Our Mid-Decade Outlook:

Are We Still Chasing The New Normal?

By Camilla McLaughlin

UNIQUE HOMES REPORTS:
What is the High End?
The first in a six-part series dissecting the who, what, why, where and how of luxury in 2015.

We may be still chasing the elusive "new normal," but our perspective has changed radically since the beginning of the decade.

"We haven't had a normal real estate market in close to 15 years. This year in particular will be a transitional year," observes Budge Huskey, president and CEO of Coldwell Banker Real Estate. "Luxury will still outperform the overall market. I think everyone continues to be bullish on luxury real estate, but I don't think anyone should expect to see the same percentage increases in luxury activity that we have witnessed over the last couple of years."

Look back over the last five years and it's pretty clear forecasts of a long, slow recovery "bumping along the bottom" were accurate. Even though the recession had officially been declared over, signs of the long-awaited recovery in 2010 were few and far between. Many locations were just hitting bottom. The number of foreclosures seemed incalculable. Some observers even ventured that it might take decades for the hardest hit places, Florida and Miami in particular, to recoup. In the past, housing had led the economy out of recession, but it was clear that real estate was only one component in what would be a complex recovery tied as much to jobs and economic growth as to housing.

For much of the decade it has been a tale of two markets. First, luxury lagged behind real estate overall in the wake of the boost from the stimulus, and then the markets flipped with upscale activity outpacing real estate overall. "The luxury residential segment has been driving the real estate recovery for several years, thanks to increasing numbers of wealthy at all wealth levels from high-net-worth individuals to billionaires," says Laurie Moore-Moore, founder and CEO of the Institute for Luxury Home Marketing. "In addition, attitudes about residential real estate as a portfolio play, as well as a lifestyle purchase, have helped to bolster luxury home demand. Today, the number of wealthy individuals in the world is at an all-time high, and real estate represents a substantial portion of their investments."

"The wealthy have come out of the recession stronger than ever, with more assets," says Paul Boomsma, president of Luxury Portfolio International and COO of LeadingRE.

"It's been very much a two-stage recovery with disparate outcomes depending on your position. Those with real estate and equities have seen on average a 40-percent gain in value in those assets over the last 30 months," says Huskey. →

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"Luxury consumers have largely rebounded from the recession, but, as Bernard Arnault has said, 'Nothing will be the same again.' We have a new normal."

— Pamela Temple, director of Keller Williams' luxury homes division, referencing Bernard Arnault, chairman and CEO of LVMH Moët Hennessy - Louis Vuitton.

At press time, the highest-priced listing in the U.S. is a $195 million estate in Beverly Hills. Luxury continues to outpace the market with deals on homes priced above $1 million rising 16 percent in October. Also falling into place in 2014 is the last component of the luxury recovery, the resort market. In the first 10 months of 2014, transactions for upscale properties in Telluride rose 31 percent, which broker George Harvey believes is the biggest 10-month surge in decades. Today, like luxury overall, the biggest problem in many resort locales is lack of inventory.

Echoing a number of the experts, Earl Lee — CEO for HSF Affiliates LLC, which operates the real estate brokerage networks of Prudential Real Estate, Real Living Real Estate and Berkshire Hathaway HomeServices — says that in 2010 he never would have foreseen such a strong recovery for luxury. But in retrospect, he says, the strength of the stock market certainly provided those individuals with cash, but "there are few investment options. Other than the stock market, the other alternative is hard assets, and real estate tends to be one of those assets."

"The ultra-high-net-worth [those with at least $30 million in investable assets] globally have invested one in five of their investment dollars in real estate. Bricks and mortar have become an asset class competitive with stocks and bonds," says Moore-Moore.

"I think we expected the recovery for luxury to be this strong. We knew there was pent-up demand and even more than pent-up demand, there was an incredible amount of cash. The amount of cash is the highest level ever," says Boomsma.

But when we rang in the new decade in 2010, luxury consumers still had buying on pause. "In the depths of the recession it appeared insensitive to go out and spend money," says Huskey. On the other hand, interest rates at a level comparable to 1952 (thanks to the Federal Reserve's aggressive quantitative easing) and prices at historic lows presented investors with a compelling opportunity. "The smart money knows it's time to buy," Alex Perriello, CEO of the Realogy Franchise Group, said at the National Association of Realtors' (NAR) conference in 2010.

By 2012 "gaining momentum" replaced "bumping along the bottom" and newly confident consumers began to view real estate favorably. "I was very worried that luxury was going to be out of favor, but it didn't last long, because real estate has stood the test of time in terms of price appreciation and price preservation. I think that's why people got back into it," observes Philip White, CEO of Sotheby's International Realty.

Most importantly, 2012 marked the first widespread increase in home prices since 2006. By year's end, inventories of $1 million-plus homes in cities such as Atlanta were down to less than a month's supply. The ultra high end began to move as well, with record-breaking sales. By 2013, with 28 months of improvement in sales nationally and more than 11 consecutive, month-over-month, double-digit price increases (an 18-percent gain in two years), it was clear the recovery was full on.

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— Sherry Chris, president and CEO of Better Homes and Gardens Real Estate.

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"As the economic recovery started to take shape, we saw a point in time when the affluent thought it was appropriate to spend again. We not only saw it in real estate, but across all luxury products, consumer goods, anything tied to luxury. And this wasn't necessarily fueled by additional wealth, but by wealth parked on the sidelines until such time they felt it was appropriate to buy again," recalls Huskey.

"As consumer confidence has increased, so have the number of transactions and the prices they want to pay," says Seattle Realtor John Brian Losh, who is also the publisher of LuxuryRealEstate.com.

