerable untapped potential and offers many attractive features.

"The country boasts more ecological diversity than any other, its economy has performed well in recent years and it is expecting a considerable boost following the discovery of what is believed to be the world's largest offshore oil field. The nation's exotic, slightly frontier character is appealing to those seeking something different within the comfort of a fully serviced resort community. Average values are low – resorts along the northeast coast average $1,400 per square metre for villas and $1,900 per square metre for apartments."

RESEARCH

BACK TO REALITY

The results of the 2008 Knight Frank Prime International Residential Index show widespread price falls in the world's most desirable property markets. Liam Bailey, Head of Residential Research at Knight Frank, reveals the figures

For most of the world's prime residential markets, 2008 was a year to forget. Prices fell in almost half of all global hot spots and sales volumes all but dried up in many markets. From Europe, to the Middle East, to the Americas and Asia, few places had much to celebrate. The impact of the credit crunch was felt first in the prime newbuild and investment-led markets. By the summer of 2008, off-plan sales in Europe, North Africa, the Caribbean and Middle Eastern resorts struggled to maintain traction and development plans were either scaled back or put on hold.

It was perhaps obvious in retrospect that investment and some over-inflated second-home markets would be hit hardest. In areas where local demand for prime property is limited or even non-existent – especially those with an abundance of stock – investors have created an artificial market. Without them there is nothing to support prices.

As returns from equity and commodity markets plunged, even HNWIs and UHNWIs cut their discretionary expenditure. But the worsening global and local market conditions meant that through the year even the prospects for the world's most expensive first-home markets – including London, New York, Hong Kong, Sydney and Singapore – weakened sharply.

The results from our Prime International Residential Index reflect these trends (see page 28). Of the 55 locations covered by our index, 23 saw prices fall over the course of 2008, six saw no change and 26 saw growth. But data for the final quarter of the year is more telling, revealing how the downturn has gathered pace. Comparing Q4 against Q3 2008, 35 locations saw prices fall as opposed to only 14 showing growth. The biggest losers were the prime districts of the big cities: Hong Kong (-25%) and London (-17%) led the decline, but several other cities saw double-digit price falls, including Singapore (-15%) and Sydney (-12%).

The most resilient prime markets last year tended to be found in the emerging economies – notably Moscow (+13%), Jakarta (+18%) and Bangkok (+23%). Even Dubai, which has been tipped for a crash for almost as long as it has being developing, managed to record growth of 11% in 2008, although by Q4 prices were slipping substantially and our data revealed a 19% decline between Q3 and Q4.

Price rises in prime Asian locations have been driven by a lag between wealth creation and slow growth in new high-specification housing. But evidence is mounting that in these locations, where annual double-digit price growth has become the expectation, performance has weakened noticeably in recent months and there is talk of steep price falls this year as wealth creation falters. Different parts of the world are at different stages of the global downturn, but nowhere will be immune from a significant fall in property values.

Tax-efficient locations, which proved to be market leaders during the boom years, have begun to come under pressure. Zero growth was recorded during the year for both the Cayman Islands and Bermuda, whereas in Monaco a respectable rate of growth in the first half of 2008 was reversed by a sharp downturn in Q3 – before values stabilised in the final quarter – leaving prices 2.1% up on the year.

Following rapid price adjustments, in addition to currency fluctuations, the league table for the world's most expensive residential markets has changed substantially since the 2008 *Wealth Report* (see chart below). Despite recent price falls, Monaco stands out at the head of the field – with an average value of €50,000 per square metre for the best properties. London, where values have been hit hard by the slide in the value of sterling, slips down the ranking to number two. Manhattan is in third place, while Asian cities (Hong Kong, Tokyo and Singapore) compete with European centres (Moscow, Rome and Paris) for the remaining positions in the table, with Sydney bringing up the rear. The impressive showing from Moscow (fourth) is influenced by the relatively small size of the city's prime market area – and the rapid growth of HNWI purchasers over recent years – although recent evidence is that price growth has slowed and turned negative in the final quarter.

AND THE FUTURE?

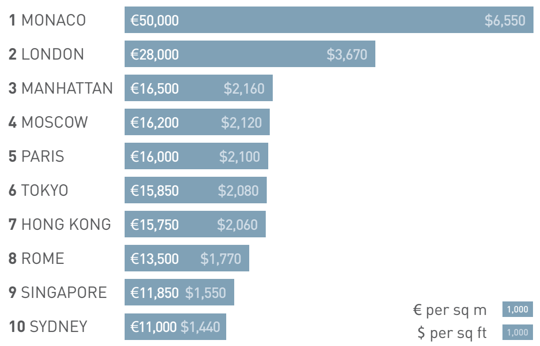
Depending on where you were in the world, 2008 saw prime market conditions range from 'challenging', to 'difficult', to 'awful'. Looking ahead to the rest of 2009 and beyond, it is very easy to become despondent about the prospects for prices and sales volumes throughout the luxury market. Rather than being immune from the wider market downturn, as many felt would be the case 12 months ago, the luxury housing sector is potentially more vulnerable

"Different parts of the world are at different stages of the global downturn, but nowhere will be immune from a significant fall in property values"

THE GLOBAL TOP 10

PRIME GLOBAL CITY MARKETS

Comparative residential pricing, Q4 2008*



*Source: Knight Frank Residential Research. Exchange rates taken on 31 December 2008: euro = $1.409; euro = HK$10.940; euro = S$2.032. PHOTOGRAPH: Richard Powers

WINNERS AND LOSERS

PRIME GLOBAL MARKETS
Residential price change, year to Q4 2008 and Q3 to Q4 2008*

	Location: Country	Q on Q	Y on Y
1	BANGKOK: Thailand	3.4%	22.5%
2	JAKARTA: Indonesia	3%	17.7%
3	BALI: Indonesia	3.7%	16.7%
4	KUALA LUMPUR: Malaysia	2.3%	15.8%
5	ISTANBUL: Turkey	2.1%	14.3%
6	MOSCOW: Russia	-5.6%	13.1%
7	DUBAI: UAE	-19.1%	10.8%
8	GENEVA: Switzerland	1.1%	8.5%
9	VERBIER: Switzerland	0.5%	7.6%
10	CANCUN: Mexico	1.1%	7.3%
11	VANCOUVER: Canada	0%	5.6%
12	MARRAKECH: Morocco	0.9%	5.5%
13	SHANGHAI: China	-3.9%	5.2%
14	GSTAAD: Switzerland	0%	4.4%
15	CAPE TOWN: South Africa	0.5%	4.3%
16	LIMASSOL: Cyprus	-0.5%	3.9%
17	PARIS: France	0%	3.8%
18	MAURITIUS	0.6%	3.7%
19	SEYCHELLES	0.5%	3.6%
20	BERLIN: Germany	0%	3.1%
21	JOHANNESBURG: South Africa	-1%	2.9%
22	MONACO: Monaco	-10.7%	2.1%
23	MONTENEGRO	-0.5%	2.1%
24	ROME: Italy	0.4%	1.4%
25	MILAN: Italy	0.2%	1.2%
26	BERMUDA: Carribean	-0.3%	0.1%
27	NICE: France	-5%	0%
28	SAO PAULO: Brazil	0%	0%
29	CAYMAN ISLANDS: Carribean	0%	0%
30	ST TROPEZ: France	-5%	0%
31	CANNES: France	-3%	0%
32	ST-JEAN-CAP-FERRAT: France	-5%	0%
33	FRANKFURT: Germany	-0.7%	-0.7%
34	LAKE COMO: Italy	-0.9%	-1.4%
35	CENTRAL ALGARVE: Portugal	-1%	-2%
36	FORTE DEI MARMI: Italy	-2%	-3%
37	SAN FRANCISCO: United States	-0.7%	-3.1%
38	FLORENCE: Italy	-2.5%	-3.6%
39	MADRID: Spain	-2.6%	-3.8%
40	NEW YORK (MANHATTAN): United States	-3.2%	-4.1%
41	TOKYO: Japan	-4.4%	-5.4%
42	COURCHEVEL: France	-5%	-7.5%
43	CHIANTI: Italy	-5%	-8.2%
44	MELBOURNE: Australia	-1.9%	-8.5%
45	MALLORCA: Spain	-5%	-10%
46	VENICE: Italy	-6.5%	-10.5%
47	SYDNEY: Australia	-6.4%	-11.9%
48	MUMBAI: India	-6.2%	-12.5%
49	BARBADOS	-5.3%	-14.3%
50	DORDOGNE: France	-5%	-14.5%
51	SINGAPORE	-2.2%	-14.6%
52	MARBELLA: Spain	-5.7%	-15%
53	LONDON: United Kingdom	-9.4%	-16.9%
54	HOME COUNTIES: United Kingdom	-10.2%	-19.4%
55	HONG KONG: China	-26.6%	-24.5%

