LUXURY REAL ESTATE

as the world's new currency

by Jonathan Miller

Since the beginning of the global credit crunch in 2008, luxury real estate has morphed into a new world currency that provides investors with both a tangible asset and a cachet that cannot be found within the financial markets. It's as if these emboldened investors zoomed out of their local Google Earth view to discover the wider global perspective on luxury real estate.

HOW DID WE GET HERE? The US dollar has weakened in the years following the collapse of Lehman Brothers in the onset of the global credit crisis. The S&P downgrade of US debt in August 2011 from its benchmark AAA rating brought a flood of investors into US financial securities. That meant that our currency allowed us to buy less abroad, and the strength of other currencies provided international buyers with large discounts when purchasing property in US dollars. But it went further than that.

THE RISE OF LUXURY REAL ESTATE AS A "SAFE HAVEN" The volatility of global financial markets and the resulting political fallout shook investor confidence, which in turn spurred a rise in foreign buyers seeking a safe haven to protect their assets. A wave of international buyers from Europe, South America and Asia entered the US housing market, helping set record prices and revive luxury markets including New York, The Hamptons and Miami.

SUPPLY-DRIVEN DEMAND The luxury real estate market has become defined by the supply of available properties. While demand has remained constant and elevated, inventory has become a critical variable, particularly at the very top of the market, where surging international demand for one-of-a-kind properties has surpassed the limited supply. The resultant record-breaking sales of "trophy" properties have enticed more owners of luxury homes to make them available for sale.

THE RISE OF THE "TROPHY PROPERTY" The trophy property has become a new market category that does not follow the rules and dynamics of the overall marketplace. One stratospheric price record is being set after another, and it is not only the list prices that are defining these record sales; the rarity of location, expanse of the views, quality of amenities and the sheer size of these unique homes have all played an important part in attracting the interest of foreign buyers.

WHERE DO WE GO FROM HERE? Driven by the global credit crunch and political instability, the two factors that are expected to remain unchanged for the next several years, the US luxury housing market is expected to remain a "safe haven" for foreign investors for quite some time.

A CONVERSATION ABOUT THE COMMERCE OF GLOBAL LUXURY REAL ESTATE

I sat down with Dottie Herman *and our friends across the pond,* Patrick Dring, *Head of International Residential and* Liam Bailey, *Head of Residential Research at Knight Frank, to chat about the state of real estate in the prime markets across the globe and the rise of a foreign investment phenomenon.*

JONATHAN MILLER: Douglas Elliman has a broad coverage area that includes some of the most affluent housing markets in the US. Are you seeing any short-term issues that may influence luxury investor decisions over the coming year?

DOTTIE HERMAN: At the end of this year, we may see a repeat of the consumer behavior we saw at the end of 2010 when US capital gains tax rates were expected to rise. Ultimately, the rates did not increase, but many consumers in the luxury market took preventative action before the potential tax increase and raced to close their sales by the end of 2010. Despite the ups and downs in the quarters that followed, the luxury housing market was not adversely impacted in the long-term.

JM: Paddy, according to Knight Frank's *Global Briefing* blog, housing prices in central London are up sharply, but the pace of growth appears to be slowing, perhaps because of the new stamp duty (a tax on properties priced at £2M–the equivalent of $3.15M–or more). What does this mean for the luxury market?

PADDY DRING: In short, the £5M ($7.85M) market is up year-on-year. The new stamp duty on property sales above £2M seems to be having an impact only on the band just above the new £2M threshold. Foreign demand remains high and, notably, we have sold to over 62 different nationalities within the last 12 months. They are less affected by the changes in stamp duty, since the rates in London are still in line with many other European countries.

