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Savills World Cities Insight – Autumn 2013

TOKYO AND NEW YORK RESIDENTIAL ASSETS NOW TOP BUYS FOR INVESTORS

- Tokyo named as top world city for investors seeking above-gilts income from residential, ahead of New York. Double digit capital growth is also forecast by 2016
- New York reconfirmed as a 'buy' for investors seeking income and capital growth, forecast to total 30% in 3 years
- Paris ranked 3rd for income, London 4th on world stage
- Some 'new world' cities look overvalued – most notably Moscow and Mumbai, delivering negative 'net of gilt' residential yields

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Residential rental growth in the world's leading cities outperformed office rents in the first half of 2013, making residential real estate look a viable investment asset class, according to international real estate advisor Savills. But, the firm cautions, low-yielding cities, where house prices are not underpinned by rental income, could be overvalued.

The firm has been tipping New York for some time, but the surprise finding of its latest analysis is that Tokyo now also looks like a 'buy' for investors seeking income. Rental yields in Tokyo look extremely attractive in relation to the extremely low returns available on government bonds in Japan and the city tops the Savills world cities investment ranking, ahead of New York. Paris and London are ranked 3rd and 4th respectively.

To understand the true appeal of residential as an asset class in each city, Savills has compared the gross rental income that investors receive in each city 'net of gilts'. This gives a measure of residential yields across its world cities, taking the return on 10 year government bond yields in each country away from gross rental returns. This measures the extent to which real estate income is performing against the local risk environment. Savills findings reveal that some world cities, particularly in the 'new world', and most notably Moscow and Mumbai, look overvalued. By the same measure some 'old world' cities look good value.

New York now offers the strongest gross residential yields, at 6.2 per cent, against US government bonds at 3.4%. Also, rents are rising - up 2.0 per cent in the first half of 2013. By way of contrast, gross yields in Moscow are also high, at 5.8 per cent, but well below the 7.4% available on government bonds making the city's residential assets look expensive – especially in relation to its relatively modest rental growth of 3.3 per cent in the first half of

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2013. New York offers a 3.6 per cent upside, whereas Moscow has a -1.6 per cent downside against gilts.

Savills believes that their 'net of gilt' yields measure sheds light not only on where income investors might put their money but also on how out of synch with underlying occupier demand a city's residential values might be. "Some of the lowest-yielding cities have seen little or no rental growth while capital values have surged", says Yolande Barnes, director of Savills World Research. "If there is insignificant rental growth in future, these capital values may look overheated and this could trigger an adjustment.

"By the same token, if capital values have not moved as fast as rental values, this may indicate some room for capital value uplift. New York has the potential for over 60 per cent capital growth if average yields were to move in to the same extent as London yields have. This assumes that rents stay stable and interest rates don't rise."

Savills believes it is realistic to look for 30 per cent growth in average New York residential capital values during the next three years.

The potential capital value uplift in Tokyo is even greater but Savills says it is unlikely to be realised because it is a more domestic and less internationally invested market than New York and London. Nevertheless, the firm believes that substantial, double digit, growth is possible over the next 3 years in Tokyo too.

World Cities ranked for residential investment	***Savills SEU* Residential Yield (Gross)***	***Savills SEU* Residential Yield (Gross) net of 10 year Government Bond Yield***	***Residential cap value growth H1 2013***	***Residential rental growth H1 2013***
Tokyo	4.7%	**3.9%**	1.2%	0.0%
New York	6.2%	**3.6%**	4.8%	2.0%
Paris	4.9%	**2.7%**	-1.4%	0.5%
London	4.7%	**2.2%**	4.5%	0.5%
Singapore	3.8%	**1.4%**	5.5%	0.1%
Sydney	4.8%	**1.1%**	1.7%	0.8%
Hong Kong	2.8%	**0.5%**	1.9%	1.8%
Shanghai	2.4%	**-1.2%**	2.1%	2.1%

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Moscow	5.8%	**-1.6%**	0.7%	3.3%
Mumbai	3.4%	**-4.2%**	3.1%	-4.3%

Source: Savills World Research

(*) Savills uses a core business unit measure, the Savills Executive Unit (SEU). This is a 7-person strong staff team representative of a start up business, designed to be a comparable measure across all cities. The table shows total costs for 2 teams, one located in a prime financial sector location, the other in a secondary/creative location to give a representative cross city costing.