to economic shocks than the mainstream market, although the most desirable and established prime locations will retain their liquidity and long-term values better than the artificially inflated newcomers to the prime arena discussed earlier.

The element that gave the sector its impetus for growth over the last decade was the expansion of global trade and economic linkages. This factor contributed to the rapid growth of a footloose and wealthy global elite, giving the global luxury market a substantial raison d'être. This trend saw an explosion in demand for multiple residences by those who ran their business in, say, Russia, raised finance in New York, and spent August in St-Jean-Cap-Ferrat and February in Courchevel.

The demand for property to facilitate this lifestyle grew substantially. As late as the summer of 2008, Knight Frank sold more European properties priced at or above €10m in three months than in the whole of 2006. The credit crunch and resulting economic downturn slowed this process.

The question to answer is whether the downturn is leading to a simple repricing of assets that had become overvalued through the late boom period, or whether something more fundamental has occurred in the global economy that will mean prime market pricing will be further suppressed and take a long time to recover. The evidence from one market at the epicentre of the downturn is that the former is more likely. London's top-end market saw the downturn accelerate in late 2008 as the market accepted that 10% or 15% price reductions were insufficient to get sales underway. By early 2009, the 30% discounts being offered triggered a rally in market activity and allied to a 20% decline in sterling against the major world currencies, offered the potential of savings up to 50% on peak prices for international buyers.

The response has been dramatic: wealthy international buyers who considered the market too hot a year earlier have come back strongly and the early evidence is that this demand has acted to place a floor underneath prices. An additional factor supporting prices is that supply is constrained when low prices are offered – the very wealthy do not need to sell their prized assets in a weak market.

The desire to own good property in the best markets is an enormous driver for the prime residential sector. The lesson to draw from the last two years is that no market, no matter how luxurious, can escape a bubble-and-bust scenario. However, when the market believes prices have returned to offer good value, activity will rise and the perennial factors that make a true prime market desirable will endure.

Liam Bailey is Head of Residential Research at Knight Frank.

*Source: Knight Frank Residential Research

CITY LIVING: A good quality of life, influential inhabitants and strong economic activity make Hong Kong a world city

THE WORLD'S BEST CITIES

A growing number of cities are staking their claim as the key location for the wealthy and influential. In this, the first edition of Knight Frank's World Cities Survey, Liam Bailey provides the definitive guide to the ones that really matter

Is there such a thing as a world city? Are there locations where the confluence of financial, creative and intellectual activity is so great that the city has an impact way beyond its national and regional borders? If the answer is yes, how should we recognise a world city when we see it? Several organisations have attempted to provide an answer, and the field of global surveys is crowded.

We asked ourselves whether there was space for yet another. A review of the competition showed that to date most have fallen into the trap of considering economic activity only, and do not place sufficient emphasis on the elements that make up the whole of a city's attraction.

In our survey (see page 31 for the results), we attempted to create the most rounded picture of the world's leading cities in order to provide an accurate measure of the locations that matter to wealthy individuals choosing first or second homes. We have considered much more than each city's share of world financial flows, important though these are. We have assessed political influence, contribution to intellectual activity and liveability.

Our assessment criteria are grouped under four main themes. Firstly, we considered economic activity – including economic output, income per head, financial and capital market activity and market share, and the number of international business headquarters.

The broader non-economic influence exerted by each city has been captured by our second measure, which we loosely label 'political power'. In this category we calculated the importance of each city to global political and intellectual thought and opinion – identifying the reality of where power is held and influence is exercised. Our ranking included the number of headquarters for national political organisations » and international non-governmental organisations, together with the number of embassies and think tanks in each city.

Thirdly, we looked at intellectual influence. This was measured for each city in terms of its own knowledge base, including the education level of inhabitants and newly arrived migrants, together with the number of world-leading international educational facilities. In addition we looked at how well each city is able to transmit this knowledge. For this we considered the number of national and international media organisations and news bureaus, and the international market share of locally based media.

Finally, we assessed the quality of life offered by each city. The range of issues considered was extensive and included measures of personal and political freedom, censorship, personal security, crime, political stability, health facilities, public services and transport, culture and leisure, climate and the quality of the natural and man-made environment.

THE RESULTS

The 40 cities in our index are dominated by the established European, American and Asian urban centres. In fact, the top 10 displays a remarkable similarity to the most expensive residential cities revealed on page 26 in our Prime International Residential Index. While the top-tier cities are likely to remain relatively unchanged in the short term, we expect to see considerable change in the middle and lower end of our ranking, not least following the outcome of the current economic crisis, which is undoubtedly opening opportunities for other cities to take market share in financial services.

The top of the table doesn't really contain many surprises. The traditional powerhouses lead the rankings, with London (number one), New York (two) and Tokyo (four) heading their respective world regions. Notwithstanding the market chaos of the past 12 months, economic power ensures a top score in all three cases.

New York scores well for political power and is second only to Washington (nine) on that measure. As the EU's official capital, while weak on economic activity, Brussels (six) scores very highly on political power but cannot offer sufficient presence on the remaining themes to eclipse Paris (three), which is in effect Europe's second city. Los Angeles comes in at number five, with high scores for knowledge and influence.

While Hong Kong (14) scores in the top five for economic activity and knowledge and influence, its poor results in political power – where Beijing (12) takes precedence – and quality of life drag down its score. As a result, Singapore (seven) comes out ahead as the second Asian centre in our survey.

One of the key insights provided by the European centres in the middle of the table – Berlin (13), Frankfurt (15), Zurich (22) and Munich (25) – is that along with Toronto (eight), these are cities that have been able to develop successful world-class economies, and at the same time provide an excellent quality of life with a high-quality public realm. With the added advantage of excellent cultural facilities, these are attractive places to live and work, and offer models for other cities to emulate.

The quality of life elements displayed with such success in Germany, Switzerland and Canada are elements that cities in the Middle East and Asia are working hard to compete directly on. Despite significant investment, Dubai (28) struggles to score well on this measure, however we expect the city to climb further in the future.

The crux of the matter for many cities in emerging economies is that while they have benefited from government investment in infrastructure and facilities, issues surrounding personal freedoms and safety, as well as broader political tension, remain stumbling blocks to their development as world cities. Despite this, we expect that the ranking for locations like Dubai, Sao Paulo (24), Moscow (20), Mumbai (39) and Shanghai (21) will improve over the next few years, as economic growth and development continue.

HOW TO BUILD A WORLD CITY

The zeitgeist is that western capitalism has been found wanting, and a new form of economic leadership will evolve, with locations like London, New York and Tokyo losing their hold on world city leadership. However, evidence from our Attitudes Survey (on the opposite page, and examined in detail on page 12) reinforces a less dramatic view. We asked our contributors to rank the key global financial centres – both now and how they imagined the order would be 10 years hence. The results suggest that both New York and London will remain in first and second positions over the 10-year period.

