

# Luxury Roundtable

WORLD'S LEADING NETWORK FOR LUXURY PROFESSIONALS, MARKETERS AND WEALTH MANAGERS

Business at its best

WEALTH MANAGEMENT

## Bank returns now compete with yields on prime residential assets: report

November 7, 2023



*London is second only to New York when comparing size of retail market, international visitor appeal, affluence and growth potential. Image credit: Shutterstock*

By STAFF REPORTS

Higher inflation and interest rates have rewritten the rules for property investors in key markets worldwide.

With cash in the bank able to compete with yields on prime residential assets, a new approach is required to assess market opportunities, argues Knight Frank partner and global head of research Liam Bailey in his November edition of the company's Wealth Report.

Mr. Bailey looked to the past to assess the current market situation.

In early February 2004, the world woke up to a new threat: stolen manhole covers.

Thefts were first reported in Taiwan, then Mongolia, before hundreds of thousands of the steel discs went missing across Asia, Europe and America, he recounts in his report.

The thefts were dubbed the 'Great Drain Robbery,' and marked the moment that China became a leading force in the world economy.

China's insatiable demand for raw materials had driven the price of scrap metal to new records, hence those dangerous holes in the road, Mr. Bailey points out.

The Chinese government responded by rapidly increasing industrial capacity. New factories and workers flooded markets to such a degree that the price of goods collapsed, inflation hit new lows and interest rates followed a 20-year decline, per Mr. Bailey.

"Add in two waves of central bank activism the first to defend the global economy after the Global Financial Crisis and the second to provide support through the pandemic and we arrive at December 2021, when the Bank of England became the first major central bank to raise interest rates, ending an era of ultra-low borrowing costs that had fueled house price growth of nearly 100 per cent from the moment the first manhole cover disappeared," Mr. Bailey said.

New rules

Disruption to the world's supply chains after the pandemic, the Ukraine crisis, the green transition<sup>1</sup> and the Western world's pivot away from China mean we are facing an enduring unravelling of positive supply conditions, Mr. Bailey said in his report.

While inflation will edge down from recent highs, and interest rates will follow, they are unlikely to fall back to near-zero again.

This is a monumental change, Mr. Bailey said.

"Just 18 months ago, an investor could borrow at a little more than 1 percent to buy a property and receive a return of 3 or 4 percent," he said. "Now, cash sitting in the bank or invested in government bonds is paying comparable returns."

Indeed, real estate suddenly requires a much more thoughtful approach.

Australia, New Zealand and Sweden have already seen residential prices fall at least 15 per cent and the correction has some way to run in other markets, per Knight Frank.

"Growth will eventually return, and when it does it will be fueled by fundamentals rather than cheap finance," Mr. Bailey said.

"Wage growth and wealth creation will be the ultimate determinants of residential values, while economic growth will be the primary driver of commercial property markets," he said.

#### Prime house prices

For now, prime housing markets are proving resilient despite higher interest rates, Mr. Bailey said in his update.

Many markets were given a shot in the arm by signs that the Federal Reserve, Bank of England and the European Central Bank may be at or approaching the end of their tightening cycles.

Average annual prices rose 2.1 percent during the year to September across the 46 markets covered by the Knight Frank [Prime Global Cities Index](#), which is the strongest rate of growth since the third-quarter 2022.

"The revival in demand is fragile and could be pushed off course if inflation surprises on the upside," Mr. Bailey said.

The U.S. Federal Reserve in particular faces an economy still growing at a rate of almost 5 percent with only a few tentative signs of cooling.

In choosing to hold the Federal Funds Rate in a target range of 5.25 percent to 5.5 percent last week, Fed chair Jerome Powell cited higher long-term borrowing costs as a potential substitute for further hikes, Mr. Bailey pointed out.

Treasury yields promptly fell on what investors interpreted as a more dovish outlook compounded by a dovish [jobs report](#) the following day which to some extent neutralized Mr. Powell's logic for holding in the first place, Mr. Bailey added.

Whatever happens to inflation in the coming months, he expects a more sustained upswing in demand and prime home values will only be achieved once interest rates begin to move lower which is unlikely to take place before mid-2024.

#### Ski markets

Home values in many markets are being flattered by tight supply, according to Knight Frank research.

Ski markets, in particular, enjoyed a mini boom during the pandemic that left the shelves bare.

