FALL/WINTER 2013-2014

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JONATHAN MILLER *is President and CEO of Miller Samuel, Inc., a New York City metro area real estate appraisal firm he co-founded in 1986. His mission is to provide better real estate market transparency; and his credits include preparation of* The Douglas Elliman Report *series.*

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EVAN JOSEPH *has been photographing Elliman's highest profile properties for almost 10 years. When he's not on the ground shooting luxury listings, he can be found dangling from a helicopter, camera in hand. Prints from his book of New York City aerial photography have been recently auctioned at* Christie's.

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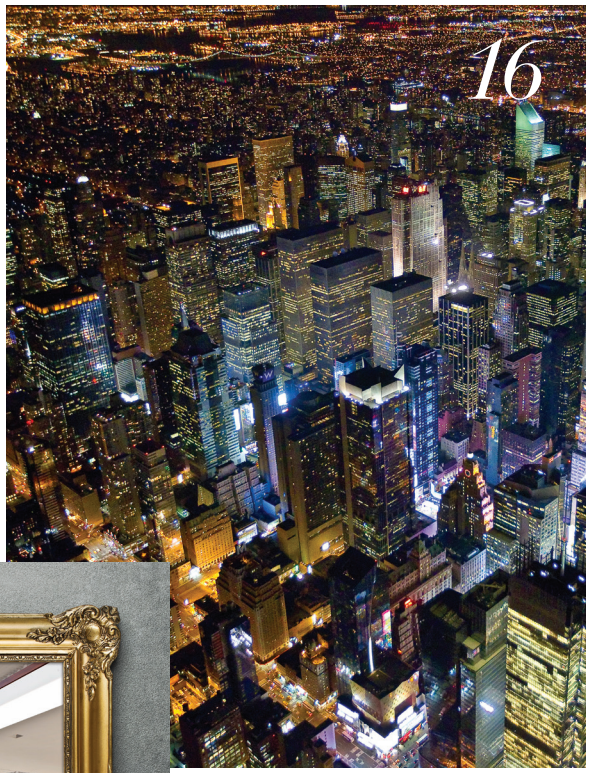

28

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LUXURY REAL ESTATE:

IN PURSUIT OF A COLLECTIBLE

Seeking Upside in a Low Return World

by JONATHAN MILLER

Since the global credit crunch began five years ago, interest rates have remained near historic lows as central banks around the world have been working to stimulate a broad economic recovery. International and domestic investors have grappled with anemic returns on cash instruments, tight credit policy, and the continued volatility of global financial markets. With limited options, these investors have looked to a variety of hard assets to provide more reasonable returns. Although the world's financial institutions continue to be risk-averse, the luxury investor populace and related wealth management institutions have sought out new opportunities, including real estate as an investment strategy in the "search for upside in a low return world." A key beneficiary of this trend has been the growth of luxury real estate.

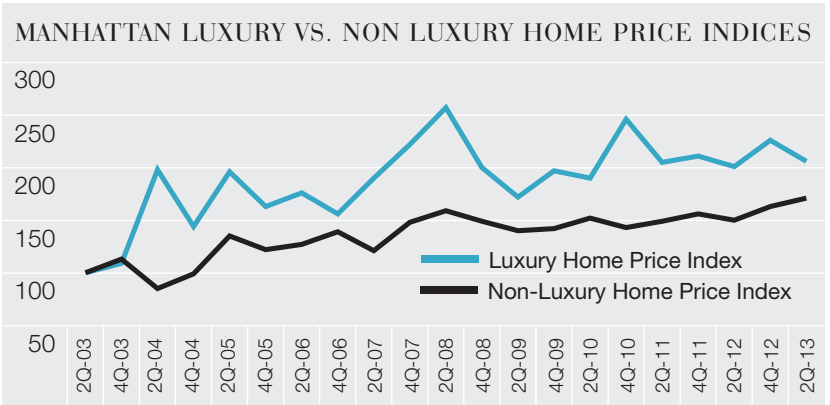
But the drive for higher returns has extended beyond the world of real estate–other tangible luxury assets within the investment space have steadily gained favor in recent years. Taking note of the trend, international real estate company Knight Frank modified their annual comprehensive Wealth Report to include a Luxury Investment Index that they developed, tracking antique furniture, watches, Chinese ceramics, jewelry, wine, art, coins, stamps and classic cars. Over the past decade, the index has climbed 174%, led by the classic car category, which increased by 430%.

