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2018: Global Luxury Real Estate to Feel Tax Impact

From New York to Sydney, major cities will feel effects of federal regulations, stamp duties and tax system overhauls

By Beckie Strum

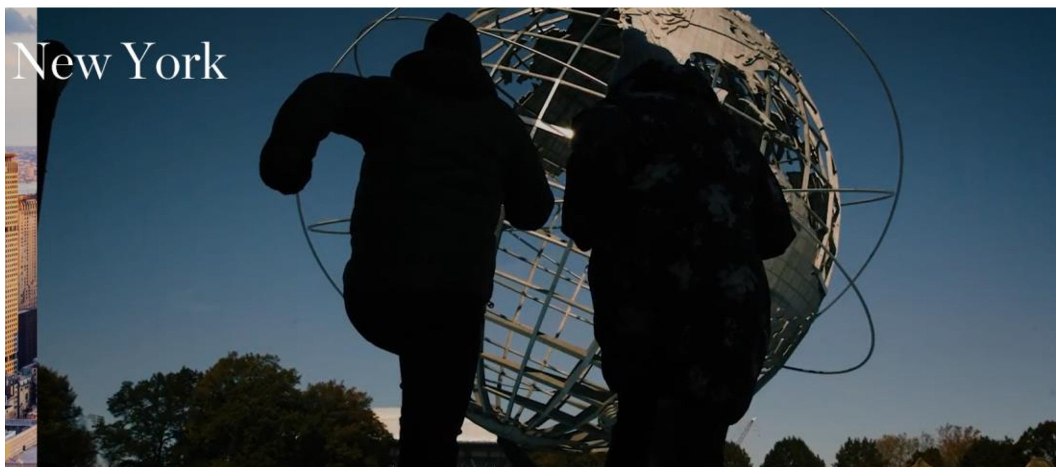
Concerns over tax changes and government regulation will buffet luxury housing markets around the world, as punitive stamp duties in places like London and Sydney and the biggest overhaul to the U.S. tax code in decades play out in 2018.

For foreign investors, second-home buyers and flexible workers, it will be a race to dodge rising taxes. In the U.S., multi-million dollar homeowners will prepare to feel the squeeze as Congress limits tax deductions for property taxes and interest on mortgages. The removal of tax deductions for state and local income tax may cause a minor shuffle as wealthy self-employed workers, empty nesters and others look to ditch high-tax states like New York and Connecticut for homes in places like Florida, where there are no state income taxes, experts say.

Outside of the United States, double-digit stamp duty—or tax on real estate transactions—in places like Sydney and London will continue to cool luxury markets there, particularly among foreign investors and second-home buyers.

Ken Jacobs, a Sydney-based luxury broker with Christie's International Real Estate, said he's already seen several eight-digit deals fall through since stamp duty on foreign buyers doubled in July in Australia.

Meanwhile in the U.K., an 18-month-old hike in stamp duty will continue to dog the British luxury market, where prices are predicted to flatline next year.



The Big Apple saw luxury sales increase over the course of 2017, as sellers chopped down asking prices to attract buyers—a trend likely to continue into 2018.

Those discounts caused luxury sales to increase 7% last year and average sales price to decline by the end of the third quarter, according to the most recent report by appraisal firm Miller Samuel. The city's median sales price was down 6% to $6.42 million in the third quarter, according to the firm, which defines luxury as the top 10% of the market.

Greater sales and bigger discounts look poised to carry into 2018, according to data from Olshan Realty. The firm, which publishes weekly statistics on pending luxury sales, has reported a rebound in activity this fall after a sluggish summer, and price cuts remain a staple feature of the market, particularly at the highest end.

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Trying to grab at the highest possible value for land, developers are pushing forward with ultra-luxury towers despite the slide in prices and the increasing risk of oversupply. A slew of super-prime towers are in the pipeline around Central Park—all catering to an ever smaller billionaire buyer pool.

New buildings include Central Park Tower, at 220 Central Park South, where the average price per square foot is estimated at over $7,000; neighboring 111 West 57th Street with prices pegged at around $5,700 per square foot; and 220 Central Park South, which is selling a quadruplex for $250 million.

"With next year's building boom promising to expand luxury market woes at the very top of the market," StreetEasy Senior Economist Grant Long said, "2018 will mark slow price growth across multimillion-dollar price points and a landscape in which high-end buyers enjoy the upper hand in negotiations."

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Dubai defied expectations that its housing market would bottom out and begin to recover and instead continued to decline in 2017.

Prices sunk another 5.6% in the first nine months of 2017, much better than the double-digit price declines of recent years but a far cry from the turnaround experts expected, said Faisal Durrani of property consultants Cluttons.