Knight Frank's [Ski Property Report](#), out Nov. 6, revealed that listings across three key French resorts are down 56 percent, on average, compared to before the pandemic.

Of course, this is not just a story of supply.

"The appeal of mountain living, the opportunity to reconnect with nature and to prioritize health and wellness made even more achievable by a new era of agile working has been a boon for the Alps," Mr. Bailey said.

"The high proportion of cash buyers in the world's top ski resorts also means the higher interest rate environment has had little impact on their appetite for a ski home," he said.

The price of a luxury ski chalet increased by 4.4 percent, on average, in the 12 months to June 2023, according to our latest index.

"Discount the pandemic years, and it represents the strongest rate of growth since 2014," Mr. Bailey said.

Swiss resorts lead the rankings for the second year running with three German-speaking resorts Klosters (16 percent), Davos (13 percent) and one of this year's new additions, Andermatt (9 percent), occupying the top spots, per Knight Frank.

A severe lack of stock and infrastructure improvements in each resort are pushing prices higher.

Chamonix (7 percent) retains its title as the top-performing resort in the French Alps a true year-round resort whose population swells from 10,000 to 130,000 during peak season.

#### Gateway markets

Meanwhile, current global market conditions will support some markets and property types more than others.

As Knight Frank noted in *The Wealth Report* in April, economic growth will prompt a 28.5 per cent expansion in the population of ultra-high-net-worth individuals (UHNWIs) between 2022 and 2027, leading to more than 745,000 people with a net worth of at least \$30 million.

"We know from experience that these individuals will favor key gateway markets for second homes and investments think Miami and London, as well as top-tier resort markets such as the Alps and Cote d'Azur," Mr. Bailey said.

Meanwhile, the pandemic has cast a long shadow over global housing supply that will continue fueling demand for rental homes.

Construction workforces were locked down and supply chains fell apart during the crisis, guaranteeing years of below-trend housing delivery, per Mr. Bailey.

Housing pressures have become a full-blown crisis in many key markets, and rents have risen by nearly 50 per cent in the past three years in cities such as Singapore, New York and London.

"Investors able to position themselves to fund badly needed housing via build-to-rent vehicles will be among the big winners of the next cycle," Mr. Bailey said.

The world's commercial property markets also face challenges as values adjust to higher rates. But there is a constant in every major market, according to Knight Frank: the lack of the type of stock that occupiers want.

"You might think that the work-from-home trend would mean demand for offices is waning, but try finding a high-quality vacant building in the best parts of London's West End or central Paris," Mr. Bailey said.

"The need for best-in-class buildings has created an extraordinary opportunity for investors skilled enough to deliver properties that meet the needs of green-minded corporates who want to facilitate networking and nurture their young employees," he said.

Ironically, Mr. Bailey's November update came the same day that co-working real estate company WeWork filed for bankruptcy in the United States.

#### New era

There will be many more opportunities than those outlined by Mr. Bailey in his update rural landowners able to position estates for a future of offsetting and biodiversity net gain stand on the cusp of a bright future, for example.

"In fact, the sheer number of property markets at turning points provide clues about the significance of the moment," Mr. Bailey said.

"It is often the benefit of hindsight that confirms when a new investment era began, as with those manhole covers in Taiwan," he said.

"While it might seem like the pandemic and the subsequent snarl up of supply chains washed over the world before easing, with time we'll see they were really the early signs of an era that is only just beginning."

[Please click or tap here to download Knight Frank's The Wealth Report](#)

---

## MOST READ

1. [Headlines: Boucheron, Ferragamo, China's Singles' Day, Chanel and Dior](#)
2. [Boucheron buys Parisian workshop to bolster high jewelry production](#)
3. [Will Kering's plan to restore Gucci to past glory work?](#)
4. [How luxury retailers can retain their edge as mass-market rivals embrace advanced tech](#)
5. [Nov. 21 Webinar: How Luxury Has Been Redefined for Consumers, Professionals and Brands](#)
6. [Report: Global secondhand luxury sales to reach \\$58B in 2028 with Gen Z sustainability no longer a barrier](#)
7. [Headlines: Jean Arnault, Gen Z, Middle East tourism, US shoppers, Louis Vuitton Hotel](#)
8. [Coming up next in November for Luxury Roundtable members](#)
9. [Neiman Marcus unveils Christmas Book catalog known for over-the-top gifts, experience](#)
10. [Nov. 14 Podcast: How Hermès Creates Desire and Demand Against the Odds](#)