One of the key reasons for selecting a wide range of criteria in our World Cities Survey was the recognition that economic drivers can only be part of the assessment. All three top cities – London, New York and Tokyo – share similarities in that they are both vast and messy. Planned in part, they are generally the result of organic growth, and have a crowded and chaotic character. The danger for some newly emerging world centres is that they concentrate on the wrong things. Excellent transport infrastructure is a good thing, and to some extent so too are shiny new business districts, stock exchanges and entertainment quarters, but the real underpinning of the current top-tier world cities is much more complex.

One of the significant conclusions to draw from our survey is that economic growth on its own is not enough. The importance of political and thought leadership in addition to a vibrant public sphere mean even medium-sized cities such as Brussels, Toronto and Munich can wield a greater influence in the world than the emerging economy behemoths.

The two cities that stand apart from all others are London and New York. Both have been hit hard by the credit crunch, but their networks remain largely intact and they should be able to recover from the current slump relatively well. The successful ingredients for both cities are in their acceptance of new ideas and invention, their open economies and free press and intellectual scenes – all of which bode well for the future. It will be fascinating to see locations like Shanghai and Dubai challenge this pre-eminence in the future.

Our survey results suggest that in order to make it as a world city, you need more than just success in a single economic field. It seems that the world only regards your city as indispensable if in addition to delivering on wealth creation, you provide an attractive built and natural environment, your universities are open to the best brains from around the world, think tanks and political activists feel free to discuss and disseminate ideas, the press can publish without fear or favour, public spaces are both well maintained and safe, and finally – and most importantly in some eyes – a city's residents and visitors have somewhere pleasant to discuss its attractions over a decent lunch.

PHOTOGRAPH: Chris Everard Intercontinental, Taverne-Agency

ATTITUDES SURVEY

Contributors were asked to rank key global financial centres – both now and how they imagined the order would be in 10 years' time.

Ranking now

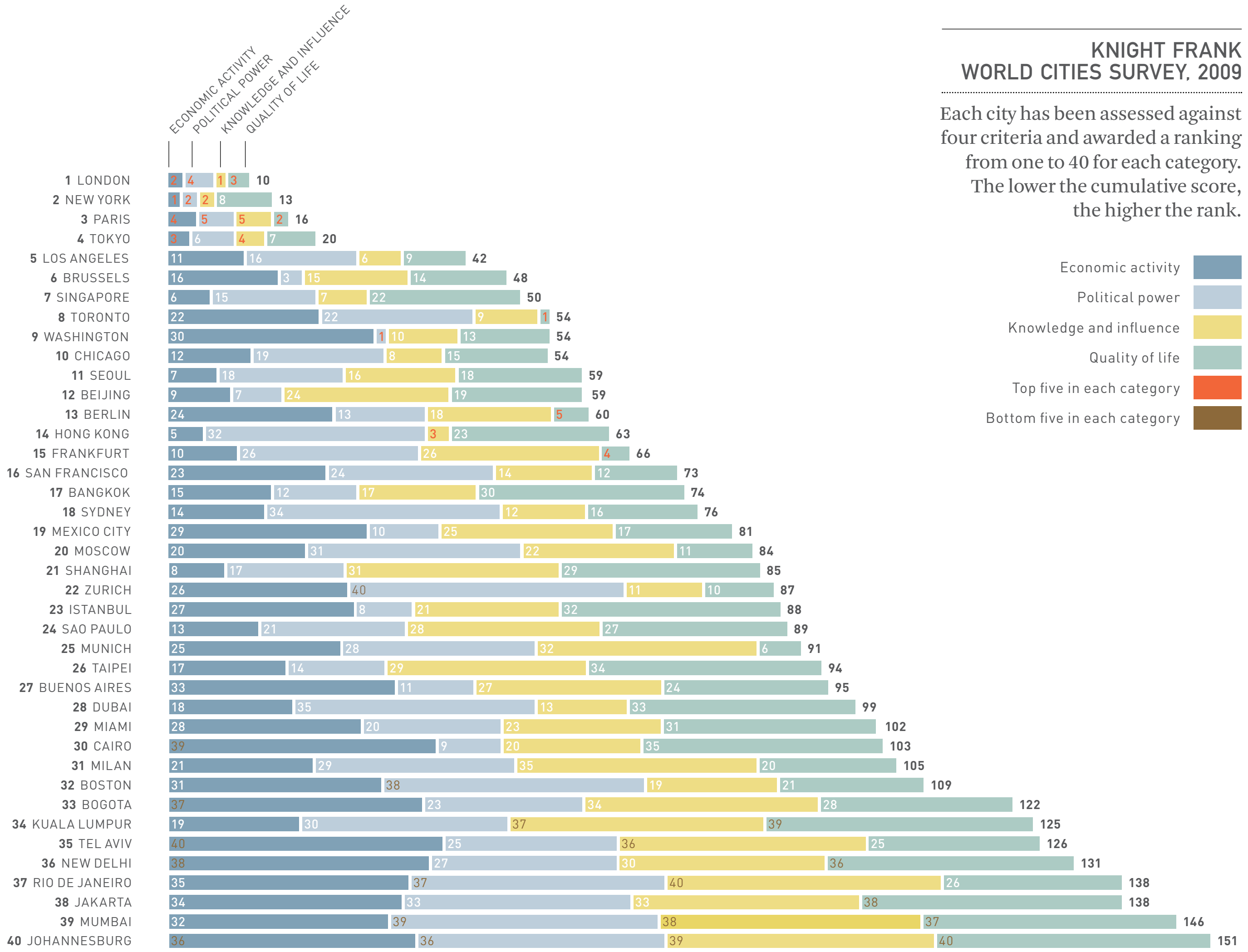
Rank	City
1	NEW YORK
2	LONDON
3	TOKYO
4	HONG KONG
5	BEIJING
6	FRANKFURT
7	SHANGHAI
8	SINGAPORE
9	PARIS
10	MOSCOW
11	MUMBAI

Ranking in 10 years

Rank	City
1	NEW YORK
2	LONDON
3	BEIJING
4	SHANGHAI
5	HONG KONG
6	SINGAPORE
7	MUMBAI
8	TOKYO
9	MOSCOW
10	FRANKFURT
11	PARIS

KNIGHT FRANK WORLD CITIES SURVEY, 2009

Each city has been assessed against four criteria and awarded a ranking from one to 40 for each category. The lower the cumulative score, the higher the rank.



Source: Knight Frank

Farmland focus PROPERTY

RESEARCH

GROWING CONCERNS

While other property markets crumbled last year, global farmland values initially kept rising. But recently that resilience has been tested. **Andrew Shirley** investigates whether agriculture is still a good investment

Agricultural land was the property market's darling for much of last year. A massive land rush ensued as new farmland funds touted for business and governments from cash-rich but food-poor nations scrambled to secure productive farmland to feed their populations.

One of the key drivers was a surge in soft commodity prices. World cereal stocks were dwindling and the price of biofuels produced from crops like maize (corn) and sugar cane escalated in tandem with oil prices. Eager investors piled into anything to do with farming and, of course, acquired land. In undervalued areas this helped push prices to more realistic levels, but in others it created an overheated market that has now started to cool, as recession forces down commodity prices and potential investors struggle to access credit. In some cases the bubble has burst spectacularly.

Ukraine falls into this latter category. A country with countless under-utilised hectares of fertile black Chernozem soils, it seemed ripe for investment. In their eagerness, many investors overlooked the issue of land tenure: in Ukraine there is no legal framework for the private ownership of land – you can only buy the right to rent it. Lease agreements of between two and 20 years were being sold for up to $1,000 per hectare at the beginning of 2008. Now, following an IMF bailout of Ukraine, they are worth only $250, according to Brown & Co, a company that advises on land deals in Eastern Europe and Russia.