"Overall, the market is still in a state of flux," Mr. Durrani said. But it's a "much more gradual ebbing of values than before."

Villas, in particular, had their worst quarter in in two years from July through August, as prices fell 2.8%, according to Cluttons.

Geopolitical events in the region have prevented the emirate from seeing a robust turnaround. Dubai stands out as a bastion of stability compared to its neighbors; a diplomatic crisis unfolded in Qatar, tensions simmer with Iran and Saudi Arabia launched a corruption purge that has led to the arrest of 11 princes.

The iconic Burj Khalifa has seen particularly depressed prices. Condos in the world's tallest building were 71.2% below their last market peak in 10 years ago, according to a Cluttons report released earlier this year. Homes at the luxury golf course Arabian Ranches are down nearly 36% their market peak.

One of the biggest challenges facing Dubai's real estate market is the lopsided pipeline favoring luxury homes over mainstream and affordable housing stock. There are about 80,000 units scheduled for delivery in the next three years, when the city will require more than 105,000 new units. That appears to bode well for housing prices, but a disproportionate number of new developments target the oversupplied luxury sector, while the majority of new residents to the emirate will be lower- and middle-income occupants, Mr. Durrani said.

Cluttons estimates values will decline another 3% to 5% in 2018, with the potential for an end-of-year turnaround.

The prime property market in the British capital has bottomed out and will begin to see prices start to rise again, though the onerous stamp duty will continue to have a dampening effect at the highest end, experts said.

An increase in Stamp Duty in mid-2016 paired with the unexpected vote to pull from the European Union, the fall in the value of sterling and the resulting economic flux dampened activity in one of the world's biggest luxury hubs. The latest data from brokerage Knight Frank shows that prices in prime central London fell 3.6% over the year ending in October and in prime outer London 1.4%.

But by the end of 2018, Knight Frank estimates prices will begin to rise again, albeit by a modest 0.5% in prime central London, and will flatline in the prime neighborhoods of outer London.

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"The sales market in prime central London continues to move towards recovery mode as pricing adjusts to higher transaction costs and political uncertainty," wrote Tom Bill, head of London Residential Research for Knight Frank in the firm's 2018 outlook.

The market for properties worth £5 million (US$6.7 million) or more were hit particularly hard in the wake of stamp duty increases but is now recovering more rapidly—a trend Knight Frank expects to continue.

One of the biggest factors moving forward will be tight supply, as owners are reluctant to market homes during a depressed prime market. The particular dearth of larger homes in prime locations has buyers looking to alternative locations, including Surrey, according to Gary Hersham, managing director and founder of Beauchamp Estates.

The biggest single obstacle to growth in the prime market, however, remains the stamp duty, Mr. Hersham said.

The tax is "hampering people's ability to move home and restricting the natural flow of changes in property ownership," he said. "The transaction costs are making many reconsider their next move, whether moving up or down."

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Los Angeles could offer some interesting—albeit outlier—news at the trophy estate level, where developers are racing to put the first $500 million listing on the market.

A slew of nine-digit listings hit the market in 2017—though whether they will sell for over $100 million is to-be-determined. Most luxury home sellers are coming back down to earth in La La Land, taking their overpriced homes off the market or cutting prices by an average of 8.4%, according to the most recent market report by Miller Samuel, which defines luxury as the top 10% of the market.

Even still, the high-end market in Los Angeles has been one of the strongest in the United States, as places like New York and Miami saw softening at the top.

After some high-end neighborhoods saw double-digit appreciation in 2016, prices in places like Malibu, Santa Monica and West Hollywood have normalized below 10% annual growth, according to Pacific Union economist Selma Hepp and real estate consultant John Burns, who held a conference in the city earlier this month.

Stronger-than-normal price growth, fueled in part by very tight supply in some quarters such as Silicon Beach—an area dense with tech companies around Venice, Mar Vista and Marina del Rey—is expected to continue through next year before tapering off, the Pacific Union economists said at the conference. They estimated Los Angeles prices would climb another 13% by 2020, with the majority of that appreciation in the coming year.

At the lower end of the luxury home spectrum, U.S. tax changes that will limit tax breaks to home loans up to $750,000 could make Los Angeles's already tight housing market even worse as people become reluctant to move or build without the tax incentive, according to the Pacific Union economists. Some of the worst hit neighborhoods may be those in Silicon Beach, where prices are climbing rapidly thanks to constrained supply.

The Bay Area's luxury housing market bounced back in a major way in 2017, following a price correction—particularly among condos—the previous year.

Sales of luxury single-family houses and condos hit new highs and prime prices were up 5.5%, according to Knight Frank Prime Global Cities Index.