Knight Frank advises that: "collectable assets can be a useful – and enjoyable – way to spread portfolio risk, especially when more mainstream asset classes such as equities are under pressure."

Over the past several years, real estate has become a global asset class, evidenced by developers' new focus on residential luxury condominiums targeted at high net-worth individuals. Demand for the luxury real estate market was "first out of the box" in the early stages of the recent housing rebound seen in major cities across the world. Not only were many investors seeking high-end real estate, but specifically properties with the unique characteristics and high standards of quality that have set new record prices and defined new market categories.

A key element of this new found interest in luxury real estate is the long-term view of the asset class. This is a significant departure from the widely held views of the past decade where real estate was viewed in the short-term, similar to stock transactions. But now, the "buy and hold" investment strategy has fueled new luxury real estate development across many global markets, even inspiring the phrase "building of bank safety deposit boxes in the sky." These investors are acquiring properties with a priority of periodic personal use rather than leasing them to generate cash flow. They are viewing their real estate acquisitions as "collectibles."

The acquisition of luxury real estate is seen as the combination of a long term investment strategy and the emotional satisfaction of acquiring "the best." Like a classic car, fine watch, or piece of art, in order to achieve both a greater financial return and a state of contentment for the owner, a luxury real estate asset needs to be unique. Addressing this need for distinction, we have increasingly seen developers collaborate with "Starchitects" and world-renowned interior designers, parlaying their existing luxury brands to elevate the identity of their buildings.



One may argue that new luxury real estate could be more challenging to create than other luxury assets, as products in this category are defined by the combination of a wide range of factors that vary with each location and property type. The right combination allows such a property not only the ability to command a premium, but also the ability to stand out among its peers over time. In recent years, some luxury real estate sellers have mistakenly attempted to define a property as "luxury" by setting a high price in order to attract interest, when in fact the true determination of value and driving market force is a higher standard of quality.

With money market returns hovering in the low single digits and credit conditions remaining at historically tight levels, cash as a purchase methodology has been de rigueur, enabling this segment to largely side step the global credit crunch. Credit conditions are expected to remain unusually constrained over the next several years.

LUXURY INVESTMENT INDEX 2Q-2013 ASSET PERFORMANCE	10-Years
Classic Cars	430%
Stamps	255%
Coins	225%
Art	183%
Wine	182%
Jewelry	146%
Watches	83%
Chinese Ceramics	83%
Antique furniture	-19%

Source: Knight Frank

The US housing market has been a key beneficiary of this new global trend of investor interest in luxury real estate assets. On a comparative basis, conditions for real estate investment in US cities like New York, Miami, and Washington, DC are perceived by both international and US investors as a "safe haven."

To international investors, this safety is relative. Their perception of the US as having less political uncertainty, regulatory risk, and tax exposure as compared to other countries has led to the growth of luxury housing, specifically evidenced in the Manhattan luxury housing market. Defined as the top 10% of all sales during a period, the luxury real estate market has outperformed the balance of the overall housing market (assuming no use of leverage).

Over the last decade, our Manhattan luxury market index has realized a 105.7% gain, outperforming the 71.4% gain seen in the non-luxury market. If leverage was used over cash, the gains would be significantly higher–had an investor used 50% leverage to acquire luxury property over this period, the gain on their initial investment could have been 211.4% in this scenario; if a luxury property had been acquired using 65% leverage, the gain would have been 387.8% over the decade, and so on.

In the aftermath of the onset of the global credit crunch, investors have been wary of the volatility in the financial markets, but frustrated by low returns on their cash holdings. In the search for greater returns and safety, luxury investors have sought tangible assets defined by their high quality, a trend based on the long-term view of this asset class, of which luxury real estate is a part. Given the weakness of economies across the world and the widespread aversion to risk, favorable conditions for luxury assets appear to be here for the long run. ■