SOIL SEARCHING

Land values in nearby countries with similar soils but more stable environments have fared better. In Russia, the primary land market consists of small blocks of land distributed to individuals following the fall of communism. This has remained stable, at about $300 per hectare, but large consolidated blocks have fallen by about 20% to $800 per hectare.

In countries where demand is also supported by indigenous farm businesses, there has been less of a slowdown. Within the EU, agricultural subsidy payments also help to level the market. In Poland, for example, arable land values have fallen since peaking last summer, but still ended 2008 at about 20,000 zlotys per hectare (€4,800), about 10% more than they were at the beginning of the year.

New EU members, such as Romania, appeal to investors because they offer the prospect of an increase in capital values as land prices, bolstered by subsidies and access to EU markets, gradually catch up with those in countries such as the UK.

Investing is not without risk, however. Agricultural infrastructure lags behind Western Europe and land tenure, while legally binding, is less transparent. Much of the land remains in small post-communist parcels. In Romania, values stayed at about €3,500 per hectare during 2008, but are likely to weaken as potential investors struggle to access funds this year.

CURRENCY CONSIDERATIONS

When looking at potential investments, shifts in exchange rates make it important to not just consider changes in home currency values. Despite falling in value in the final quarter of 2008, English farmland increased by 16% overall to almost £12,000 per hectare, according to the Knight Frank Farmland Index. But sterling's slide against the dollar and euro means land at the beginning of this year was 16% cheaper for US buyers and 11% down for those from the eurozone.

Brazil is another country where fluctuations are working in favour of outside investors. One US dollar bought 1.5 reais last August; now it will buy about 2.3. In reais, average values rose by 8% last year to R$4,330 per hectare ($1,850), according to the AgraFNP land price survey. But land used to grow sugar cane has been badly hit by falling ethanol values and prices in some areas are said to have fallen by up to 50%. South America offers vast swathes of cheap, undeveloped land that can be converted into valuable cropping or pasture land and sold on for big profits. In Brazil it is still possible to buy 100,000 hectares of undeveloped land in a single block. Prices vary, but can be as low as $200 per hectare.

US land values are linked to farm profitability and have been rising strongly. The US Department of Agriculture estimates farm incomes reached almost $90bn last year, 42% above the 10-year average. Much of this was fuelled by a rash of new maize-hungry bio-ethanol refineries. Farmland values in the Midwestern breadbasket states rose rapidly as a result, with prices in Iowa up 14% to $11,000 per hectare. Further rises now seem unlikely, as falling ethanol prices threaten the viability of refineries.

While the credit crunch has affected demand for land in most parts of the world, Australia and Canada actually seem to be benefiting. The combination of relatively cheap land and a low-risk political and economic environment is attracting investors who might otherwise have considered South America or Eastern Europe. In the Canadian prairie states, average values rose 10% in 2008 to C$2,100 per hectare ($1,725), says fund manager Agcapita, while in Australia, productive cereal land rose 10% to A$4,950 per hectare ($3,450).

LONG-TERM OUTLOOK

For the far-sighted investor, an agricultural downturn could be the ideal time to buy farmland. Most commodity analysts believe the current situation is a dip in a longer upwards trend driven by factors such as an increasing world population and a slowdown in agricultural productivity gains. Deciding where to invest depends on your aversion to risk – some areas with the highest potential returns also offer the biggest challenges, particularly where the politics of food production are contentious.

Rich nations with limited agricultural resources have already been accused of neo-colonialism as they try to secure land in some of the world's poorest countries. Escalating food prices prompted riots across the developing world last year, and foreign ownership of land may not sit well with poor populations struggling to feed themselves.

Andrew Shirley is Head of Rural Property Research at Knight Frank.

Farming in figures...

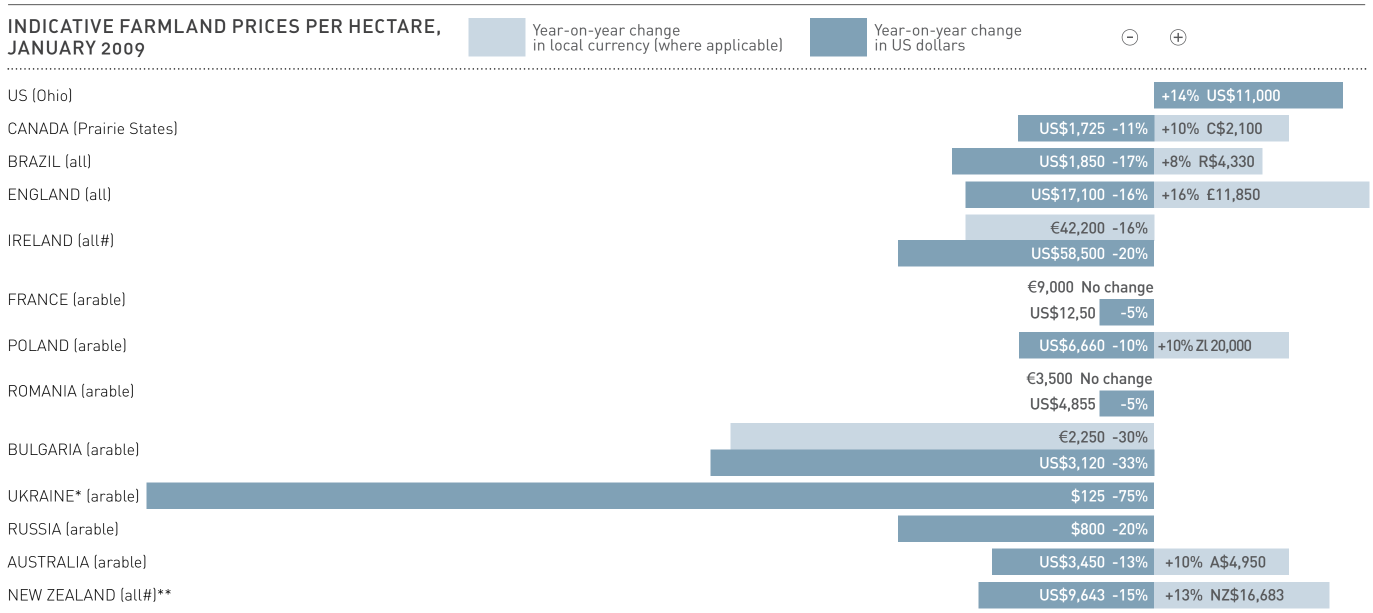
£182
Price, per tonne, of UK wheat at its peak in 2008. By January 2009 this had fallen to £107 per tonne, a drop of 41.2%.

48.7%
The fall in the price of US corn (maize) from its 2008 peak of $7.60 per bushel to $3.90 this January.

44.8%
The fall in the price of ethanol, in dollars per gallon, from its 2008 peak to January this year.

Source: Enagri

INDICATIVE FARMLAND PRICES PER HECTARE, JANUARY 2009



* Right to lease ** Until June 2009 # Including buildings and houses Sources: Knight Frank, Brown & Co, FCC, AgraFNP, QV NZ. PHOTO: Getty Images PHOTOGRAPH: Getty Images

EXPERT OPINION

TIGERS TAKE ON THE WEST

Will burgeoning Asian financial centres such as Singapore and Mumbai oust London from its place? Economist Joergen Oerstroem Moeller argues controversially for the East, while Stuart Fraser presents the counter view

ILLUSTRATIONS BY LUKE WILSON

Trading places

Joergen Oerstroem Moeller

THE US, EUROPEAN AND JAPANESE economies are likely to contract by 1-2% this year as the global recession bites. By contrast, most of Asia will probably be capable of maintaining growth, albeit at a slower rate than the last decade. China and India will expand by about 6% – perhaps higher with some luck – and a number of other economies in Southeast Asia will grow by 3-5%.

