Keys to the Penthouse

Why the Rich are Flocking to Prime Urban Real Estate

by

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An honors thesis submitted in partial fulfillment

of the requirements for the degree of

Bachelor of Science

Undergraduate College

Leonard N. Stern School of Business

New York University

May 2013

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Acknowledgements

I would like to thank Professor Charles Murphy for his guidance throughout this process. His insights on HNWIs, global wealth, and current events have been instrumental, and I have thoroughly enjoyed learning about this topic under his mentorship.

I am also thankful to Professor Marti Subrahmanyam and Jessie Rosenzweig for organizing and allowing me to be a part of the Stern Honors Program.

Finally, I thank my family and friends for their support and belief in me.

Executive Summary

High Net-worth Individuals (HNWIs) are extremely aspirational—in relation to themselves and regular individuals. To satiate their desire for individuality, HNWIs purchase scarce, consumable assets, such as luxury homes.

Luxury homes enable HNWIs to (1) live an exclusive lifestyle and (2) possess an asset that has the opportunity to financially appreciate. In the post-Lehman environment, a scarcity of “safe assets” has motivated HNWIs around the world to invest in luxury apartments in major global cities, like New York and London.

As financial asset performance has struggled during this period across the US, the EU, and Asia, HNWIs have felt the need to be in major global jurisdictions to neutralize political uncertainty in developed and developing markets.

This trend uncovers an entrenched competitive advantage in cities like London and New York: global appeal. HNWIs are shunning offshore isolation for locales with economic diversification, commerce, and tourism. HNWIs believe that property in such areas will always be in demand and be aspirational for the wealthy.

HNWIs from emerging markets have been eager to announce their arrival and have hence been core drivers of prime property investment. They have taken advantage of weaker exchange rates and low interest rates in developed markets to acquire property in New York and London. As a result of this sustained demand, prime urban property has proved to be a stable investment since 2007/08.

Moving forward, however, shifting societal attitudes over inequality and the threat of political intervention are the biggest risks HNWIs face.

Introduction

The global investing environment has changed since the Lehman crisis. Global equity markets are more correlated and volatile, and fixed-income struggles to deliver decent returns to investors in developed markets; meanwhile in developing markets, rampant inflation is eating away at many investors' returns. Furthermore, the onset of the Eurozone crisis has worsened returns across many financial assets. Governments have done little to allay fears, and instead, with popular votes on the line, have chosen to target High Net-worth Individuals (HNWIs) for additional revenues.

Thus, global HNWIs face a dilemma: where can they invest with a looming threat of higher taxation and a lack of stable assets able to generate appropriate risk-adjusted returns?

While there is no clear-cut solution to this problem, HNWIs in the post-Lehman era have found one possible solution: prime urban property—especially in cities like London and New York.

The following discussion is divided into two sections: Part I (Background) introduces HNWIs and their attraction to luxury real estate. Part II (Current Events) examines why HNWIs have been flocking to prime urban property since the Lehman Crisis.

Part I: Background

Understanding HNWIs and Personal Investing

In broad terms, an individual's expenses and investments revolve around two categories: living needs (daily requirements and retirement needs) and legacy needs (generational and societal needs). When allocating income into investments, an individual gives his/her daily requirements top priority. Cash leftover after daily needs are taken care of is usually saved for retirement—i.e. future expenses. After these living needs are satisfied, individuals can begin planning for their personal legacies—i.e. for their children and/or for society.

Typically, the poor of society struggle to generate sufficient cash flow to look after their daily expenses and hence rely on government handouts and charities to sustain themselves. Thus, they seldom have cash leftover to plan for the future.

Individuals of the affluent middle class generate sufficient cash flow to ensure they meet their daily requirements and hence plan their investments for retirement—i.e to generate cash flows when they stop working. Thus, their investments focus on generating regular cash flow to meet longer-term liabilities. Often, these individuals will have some cash leftover which they can use to plan for their legacy needs, or most importantly, their children's futures. Nevertheless, the bulk of their investment planning will focus on their individual living needs.