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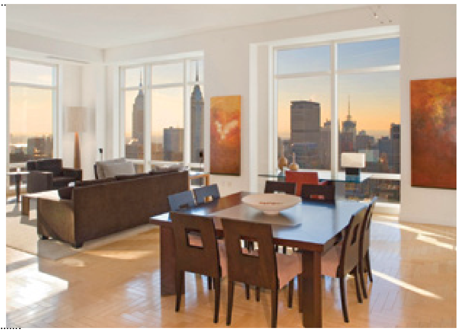

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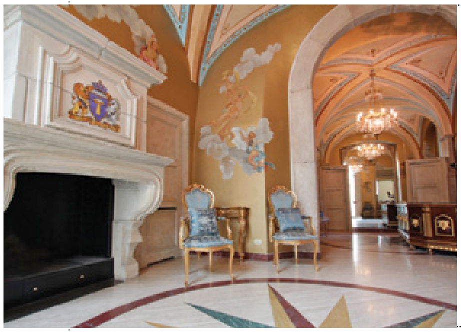

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JM: Dottie, your firm has sold a large number of luxury properties this year, despite a lukewarm economy and tight credit conditions. Record sales and listing prices are becoming nearly commonplace and a significant portion of this demand for luxury real estate is coming from abroad. Do you see this developing into a long-term trend?

DH: It's certainly been a year of records and I do think we are embarking on a period where luxury real estate has the potential to outperform the rest of the housing market. Several of the markets that we cover, Manhattan and Miami in particular, have been firmly established as highly sought-after international destinations. As much as we fret about how slowly our economy is recovering, the US has proven itself as a "safe haven" for many international investors who are concerned about the turmoil of the world economy and political stability. Luxury investors from much of Europe, Russia, Asia and South America have been buying here at the highest pace we have seen since the credit crunch began.

JM: Liam, the US is seeing a higher-than-normal influx of real estate demand from foreign investors who seem to be focusing on the upper end of the housing market. These investors are well represented from Europe, Asia and South America. Are you seeing the same phenomenon when it comes to luxury properties in the UK? What are the primary regions where this demand is coming from?

LIAM BAILEY: The focus of demand continues on London and its easily accessible suburbs. London is facing even higher global demand than New York, with the top end strongly led by Russia, Europe, Canada, and the Middle East, and demand in the new development investment market very much led by Asia.

JM: In the US, access to financing is a key challenge to domestic purchasers, including luxury investors. What are some of the key challenges facing your clients who are looking to purchase real estate outside of their own countries?

PD & LB: Financing remains a consideration for many, although mortgages are more available in many of the markets than people are led to believe. Of course, the property needs to be quality and in a core location and have a more conservative loan-to-value ratio, however, many of our clients purchase in cash, so they are more affected by market sentiment and, of course, liquidity if they need to sell unexpectedly in the future. Factors affecting market sentiment include the usual considerations, such as exchange rate, a stable political base, as well as a sound legal system that guarantees clarity of title and tax considerations. The latter of course is affecting not only the cost of acquisition (stamp duty), but also, in some countries, the cost of holding (wealth tax) and ultimately selling (capital gains tax). Access, infrastructure, and climate (if lifestyle-driven) all remain key, as do low crime rates as people become more aware of their privacy and personal safety.

> *…the US has proven itself a "safe haven" for many international investors who are concerned about the turmoil of the world economy.*
>
> ~ DOTTIE HERMAN

JM: Since the beginning of the credit crunch, you've constantly stressed to your clients that the terms of a sale are just as important as the price of a sale, given the challenges of obtaining financing. How do international buyers fit into this new world defined by tough lending standards?

DH: Despite mortgage lending in the US remaining tight, luxury markets in the areas we cover have improved quickly. I can only imagine how much stronger the US housing market would be if we saw credit ease to historically normal levels. International buyers tend to pay cash or obtain financing from their native countries, which has given them an advantage over many domestic purchasers. Combine the ability to pay in cash with both the weakness of the US dollar against many of their native currencies and a volatile global economy, and you can begin to understand why we are seeing a strong presence of international buyers in our markets. Like our friends at Knight Frank, these luxury investors are interested in our proven core markets that already have a large concentration of luxury properties. Overall, we continue to be excited about our market's expanding presence in the global luxury housing market—there are many opportunities out there for this new international investor to explore. ■