A hot issue has been whether or not Asia has decoupled from the US economy. That is mainly a question of vocabulary. Asia has been less hit by the calamities haunting the US economy than it would have been five or 10 years ago, and under half of the lower growth can be subscribed to a drop in net exports. Out of this cauldron, the US, Japan and Europe will emerge weaker while rising Asian powers such as China and India will grow stronger. Financial centres like Shanghai will topple New York and London from their positions as undisputed global financial hubs.

Asia has for many years stood for the world's savings. The flywheel for the global economy was China's readiness to allow the US to consume beyond its means. China put its savings at the disposal of the US consumer and was paid with two trillion in greenbacks, which accumulated in its coffers. China's own financial system, however, was weak, not only making foreign assets attractive, but also disqualifying Chinese financial institutions as players on the global financial markets.

Consequently, the Chinese authorities concluded that their interests were best served by asking Western, primarily US, financial institutions that excelled in knowledge, expertise and reputation to invest the money and ensure a high yield. This is how Wall Street and the City became guardians of the world's savings.

The crash disclosed that this perception had little to do with reality. Some Western institutions proved to be not only not able, trustworthy or competent, but also irresponsible, violating almost all rules about how to serve the interest of the depositor.

This breakdown has undermined the attractiveness of the Western edition of capitalism as the model to lead the world into decades of growth and prosperity. It has also revealed the unwelcome truth that this system was morally decadent, driven by greed, and suffered from severe flaws in its economic performance.

China and other creditors who once trusted in the system will not waste much time concluding that it did not, after all, look after their interests, so why go on putting their savings at its disposal?

Their first reaction has been to buy shares in a number of well-known Western financial institutions in order to transfer the knowledge base built over decades, even centuries, from Western institutions to Chinese institutions. The second reaction will be a gradual one in which Chinese stockholders use their influence to change the investment pattern in a way better suited to their interests. Gone are the days when Chinese and other creditors lined up to buy treasury bonds the American public did not want.

The Western institutions' liberty to shuffle funds around with an eye to their, and Western, interests has ended. Instead of financing expansion of Western multinationals, the financial institutions will be mobilised to finance Asian companies. As the West used its savings to sustain its economic expansion, so will Asia.

The third reaction will be to transfer power from Western institutions partly owned by Asian investors, including Asian governments through sovereign wealth funds, to genuine Asian financial institutions domiciled in the region. These will primarily be Asian financial centres such as Shanghai and Mumbai, but maybe also Singapore, Hong Kong and Tokyo. It is too early to predict exact locations. Asia will follow in the footsteps of Europeans in the 19th century and the US in the 20th century, combining manufacturing and high technology with financial power to create a real power base for exercising global leadership.

It is an inescapable conclusion that financial power moves to where production takes place. The world has never seen any other model. The answer is no longer blowing in the wind. It is right here before our eyes, telling us that Asia will take over establishing the world's coming financial centres. It will not happen overnight. It will take time, but it will happen.

Joergen Oerstroem Moeller is Visiting Senior Research Fellow at the Institute of Southeast Asian Studies, Singapore and Adjunct Professor at Copenhagen Business School and Singapore Management University.

City stickler

Stuart Fraser

THE FINANCIAL SERVICES SECTOR the world over is still reeling from the turmoil of the credit crunch. The City of London Corporation supports and promotes the Square Mile – and we know that nothing can be taken for granted as we move forward. But we must remember the City's many advantages in an increasingly competitive world.

To prepare for the recovery, we must invest now to attract global business. We all know what firms look for in a financial centre: a friendly and predictable tax regime; good regulation; a pool of skilled and talented people; a pleasant living and working environment; and good transport. That is why projects such as Crossrail, a large rail infrastructure initiative that the City of London Corporation has championed for over 15 years, are so important.

Our international residents particularly enjoy the openness and tolerance of UK society. This is why so many have taken advantage of our diverse and transparent residential and commercial property market to establish permanent homes.

The eastward shift of the global economy will continue, and financial centres in Asia will grow in importance, but this is not necessarily bad for London: we can position ourselves as the partner of choice for these growing centres. London has exceptional expertise to offer – in traditional areas such as the English legal system as well as innovative new fields such as carbon trading. Our language, accepted as the mother tongue of business, is a strategic advantage and, as a full member of the EU, we can act as a bridge between the world's largest trading block and the rest of the globe.

Taxation is one of the most important factors businesses consider when choosing where to locate. The government's decision last year to tax profits where they are earned could make the UK a highly attractive location for headquarters. Research shows companies want not only low rates, but also a predictable tax regime enforced consistently.

In our eyes, the growth of the East is an opportunity to build strong partnerships with Asia's leading financial centres, which can only strengthen the financial services sector here.

Stuart Fraser is Chairman of Policy at the City of London Corporation. www.cityoflondon.gov.uk

BUTTERFLY EFFECT: Sotheby's £111m Damien Hirst sale last September, which included this piece, was the swansong of an overheated contemporary art market

PHOTOGRAPHY: Rex Features, Getty Images

An invested interest

Andrew Shirley assesses how the markets for fine wine, art and fast cars have fared during the credit crunch and discovers that there are some shrewd purchases to be had for the canny investor

A **portfolio of stunning** property is only one of the accoutrements needed to create a luxurious lifestyle. Millions are spent ensuring wine cellars are bursting with the right vintages and garages are lined with gorgeous, growling thoroughbreds from classic marques – and there seems little point owning the most expensive real estate if its walls aren't adorned with the most desirable art.

But, like bricks and mortar, such luxury assets increasingly serve two purposes. They are to be enjoyed, savoured, admired and sometimes even consumed, but commonly their owners also expect a more tangible return. Wine, art and cars are now all considered, by some at least, as investment classes in their own right. Indices track their performance and funds buy and sell them without enjoying or even appreciating the desirability of their assets. So how have the markets for these luxuries been performing while the credit crunch sliced and diced its way through more traditional investments? If you believe the headlines, some markets have virtually collapsed. Speak to the experts, however, and it becomes harder to generalise.

Like property, the art market has suffered a very public fall from grace. Breathless commentators followed prices ever higher and then gleefully unleashed their gloomy headlines when the market turned. However, the Mei Moses index, which tracks auction results, reveals prices actually fell on average by a relatively modest 4.5% last year. But this comes after five years of stratospheric growth averaging 20% a year and masks a sharp downturn in certain sectors of the market.

Contemporary art has suffered most, with many works failing to sell at auction at the end of 2008. But, as Henry Wyndham, Chairman of Sotheby's Europe, admits, the market – which reached a spectacular zenith with his firm's £111m Damien Hirst sale last September – had become overheated. "Since 2006, prices had doubled or even trebled in some cases." Contemporary prices have got to be readjusted back to levels seen in 2005 or 2006, he states. "I think now could be the time to buy."

Other sectors and even some relatively modern artists are still delivering strong results, says Wyndham. "There is definitely still a market out there and there are still a lot of people with a lot of money." Last November, for example, a 1916 work by Russian artist Kazimir Malevich achieved $60m at auction by Sotheby's in New York. Works by Degas and Munch also sold for over $30m at the same sale.

The market for Old Masters is far less dictated by fashion and tends to be dominated by serious collectors who have been buying for many years. Market estimates for this year's sales will reflect » the economic downturn, says Wyndham, but not nearly as dramatically as for contemporary art. "If you don't buy a Rembrandt today, you might have to wait years for the opportunity."

Jonathan Binstock, Senior Adviser at Citi Private Bank's Art Advisory Service, believes the market is correcting, not disintegrating. "A lot of what happened was irrational, but the speculators have gone from the market and some of the serious collectors who were put off by the 'hot' prices are now back."