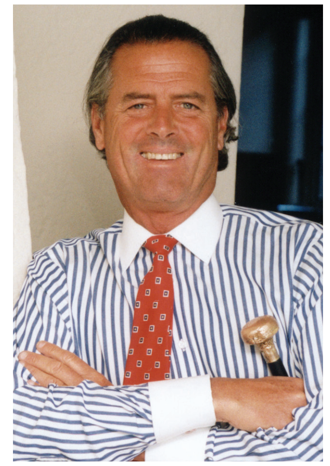
Today, on the cusp of the mid-decade benchmark, some degree of uncertainty once again dogs housing. Sales in 2014 softened a bit. Inventories began to build, which overall is a positive because bare bones inventories in many markets left buyers with few choices. Lending constraints put a damper on activity for both builders and consumers. "We are in the early stages of a long-term recovery," says Sherry Chris, president and CEO of Better Homes and Gardens Real Estate. "And if you look at anything long term, there will be little bumps along the way."

"Strict lending has been the biggest challenge, and many areas have not yet returned to pre-crisis valuations, despite prices rising for three straight years on a national level. After a rapid increase in sales and prices in 2013, the market began settling into a more sustainable growth pattern in 2014. NAR is predicting that 2014 home sales will be close to what we saw in 2013, and then jump 7.7 percent in 2015. They are hoping for general economic improvement, a return of first-time buyers, and pent-up demand from overall population growth combining to fuel a robust housing market," explains Shaun White, director of marketing for RE/MAX.

"We're cautiously optimistic about 2015. While local conditions vary, overall trends are promising: We're seeing more inventory, price increases are stabilizing and mortgage rates remain historically attractive," explains Pamela Temple, director of Keller Williams' luxury homes division.

Projections from Anand Nallathambi, CEO of CoreLogic, put home prices in over half the country by mid-2015 at or above levels last seen at the height of the housing bubble.

Although lending is expected to ease up a bit in 2015, and inventories improve as homebuilders amp up production, the economy and jobs remain the essential catalysts. "The U.S. economy is finally off and running with the number of jobs continuing to grow and wages starting to rise, which will also bolster the prospects for a housing recovery," says Mark Zandi, chief economist at Moody's Analytics.



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— John Brian Losh of LuxuryRealEstate.com

Jonathan Smoke, Realtor.com chief economist, expects both GDP and jobs in 2015 to outperform 2014, which saw the best GDP since 2005, and the best job creation since 1999. He pins his outlook on younger buyers who, he says, "empowered by improvement in employment, will return to the market and fuel the continued housing recovery. If access to credit improves, we could see substantially larger numbers of younger buyers." Smoke calls for an 8-plus percent increase in sales and a 4.5-percent to 5-percent gain in prices in 2015. Estimates from other housing economists for price gains range from Zillow's 2.4 percent to 4 percent from NAR's Chief Economist Lawrence Yun to 4.9 percent from Fannie Mae.

Already Millennials are becoming influential — even in luxury, in some locations — which, as the decade winds down, will influence the kinds of homes produced, popular locations and energy efficiency. "The thing about real estate — especially luxury real estate — the buyers are getting younger, and they are getting older," says Losh, referring to the two dominant demographics.

For luxury, Huskey says, "We should continue to see activity, albeit strong activity, but in a more normalized path as price increases begin to trim, and supply and demand stabilize. This is moving us back to a more sustainable market."

One of the biggest changes in this decade has been a surge in foreign buying. In spite of slowing demand at year's end, most experts say it will be an ongoing trend for luxury. Many anticipate the number of buyers from outside the U.S. to remain steady or increase as we go through the decade. "I have seen first-hand the ebb and flow of foreign investment in luxury properties, usually fueled by economic and political realities in countries like China, Russia, Ukraine and Venezuela," says Bob Hurwitz, president and founder of the Hurwitz-James Company in Beverly Hills. "For the foreseeable future, I expect an ever-growing demand from foreign investors. At this moment, I have six properties under contract and set to close, ranging from $2 million to $30 million with Russian and Chinese buyers alone, and that is only the tip of the iceberg. Wealthy foreign citizens will find the U.S. both a safe haven for investment, and with trophy properties in abundance."

Moore-Moore expects the recent drop in oil prices to have a varying impact. Oil exporting countries, like Russia and Venezuela, will suffer negative economic consequences, but in the short term we might see a flight to international real estate as a financial hedge on the part of wealthy residents.

Boomsma believes one of the biggest changes since the rebound is a new global attitude among the wealthy. "Global has become a reality that people now accept. Before it was something they heard about and there was a certain caché attached to being global. Now people are comfortable traveling and living in a very global society. Now a lot of people are saying, 'I am not just hearing about it, I am experiencing it. It's a reality.'"

In a recent Wealth Insights, Barclays heralded the emergence of what it dubs the global citizen, and Boomsma also sees a growing commonality among the affluent worldwide. "I think the affluent of the world are becoming more aligned. Those who have the means to travel live in a very global sphere. Even though they come from different cultures and countries, they have some of the same values when it comes to products, services and experience."

In the depths of the downturn, "the new normal" became a catch phrase. Today the phrase isn't heard very often, and although the recovery is here, we are still sorting out what normal means.

"Because of the dramatic market shifts we've experienced over the past five years, consumers remain cautious. They're saving more, delaying instant gratification, and making sure they're well informed before making major purchase decisions," says Temple.

Boomsma explains that for the wealthy today, work-life balance is most important. In addition to work, they are passionate about having quality time, meaningful relationships and quality experiences. "So," he says, "if they are doing things in the U.S. or in Asia, they are going to have a home there. Certain global destinations have become incredibly international because it's part of being time-compressed."

Things may be getting back to normal, but there is no guarantee it will stay that way. "Inventory is down and everything else is up, and it can change in an instant," shares Losh. UH