"We tipped New York as a 'buy' last autumn, and the city's residential real estate continues to appear a sound investment both for income and capital growth potential," says Barnes**.** "Tokyo now looks a surprise but convincing 'buy' for investors, offering a gross yield at +3.9% over government bond rates. By contrast, Mumbai is unlikely to see substantial investor activity in the near term, combining negative rental growth with pitifully low 'net of gilt' yields."

Residential and commercial rents have been growing more modestly than capital values in many cities in the Savills index. "Rental values reflect the fundamentals of occupier demand, while capital values are a good indicator of investor activity," says Barnes. "We now expect the slowdown in many of the emerging and recently-emerged world economies to have a more profound impact on real estate values than legislation and taxation. In fact, we are seeing a re-balancing in the performance of real estate in the old world with the new world as these changes occur."

Prime and secondary office rents remain down -12 per cent and -2 per cent since the second half of 2008, but while the more established 'old world' prime office rents are now +3 per cent over peak, 'new world' rents remain -25 per cent down, raising questions over the fundamentals of demand and supply in locations such as Singapore, Mumbai and Moscow - even in prime commercial.

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NEW YORK RISES UP THE RANKS OF WORLD'S MOST EXPENSIVE CITIES

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New York has displaced London as the world's second most expensive city to rent business and residential space for employees, behind Hong Kong, while Singapore offers businesses locating in the city the best value accommodation in relation to the size of its economy according to international real estate advisor Savills.

In its latest World Cities Review, published today, the firm updated its 'total accommodation cost' measure of the top 10 world cities and found that it has remained broadly stable, falling an average of just -0.05 per cent in the first half of 2013, but having risen in 'old world' cities and fallen in 'new world ones.

This has made emerging and recently emerged markets relatively more competitive again, with Sydney, Shanghai and Mumbai offering the lowest total base business costs, with Mumbai costs around a quarter of Hong Kong. The costs of accommodating core international business units in both prime financial and secondary 'creative' locations along with the associated residential rental requirements of 14 households are taken into account in the 'total costs' measure.

New York has risen from being the fifth most expensive city at the beginning of 2010 to 2nd by June 2013 having seen total costs rise 36 per cent from their end 2009 nadir and a total of 19 per cent over the past five years. London has recovered strongly, totalling 17 per cent since bottoming out in 2009 to sit in 3rd place.

	Total cost ranking June 13	Price growth H1 2013	Total costs* **US$m/per year**	Total costs divided by city GDP per capita	**Value for money (1 = best value)**
Hong Kong	**1**	-1.0%	1.625	33.4	**9**
New York	**2**	1.5%	1.553	24.6	**4**
London	**3**	0.5%	1.533	29.5	**7**
Paris	**4**	0.6%	1.400	26.0	**5**
Tokyo	**5**	0.6%	1.089	26.3	**6**

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Singapore	**6**	-0.4%	1.005	**16.1**	**1**
Moscow	**7**	0.2%	0.947	21.1	**3**
Sydney	**8**	-0.1%	0.878	19.4	**2**
Shanghai	**9**	0.8%	0.613	28.7	**8**
Mumbai	**10**	-7.3%	0.444	74.7	**10**

Savills has created a 'value for money' ranking, measuring accommodation costs against city GDP per head which is taken as an indicator of the income potential for businesses located there.

By this measure, Hong Kong, where total accommodation costs are almost four times those of Mumbai, actually looks three times cheaper than Mumbai, where locating an international business might be viewed with regard to market volume and labour availability rather than premium revenues. This makes real estate in the Indian city look very fully valued, particularly as the BRIC economies are slowing at the present time and rival economies are emerging as sources of low-cost labour.

Singapore, where unadjusted total accommodation costs are high in a new world context, proves to be the cheapest city in relation to its GDP per head. Ranked in this way, Singapore is less than half the cost of Hong Kong and approaching five times cheaper than Mumbai.

"Headline per square foot office rents are a misleading indication of the total real estate costs faced by relocating companies," says Yolande Barnes, director of Savills World Research. "The value of real estate is higher where more corporate revenue can be generated.

"In other words, it is worth paying more to accommodate an executive team in Singapore with its high GDP than in the low GDP Mumbai."
End.

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