Although he says auction houses will be attaching far more conservative estimates to their 2009 sales and certainly won't be offering the kind of price guarantees that were seen at the peak of the market, Binstock cautions that public sales don't tell the whole story. "In this market I think more people will choose to sell privately and a number of sales on the private market have been very encouraging," he says. "The market is not gone by any stretch."

Fine wine is another area that has experienced some sharp headline drops since the credit crunch, but again those in the trade remain optimistic. "The wine market was slow to react," says Thomas Jenkins, Broking Manager at Justerini & Brooks, one of London's oldest wine merchants. "While well-known banks were going to the wall, some 2000 vintage Bordeaux achieved record prices at auction." Even in December, a Hong Kong-based wine lover paid HK$3.2m (about £112,000) for a case of 1961 Latour auctioned by Christie's.

What eventually took some of the steam out of the market, says Jenkins, was not a drop in demand from private purchasers, but a sudden off-loading of specific vintages in the last few months of 2008. These were sold by wine funds set up over the past 10 years to capitalise on the demand for alternative investments. "In September, a case of 2005 Lafite was worth £9,400; at the beginning of the year it was down to £6,800. It could go down a bit further, but we've already seen the market start to pick up again now there is no stock on the market. A lot of people with a lot of money are waiting to buy quality wines at bargain prices."

Growing global demand and a fall in production by some leading chateaux should also help maintain prices, believes Jenkins. "I think there is enough wealth out there to maintain prices at current levels and we'll be back to mid-2008 values by 2010."

Despite losing its grip on the mass market, France is still king when it comes to the very top of the wine hierarchy. Classic Bordeaux like Mouton, Latour, Lafite and Margaux remain the investment wines of choice, but supply is strictly rationed to long-standing clients. This means that wine funds have to compete on the open market and pay premium prices if they want to include the best vintages in their portfolios. The production of some first-growth vintages is down to only 15,000 cases, as producers concentrate on quality at the expense of quantity. Burgundies are also sought after, but with some vineyards issuing as few as 200 cases, getting hold of the most desirable vintages can prove extremely difficult, even for those who have the best connections.

GOON DOWN: Despite its status as a schoolboy fantasy, the Ferrari 275 GTB (here driven by Peter Sellers in 1965), has softened in value

"While some well-known banks were going to the wall, 2000 vintage Bordeaux achieved record prices at auction"

In the world of classic cars, James Knight, International Managing Director of Motor Cars at Bonhams, says he knew the credit crunch had started to bite during his firm's annual winter auction of Ferraris in Gstaad. "Usually we have a 70% sale rate; last year it was down to 40%. However, those cars that did sell still went for good money."

Knight believes that car values will weaken as the global recession deepens, but he doesn't think that the decline will be on the same scale as in the early 1990s, when prices collapsed. "Many of the cars that had to be sold in a hurry then were bought with borrowed money. In recent times, the market has been far more liquid and fewer cars are bought like that now."

He also says many of the people whose fortunes have been most affected by the credit crunch were not big buyers of classic cars anyway. "Most of the rich from emerging markets where a lot of wealth has been created and lost tend to prefer the latest high-performance and luxury cars. It's the same in London. A lot of people from the banking sector who sadly lost their jobs would have been driving the newest Aston or Ferrari, not a classic."

As with the art market, much will come down to supply and demand, with some marques holding their own while others lose more ground, predicts Knight. "There will always be some cars, like the Jaguar D-type, that are regarded as very important. There are only about 85 of them left."

Cars that could see their values soften are those which though extremely desirable are not especially rare. The 1965 Ferrari 275 GTB is a case in point, says Knight. "It's every schoolboy's fantasy, but recently there were eight of them on the market. If there were only one or two it would be a different story."

The message from those who deal with the finest examples that the worlds of art, cars and wine have to offer seems to be to act now if you're looking for a bargain. There is only a finite supply of the very best and demand could soon start to outstrip supply once again.

SELLING PRICE
1965 FERRARI 275 GTB

NEW	£6,000
EARLY 1970s	£3,000
LATE 1970s	£18,000
EARLY 1980s	£24,000
1987	£150,000
1989	£800,000
1991	£120,000
2006	£500,000
2008	£700,000
2009	£600,000

Prices at auction. Source: Bonhams

The new nationalism in art collecting

George Bailey

AN OBSERVER OF THE ART MARKET in 2008 could not fail to note how fundamentally the collecting landscape has changed. An art world once largely confined to Western Europe, the United States and isolated parts of Asia had, in the space of a decade, become complete. The end of communism and resulting creation of private wealth returned two great players to the art market – Russia and China.

Last year an astonishing £183m-worth of Russian art changed hands at Sotheby's and Christie's. Eight years ago it was a mere £4m. Likewise, sales of Chinese art have grown exponentially, particularly contemporary art, which raised $133.7m at Sotheby's in 2007, compared with $2.9m in 2004.

The re-emergence of China and Russia on the world stage and the attendant economic growth and cultural transformation has brought about huge demand for the very finest works of art, and for objects of the greatest artistic and historical significance. This has transformed auction houses into a platform for repatriating Chinese and Russian cultural treasures.

For Russian art, the defining moment came in January 2004 when Sotheby's sold Malcolm Forbes's fabled Imperial Fabergé Collection to prominent Russian industrialist Victor Vekselberg for $100m. Vekselberg returned these treasures of Russian heritage to their homeland to great acclaim.

The artistic legacy of China stretches back five thousand years, and there have recently been similar stories of repatriation of lost Chinese cultural relics. In 2007, Sotheby's sold an 18th-century bronze horse head, cast by Jesuit missionaries for the Summer Palace, for HK$69.1m to Dr Stanley Ho, who donated it to China. The sale of Xu Beihing's masterpiece, *Put Down Your Whip*, achieved HK$72m, an auction record for a Chinese painting.

This new nationalism is not limited to just Russia and China but also applies to Greece, India, Turkey and the Middle East. Sales of Greek art at Sotheby's alone have grown 550% since 2000, while in the Middle East a multitude of new museums and galleries are acquiring on a large scale.

Today, prices have seen a degree of recalibration, but results show that great art continues to find buyers, and that collectors – whether Russian, Chinese or British – are still attracted by art that is rare, high-quality and of exceptional provenance.

George Bailey is Chairman of Business Development for Europe at Sotheby's. www.sothebys.com

Luxury reinvented

PHOTOGRAPHY: Scott Frances: Marge Casey + Associates

Will the credit crunch affect the trends the wealthy follow as much as the value of their houses and investments? Luxury commentator ***Katherine Vaughan*** *investigates*

When fashion guru Karl Lagerfeld of Chanel says that bling is over and has been replaced by something he terms the "new modesty", you know that even in the rarefied world of the super stylish the credit crunch is having a dramatic impact. From fashion to design, the new emphasis is on recessionary luxury, and there is a tangible shift towards something more considered in terms of consumption and lifestyle – more suited to these crisis-ridden times. Inconspicuous consumption does not mean that the luxury lifestyle has vanished. The move is towards something more thoughtful, more sophisticated and of course much better for us.

Property

In difficult economic times we can expect a return to the safe and familiar. As the trend spotters at the New York-based Luxury Institute noted recently, "Wealthy customers will opt for classic luxury that is unique and exclusive." This trend is mirrored in the international second homes market, where Patrick Dring, Head of International Sales for Knight Frank, says the tried-and-tested playgrounds and investment hot spots of the rich and famous are still the places to be. The list of sought-after locations reads like a classic guide to the traditional world of the international super-rich. In Europe, it's Saint-Jean-Cap-Ferrat, Cap D'Antibes, Cannes, St Tropez, Mallorca, Ibiza, Portofino, Capri, Tuscany and Como. In the US and Caribbean it's New York, The Hamptons, Palm Beach, Barbados and Mustique.