High net worth individuals (HNWIs) are a unique set of individuals that generate sufficient cash flow to cover their daily needs and retirement needs. Their living needs are seldom at risk and, hence, their investment goals often focus on legacy. Stated differently, HNWIs focus on liabilities that can span generations as opposed to a single lifetime. As a result, most HNWIs prioritize capital preservation over long-term horizons as opposed to aggressive short-term risk taking.

The Geography of Wealth

Since 2007, Asia, North America, and the EU hold approximately 90% of the world's HNWIs—i.e. individuals with more than US$1mn in investible assets.[1] While Asia closes the gap with its deca and centa millionaires, the US still holds the most billionaires in the world: 396.[2]

Historically, the US, Canada, and the UK have created the majority of the world's HNWIs due to "plutonomy" economic factors.[3,4] These developed markets have strong intellectual property rights, stable law, and sophisticated financial markets. These markets also promote innovation and capitalism. In particular, innovation in finance and technology—i.e. innovation that builds connections between people, capital, and businesses—has enabled a minority of the population to control and grow disproportionate amounts of wealth.[5]

While innovation and capitalism are prerequisites for wealth creation, inequality becomes an important wealth preserver as it enables the wealthy to concentrate and grow their assets. Thus, global *plutonomies*—or economies in which the wealthiest class of society controls economic growth—will power the rise of future HNWIs. Moving

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1 Capgemini and Merrill Lynch. *World Wealth Report*. Rep. Capgemini and Merrill Lynch, 2012. Web.

2 Carbone, Nick. "Brimming Billfolds: Which Countries Have the Most Billionaires?" Time Magazine. April 17, 2011. Accessed January 2012. http://newsfeed.time.com/2011/04/17/brimming-billfolds-which-countries-have-the-most-billionaires/.

3 Kapur, Ajay, Niall Macleod, and Narendra Singh. *Plutonomy: Buying Luxury, Explaining Global Imbalances*. Rep. N.p.: Citigroup, 2005. Print.

4 Charrington, Peter, and Patrick Ramsay. "The rise and rise of wealth" *The Wealth Report 2007*. Knight Frank and Citi Private Bank, 2007. Web. Nov. 2012. p. 11

5 ^*ibid*

forward, emerging markets like India, China, and Russia will be vital sources of high net-worth growth. As these markets grow over the coming decades, their legal and financial systems will strengthen and enable these societies to create wealth.

Globalization will also aid the creation of wealth of economies in the East. LSE Professor Danny Quah notes this shift in power as he traces the world's economic center of gravity. He finds than in the 1980s, the center lay in the mid-Atlantic, while in 2008 the center moved east of Helsinki and Bucharest. By 2040, Quah projects the economic center of gravity to lie between India and China.[6]

Thus, my analysis of global wealth primarily focuses on HNWIs in the US, EU, and Asia, as these regions have dominated, and are likely to dominate, economic activity.

Luxury Real Estate and Scarcity

As a group, HNWIs are extremely heterogeneous for a variety of reasons: geography and legal jurisdiction, strategic goals, culture…etc. Their risk profiles and investment goals are diverse and, hence, each HNWI requires a tailor-made investment strategy that carefully plans for legacy needs, taxation, risk, and return.

When viewed from a different perspective, however, HNWIs do behave in similar ways. In particular, they are extremely aspirational and exhibit strong desires to remain exclusive and unique—in relation to both, regular individuals and other HNWIs. As a result, HNWIs like to purchase assets that signal their status and differentiate themselves. As a result, HNWIs often consume "investments of passions"—i.e. unique and customizable assets that convey exclusivity: Jets, yachts, cars, art, and, luxury homes.

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6 Quah, Danny. "The Global Economy's Shifting Centre of Gravity." *Global Policy* 2.1 (2011): 3-9. *Wiley Online Library*. Global Policy, 5 Jan. 2011. Web. Feb. 2013.

Residential real estate, in particular, is a common and customizable asset through which HNWIs distinguish themselves. Furthermore, unlike other large capital purchases, luxury real estate—due to its inherent scarcity—has the option to appreciate over time.

Thus, scarcity becomes an important selling point that luxury real estate offers HNWIs. From a qualitative perspective, luxury real estate serves as a "quality of life"/ego factor that demonstrates an HNWI's status, success, and prestige. From a quantitative perspective, scarcity implies that luxury real estate has a unique risk and return profile.