With tech stock soaring, next year is looking like more growth, particularly in the first part of the year, said Patrick Carlisle, head of research at Paragon Real Estate Group.

"It looks like 2018 will be a very strong year at least in the initial period," Mr. Carlisle said. "My guess is that the stock market will go crazy over what is being labeled as 'tax reform'."

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Booming tech stocks have recently helped fuel Bay Area wealth. The S&P Information Technology index, which includes Google (Alphabet), Apple and Facebook, is up 40% year-over-year.

"There are a lot of people feeling a lot wealthier," Mr. Carlisle said.

Stellar stock market gains also has renewed IPO chatter among San Francisco-based companies like AirBnB, Uber, Palantir and Pinterest. If any one of those companies were to go public, there would be scores more millionaires in the Bay Area looking for housing, Mr. Carlisle said.

"When someone becomes a millionaire, the first thing they do is look for a new house or condo," he said. The San Francisco luxury market sees only about 600 units trade hands each year, meaning a windfall for a local tech company would have a major effect on the housing market.
Outside of the U.S., Chinese investors have fallen out of the San Francisco market as the government puts more capital constraints on money leaving the country, though that has had a negligible effect on the luxury housing market there

Luxury hunters once headed for Miami are steering north to Fort Lauderdale, where luxury condo development is booming.

Take Hallandale, about halfway between Miami and Fort Lauderdale, where developer Shahab Karmely is building a 64-unit luxury condominium, 2000 Ocean, comprised of half- and full-floor apartments on the beach with prices starting at $2.5 million.

While coastal Miami has seen its luxury prices and sales dip over the past year, Fort Lauderdale's luxury market is moving faster as it draws snowbirds from the Northeast, Canada and Brazil. Fort Lauderdale ranked No. 6 for real estate investment in PricewaterhouseCoopers's 2018 "Emerging Trends in Real Estate" report, the largest upward movement of any city ranked in the report.

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Miami and its submarket, Fort Lauderdale, have risen to the top of PwC's list as primary luxury markets like New York and Los Angeles become prohibitively expensive.

South Florida, which already benefits from buyers fleeing high-tax states like New York, Connecticut and Illinois, is likely to see an uptick in interest thanks to the U.S. tax overhaul, Mr. Karmely said. The law caps a federal deduction for state and local income and property taxes at $10,000, giving people more incentive to look for tax homes in places like Florida or Texas where there is no income tax.

"I'm a believer in Miami, in the continued growth of Miami as a city and as an international hub in the long term," Mr. Karmely said.

The race for buyers in South Florida has developers offering better and more exclusive amenities and lifestyles, said Oscar Rodriguez, principal at ROVR Development. ROVR is in the middle of building a boutique condo development in the lush residential area of Coconut Grove, which will open in summer 2019.

"They don't want to live with 400 other people," said Mr. Rodriguez, adding that Miami's luxury buyers are much more cognizant of the finishes, from kitchen cabinets to amenity spaces than they once were. "It has driven the development industry to produce a much more premium product."

This year, Sydney joined a growing list of global cities imposing greater taxes and regulation on foreign and pied-a-terre buyers in response to rapid price growth—changes that already have had a cooling effect in the luxury market, brokers say.

On Aug. 1, the state government doubled the stamp duty in New South Wales to 8% for foreign buyers, raised the annual land tax to 2% from 0.75% and introduced a so-called "ghost tax" on properties left vacant for six months of the year. In addition, there was already a roughly 5% to 7% tax on homes over $3 million.

The most expensive home to sell this past year was a Point Piper estate that went to a local Aussie buyer, Atlassian founder Scott Farquhar, for A$71 million (US$53.6 million). Had it sold to a foreign buyer, however, he or she would have had to cough up more than A$10 million (US$7.52 million) in stamp duty thanks to the increased stamp duty, said Ken Jacobs, a luxury broker with Christie's International Realty. That's not to mention another A$1.9 million annually in land taxes.

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Tax hikes on foreign buyers and investors—whether in Sydney, Toronto or Hong Kong—have been a quick-fix response by governments responding to homebuyer frustration over a tight and unaffordable housing market. In Sydney, the measures have primarily hit the prestige market, which has seen prices climb more than 11% so far this year, according to Knight Frank's Prime Global Cities Index.

Sydney's once-less-expensive luxury market has been catching up with its peers, logging double-digit annual growth for the past three years. But that heady price run is grounding to a halt under the new regulations. In the third quarter prices grew a paltry 0.7%, according to Knight Frank.

"We're getting back to what we would call a normal market," Mr. Jacobs said, "and that should continue into next year."

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