The credit crunch has reinforced a trend towards downshifting in terms of lifestyle, which has fed a greater interest in both provenance and authenticity. Although the wealthy have long sought out bucolic boltholes, these are » becoming more than just places to relax and consume. Celebrity exponents of a luxury grow-your-own lifestyle include rock star Sting and his wife Trudie Styler who have developed both their UK-based Lake House organic brand, supplied from their farm in Wiltshire, and sales of honey and extra virgin olive oil from their Il Palagio estate in Tuscany. On a smaller scale, the ever-glamorous Elizabeth Hurley manages to combine her various ventures with a new business. She has started supplying British pork from heritage breed Gloucester Old Spots to local butchers and retailers from her 400-acre Gloucestershire estate.

Even on a determinedly non-commercial scale, international buyers are looking to get the maximum lifestyle value out of their country properties by installing beehives for home-grown honey, establishing fruit orchards and creating the most elegant but also productive of old-fashioned kitchen gardens. For the super-rich, simple entertaining at home, serving truly home-grown produce, wins hands down in the glamour stakes over the latest celebrity chef's restaurant. Seasonal, sustainable, good for the planet and very eco-chic.

If one of the joys of having serious amounts of money is the luxury to indulge one's passions then, for wealthy wine aficionados, seeking out the perfect chateau with accompanying vineyards is still high on the agenda. Whether it's in Europe, the US, Argentina, Chile, South Africa, New Zealand or Australia, buying a vineyard is an increasingly popular venture. Amanda Skinner, from UK wine experts, Private Cellar, says, "Although there's no doubt that this is a capital-hungry occupation, you end up with a lifestyle that money alone can't buy."

Some celebrated names have led the field, such as Sam Neill, the New Zealand actor, who produces Pinot wines under the Kiwi Two Paddocks label, and film director Francis Ford Coppola, who sells under the Niebaum-Coppola label from Napa Valley.

Design and interiors

The main themes in design and interiors are very simple – quality and sustainability. Good design has always been an international currency. The world of luxury homes and interiors hasn't disappeared beneath the radar but has evolved into something beyond brands and definitely doesn't come blazing a logo.

The Luxury Institute believes consumers will look extensively to their own peers for guidance of what is, and what is not, true luxury. Craft has returned, with a focus on longevity. The new interiors trends look to emulate the qualities of a Savile Row suit – beautiful materials, textures and fabrics, exquisite detail and bespoke design. The wealthy are still buying, just less but better.

BRIGHT IDEA: Pieke Bergmans' 'Light Bulb' chandelier. Innovative lighting is considered sculpture in its own right

> *"The very wealthy don't want statement designs any more. Now it's all about wealth whispering"*

Textile designer Geraldine Larkin is a perfect example of this new ethos. She has a world-class reputation for designing highly luxurious and understated hand-embroidered textiles that are used by many of the most famous fashion and couture houses and interior decorators. Larkin says: "The top end of the market is still spending but in an understated way, where the textiles speak before the label. The very wealthy don't want mass-branded products and they don't want statement designs any more. They want style and simple luxury: now it's all about wealth whispering."

Karen Howes, of Taylor Howes Designs, which won the prestigious Andrew Martin Interior Design Award in 2006, is currently working on Imperial Wharf, a riverside development in London. She says: "Understated quality and discreet luxury are the trends moving forward at the high end of the market."

According to acclaimed interior designer Janine Stone, "We are seeing a new level of refinement in the artisanal quality and specification that high net worth clients expect." She predicts that this year "textures and finishes will be understated luxe, moving away from lavish detail to show honesty, simplicity and integrity. There will be a focus on properties and objects that reflect a sense of authenticity, craftsmanship, heritage and skill."

Houston Morris, of contemporary design company Houston Morris Architects, believes that quality of space and light is at the heart of enhancing his clients' way of living. Adding volume rather than just floor space may once have been deemed counter-intuitive in terms of enchancing a property's value – for example, by adding a structural double-height conservatory made of frameless glass – however it works because it makes daily living indulgent. Uber-hip designer Martin Brudnizki has a self-termed signature style of 'minimalism deluxe' that reflects the design trend for comfort and indulgence alongside pared-down purity and simplicity. As he puts it: "Pair sumptuous materials with straightforward architecture and you'll have the ultimate refuge."

Art

Although contemporary art has taken a hit recently (see page 36), contemporary furniture is still highly fashionable. Names to watch include Ron Arad, Donald Judd, Danny Lam and acclaimed architect Zaha Hadid, who has extended her reach into the world of furniture, lighting and bathroom fittings. And don't miss Klauser & Carpenter, whose work was showcased at last year's London Frieze Art Fair.

The trend for innovative lighting also continues; 21st-century 'chandeliers' are increasingly sought after. Now seen as collectable sculptures in their own right, these pieces can command enormous sums. The recently held global design forum, Design Miami, saw a perfect example of this, with a select group of collectors ordering Dutch artist Pieke Bergmans' 'Light Bulb' chandelier from the Netherlands-based Priveekollektie Contemporary Art/Design gallery. Swarovski Crystal Palace showcased a chandelier-based installation, comprising a chandelier and table entitled 'Liquid Space', by world-renowned British industrial designer Ross Lovegrove, which sums up the mood for 2009: it celebrates uniqueness, movement, rarity, simple organic forms, modest designs and natural materials combined with cutting-edge – albeit hidden – technology. The chandelier and table that make up 'Liquid Space' are custom-made and priced at a suitably luxurious $825,000 and $425,000 respectively. An opulent price for a contemporary slice of world-class design. Very 2009.

Travel

Luxury travel is no longer just about an infinity pool and unbeatable service: the very perception of what is luxurious is changing – and it's being defined by the individual. Anonymous luxury has been replaced with a drive towards real local experiences that are strongly linked to the destination, environment and indigenous culture. Ledbury Research, which specialises in helping brands to understand and reach the wealthy, says wealthy travellers are looking for educational experiences rather than just relaxation. Now, more than ever, guests want to be participants, not spectators. So what do the cool finders predict for this year?

Urban resorts are very much on the agenda, offering the perfect mix of architectural and cultural significance, together with opportunities for creative curiosity. Rocco Forte's boutique hotel, The Augustine, opens in Prague this spring. Created from a complex of historic buildings, such as the 13th-century Augustinian St Thomas's Monastery, it has kept many key historic features, including the echoes of plainchant from the in situ monks.

When it comes to cool destinations, our industry insiders are unanimous, touting South America as the place to explore this year. Watch out for Trancoso in Brazil, 'the St Barts of South America', which is more than cool enough for the likes of Leonardo DiCaprio and Matt Damon, while Uruguay and Argentina are also being tipped.

Extended holidays are a growing trend, states The Future Laboratory. According to them, it's about the luxury of total contact – a merging of business and pleasure where we take longer holidays but still spend time working remotely, too. Of course this requires a rethink of, and reinvestment in, the traditional hotel business centre. From being something of the poor relation, it's now moving up the scale of importance. The Future Laboratory predicts that it will become as crucial to luxury hotels as the spa or wellness centre.

And what about the most important trends in travel for the 21st century – sustainability and the environment? According to Sonu Shivdasani, Chairman and CEO of Six Senses, despite the fact that "people are facing the reality of a financial rather than environmental crisis, there will be a continued emphasis on sustainable travel". He maintains that the current situation is making sophisticated luxury consumers even more aware of the plight of the planet.

Despite the credit crunch, luxury has not disappeared but reinvented itself.

Katherine Vaughan is a freelance writer specialising in luxury lifestyle brands who contributes to *Spectator Business* and TTA Group's *Industry Insights*.