This paper identifies scarcity's role in the "safe-haven" concept that has developed in the aftermath of the Lehman crisis. As financial asset performance has suffered due to financial uncertainty in Europe and the US, HNWIs, from around the world, have invested their capital into property in large global cities—emphasizing London and New York. Moreover, HNWIs from emerging market have taken advantage of temporary weaknesses (i.e. low interest rates, weaker exchange rates) in prime developed markets and have been the core drivers of demand over recent years. As a result, luxury apartments have been relatively stable assets amidst the Lehman and on-going Eurozone crises.

Literature Review and Data Sources

Due to the nature and heterogeneity of HNWIs, data about assets and trends are extremely difficult to find. For privacy reasons, most private banks and wealth managers are unwilling to share data on HNWIs and their behavior. As a result, I have relied heavily on Knight Frank and Citi Private Bank's *The Wealth Report* from 2007-2013 to gauge attitudes and behavioral trends. In these reports, Knight Frank surveys wealth managers to understand trends in the [luxury] real estate asset class and supplements these results with its in-house analysis. Unfortunately, the questions and respondents vary from year to year, which makes longitudinal data difficult to compare. For instance, the reports in 2007 and 2008 focus extensively on HNWIs in the UK, while the 2012 report includes a geographically diverse set of respondents. Moreover, the reports rely heavily on data produced by wealth managers, rather than by HNWIs. Thus, I focus more on the general trends in each report and on the market and behavioral insights Knight Frank and Citi Private Bank provides.

Furthermore, I have used the Economist Intelligence Unit's Global City Competitiveness report to gain insight on the various factors that make cities globally competitive. This report identifies eight competitive factors (subsequently broken down into observable/countable data) to assign each city a competitiveness score and rank. The eight factors this report identifies are: Economic Strength, Physical Capital, Financial Maturity, Institutional Effectiveness, Social and Cultural Character, Human Capital, Environmental and Natural Hazards, and Global Appeal.

I have also referenced NYU Stern Professor David Yermack's 2007 paper on CEO home purchases and future stock performance. Professor Yermack has built a database of home location, size, market value, and proximity to amenities for all CEOs in the S&P500 as of 2004. Although dated, the data provide insights on the relationship between lifestyle and wealth as it illustrates the size of homes S&P500 CEOs own. In particular, Professor Yermack shows the likelihood of a large home purchase is more likely in the year an executive becomes CEO—illustrating individual desire to "announce" status.

Additionally, Barry Ziering and Willard McIntosh's 1999 paper "Property Size and Risk: Why Bigger is not always better" provides insight on the investment proposition of trophy properties. The pair conducted research for Prudential Real Estate Investors and examine larger properties as an asset class. While commercial property prices form the bulk of Ziering and McIntosh's observations, their research does provide insight on large property as an investment. Ziering and McIntosh have analyzed 6,999 properties over an 18-year period from 1981-1999 to conclude that larger properties do behave differently than smaller properties and can diversify a portfolio if harvested appropriately.

Finally, I have relied on the vast array of articles on HNWIs and luxury real estate that can be found through various news and business sources, such as The New York Times, Bloomberg.com, FT Online, and Forbes.com, to gain further insight.

The Lifestyle Factor

Unlike equities and bonds, real estate, especially residential property, is a deeply personal investment decision as individuals can physically use and enjoy the asset—even if the market value falls. Furthermore, Large homes are the most distinguishable assets that demonstrate wealth.