EXPERT OPINION

THE CARBON FACTOR

World-leading architect and urban designer Alejandro Gutierrez says cities must change radically if we are to win the battle against global warming. Andrew Shirley meets him

ILLUSTRATION BY LUKE WILSON

Alejandro Gutierrez speaks calmly as we discuss the issues facing cities today – the pollution, the congestion, the vast carbon footprint hastening the process of global warming. He doesn't raise his voice or gesticulate, unlike many environmental campaigners when they start to proselytise, but the visionary young architect and urban designer leaves you in no doubt as to how serious he thinks the consequences will be for urban areas, which by 2050 will house two-thirds of the world's population, if we don't start addressing their problems now. Climate change and dwindling or polluted natural resources will threaten both cities' and mankind's ability to survive. It's a fairly bleak assessment that leaves no room for complacency.

Gutierrez, who works for engineering and design giant Arup, also makes it clear that he's not anti-city. In fact, the Chilean-born Hampstead resident loves cities, which probably explains why he wants to help save them. What inspires him is the ability of the public parts of cities to improve the lives of their inhabitants. "The parks, the pavements, public transport, the way city dwellers procure their energy are all so relevant to quality of life," he says. "We tend to focus on the quality of our private and commercial space, where we work and live, but as anybody in the real estate industry knows, the context of where you put a thing, whatever that thing may be, is as important as the thing itself."

As a student of both economics and architecture, Gutierrez is fascinated by how the relationship between built form and the way it is shaped by economic, social and environmental drivers is crystallised in cities. Medium-sized ones – Verona in northern Italy is a favourite – are the most interesting, he says. "They have a scale that allows you to do things in much quicker, faster and easier ways and to have social contact while at the same time, having the diversity and resilience as an economic entity to allow the supply of good jobs, retail opportunities and services. Big cities work less well in the sense that regardless of the level of wealth or development, the sheer distance you have to go through makes them difficult."

Despite its size, London is one of the few big cities that works, he says. "It's more a collection of villages and because of that you can at least partially get the life of a medium-sized city. I can cycle to work in 15 minutes and do everything I need to do around where I live."

Acknowledging that not everybody is so lucky, Gutierrez believes one of the key things for the future will be to start making, or helping, people make the right choices by pricing carbon or fuel in different ways. London's congestion charge, which he applauds, is an obvious example, but some of the ideas he mentions go much further than that. In the US, for example, the idea has been mooted of mortgages where the interest rate becomes more expensive the further you live from your place of work. "When you start looking at things at that level, it will start to cluster people around their work places in a highly efficient way. These are the things that will start to change the future of cities."

Ideas like this may sound uncomfortable to most of us now – uneasy as we already are with the growing influence of politicians and regulators on our lives – but something has to be done, says Gutierrez. "We are already experiencing a traditional economic meltdown, but I think the biggest challenge we will have is how we get hold of resources to fuel our lifestyles – and that includes the Chinese, the Brazilians, the Russians and all those other countries that are fast developing. As we produce things today, as we create energy today, the way we move around cities today, there are not enough resources. There needs to be a fundamental change in how we use resources, how we reduce resource consumption and we need to stop depleting the elements that support life, like water and air. It sounds simple but we are not doing it."

Such things sound expensive, especially during a global recession, but Gutierrez envisages a new greener economy where environmental measures will shift from becoming a burden to creating new investment sources and industries, offering the opportunity to tackle both the economic downturn and the climate crisis. "That could be the most powerful thing to happen in the next 10 years. We need to have environments of a sufficient scale to test the new technologies and systems."

He says there is already an investment case for reducing carbon emissions, which could provide avenues for the wealthy investor looking for sustainable, yet profitable, opportunities. "Surveys in the US show that buildings certified by the Leadership in Energy and Environmental Design scheme [which meet certain sustainability standards] attract a higher rent per square metre, because people value their energy security, energy efficiency and lower operational costs, as well as the prestige of being able to say in the annual shareholder report that they reduced their carbon emissions by taking space in those buildings."

"Parks, public transport, pavements and the way city dwellers procure their energy are all relevant to quality of life"

Although initiatives such as the Clinton Foundation's C40 alliance, which has persuaded 40 of the world's leading cities to commit to reducing their carbon footprints, are encouraging, Gutierrez despairs when he sees so much unsustainable development continuing around the world. "But if we focus on those disasters we could be crying. We need to focus on those things that could get us out of the very risky position the planet is in today."

Again, Gutierrez comes back to the need for the right incentives or legal frameworks that allow governments to make the right decisions. "The moment you put a price to carbon, however you do it – through trade, tax or pricing it at a personal level – you will see behaviour change and that change will be at all scales, from personal, to metropolitan, to national," he says.

Saving the world may sound a slightly ambitious addition to the traditional role of the planner or architect, but that is what makes integrated urbanism – the idea that cities need to adapt into more habitable places to live, which Gutierrez and his colleagues pioneered at Arup – different. "People are doing design better or worse, but they're not addressing the central problem of this age, which is resource efficiency, and how it relates to cultural, social and economic development."

Talking, of course, is easy but as the lead designer of Dongtan, the world's first major eco-city designed completely from scratch, Gutierrez has shown, on paper at least, how his ideals can coalesce into a viable, attractive and environmentally sustainable urban environment. Ironically, his creation is in China, the world's fastest growing polluter. But even China, it seems, recognises that the detrimental side effects from rapid and unchecked »

URBAN BLUEPRINT: Dongtan offers a sustainable housing solution for big cities

industrial growth eventually start to put the brakes on further wealth creation, as natural resources become polluted and unusable. Located on an island in the Yangtze Delta close to the financial powerhouse of Shanghai, Dongtan was supposed to be part of the country's solution, a blueprint that other developing Asian nations can copy, though the city remains unbuilt at the present time.

Arup's brief for the new city left little room for compromise. In addition to the inherent challenge of building a large settlement on a low-lying marsh, all Dongtan's power needed to come from local renewable energy sources and the delicate ecology of the island, home to the rare black-faced spoonbill bird, could not be harmed.

Settling on the right population density was key to Gutierrez's master plan. He wanted to avoid unsustainable high-rise developments while ensuring there were sufficiently dense population clusters to make local renewable power generation viable and to encourage walking or cycling between home, leisure and work spaces. The result was surprising. Despite limiting buildings to a maximum of eight storeys, 500,000 people could be fitted into an area originally mooted for just 50,000. Commuters would reduce, on average, travelling time by 20 days a year, but 65% of the land could still be devoted to parks, farmland and the ponds and flood cells needed to cope with changing water levels.

A centrally located power plant burning rice husks, a common agricultural by-product in China, would heat and cool the entire city, while at the micro level homes would be fitted with energy performance meters, coupled with usage-based price tariffs, to help homeowners reduce their consumption. What is proposed is a totally integrated urban ecosystem with its own environmental rhythms, far removed from a conventional planning blueprint.

> *"People laugh at me when I talk about cities being carbon neutral in 40 years, but we have seen changes of this magnitude before"*

Dongtan looks like an impressive model for the future, however the biggest challenge is retrofitting the existing cities that account for the majority of built stock, says Gutierrez. "It should, for example, be the norm for energy service companies to export energy from new developments into surrounding districts." Economics will also force change – not necessarily by changing the physical structure of cities, but by altering how we use it.

"It will be based on a different paradigm," says Gutierrez. "Cheap oil has generated this way we move around cities, but it is now becoming depleted. I don't think commuting from any distance will make sense. Instead of everybody travelling to work in the same place, more people will work from home and firms will have smaller offices in different locations.

"People laugh at me when I talk about cities being carbon neutral within 40 years, but we have seen changes of this magnitude before. Who would have believed in 1770 that in just 40 years the amount of cloth produced by 200 workers would be made by one machine? It can happen." Some of the changes needed to make it happen will not only affect the houses and cities we live in, but also our lifestyles. "We may not have any freedom if we keep all the freedoms we have today."

It's a tough message, admits Gutierrez, but if we change the way in which we consume, travel and procure energy and food, in 50 years' time we may be leading much healthier lifestyles than today.

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Insight into global wealth