When choosing primary residences, HNWIs give the most preference to the quality of life and accessibility a location provides. In the US for instance, elite suburban locations have better access to schools and leisure amenities, such as golf courses, and hence enable HNWIs to raise a family away from work. Often, such residences are large properties—often 3 bedrooms and more—and are located in neighborhoods that provide easy access to work and also offer social amenities.[7]

For instance, median S&P500 CEOs homes include 11 rooms plus 4.5 bathrooms with a floor area of 5,600 square feet. Furthermore, 12% of S%P500 CEO homes sit on a waterfront and 8.5% of homes are near a golf course.[8] A large proportion (>20%) of CEOs also purchased new primary residences in the years they were appointed CEO, illustrating the home's role in announcing individual status.[9]

British HNWIs also behave similarly and believe travel time to work should not exceed one to one-and-a-half hours. They also prefer a variety of social amenities such as schools and restaurants should be within a fifteen to thirty minute radius of the property—even for rural properties.[10] In Asia and other emerging markets, newly minted HNWIs identify status and prestige with luxury American and European brands and are hence eager to purchase secondary property in major global cities, like New York and London.[11]

In their primary domiciles, HNWIs are likely to show their wealth through large statement purchases in exclusive neighborhoods.

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7 Liu, Crocker, and David Yermack. "Where Are the Shareholders' Mansions? CEOs' Home Purchases, Stock Sales, and Subsequent Company Performance." W.P Carey School of Business, Arizona State University and Stern School of Business, New York University, 2007. *Where Are the Shareholders' Mansions? CEOs' Home Purchases, Stock Sales, and Subsequent Company Performance*. W.P Carey School of Business, Arizona State University and Stern School of Business, New York University. Web. p. 37

8 ^*ibid.* p. 16

9 ^*ibid.* p. 43

10 Knight Frank and Citi Private Bank. "Attitudes Choosing Residences" . *The Wealth Report 2008*. Knight Frank and Citi Private Bank, 2008. Web. Nov. 2012. p.34

11 Lawson, James. "Old Habits Die Hard" Ledbury Research. *The Wealth Report 2012*. Knight Frank and Citi Private Bank, 2012. Web. Nov. 2012. p.34

In an extreme example, Mukesh Ambani, India's richest man and the world's 4th richest man, built a 27-floor personal home over an elevated plot in Mumbai, India.[12] Given that his conglomerate, Reliance Industries, attends to the bulk of its corporate affairs in Mumbai, India's financial hub, Ambani now has the added luxury of hosting (and impressing) dignitaries in his own home. Furthermore, with three helipads, Ambani has a timely alternative to a gridlock commute on Bombay's roads. While the residence might appear as over-the-top for a family of 5, it reinforces (and even augments) the Ambanis' status in a culture that prides one-upmanship. Furthermore, in relation to other HNWIs around the world, Ambani's structure serves as a statement to his grandeur.

Nevertheless, While lifestyle factors do set HNWIs apart from one and other, they seldom invest in such large and illiquid assets without considering financial returns. Large properties are sources of diversification and do offer HNWIs an investment proposition.

The Investment Proposition

In 2011, former Citibank chairman Sandy Weill, sold his 6,744 sq. ft. penthouse at 15 Central Park West for US$88mn to Ekaterina Rybolovleva, daughter of Russian billionaire, Dmitry Rybolovleva.[13] While the apartment was the most expensive residential property to be sold in New York at the time, it netted a 49% profit for Weill, who purchased to property for US$43.7mn in 2007—a then New York City record.[14] While this home reflects Rybolovleva's spending ability and status, it also underscores a

12 Woosley, Matt. "A Peek into Mukesh Ambani's $2 Bn Mumbai Home." Forbes. April 30, 2008. Accessed February 2013. http://www.forbes.com/2008/04/30/home-india-billion-forbeslife-cx_mw_0430realestate.html.

13 Vecsey, Laura. "Russian Billionaire's Daughter Gets $88 Million Penthouse as NY Crash Pad." Weblog post. *Zillow Blog*. Zillow, 21 Dec. 2011. Web. Feb. 2013. <http://www.zillowblog.com/2011-12-21/russian-billionaires-daughter-gets-88-million-penthouse-as-ny-crash-pad/>.

14 ^*ibid*

guiding principle HNWIs consider when purchasing residential property: the investment proposition. Implicit in this record-breaking purchase is the idea that Rybolovleva can emulate Weill and "flip" the penthouse for a much larger and staggering sum.

Although most HNWIs treat their primary and secondary properties as consumable goods, they are well aware of large property's ability to appreciate.

Ziering and McIntosh's 1999 study on property size and risk concludes that large properties, measured by market value, do behave differently than smaller properties.[15] They define "trophy properties" as properties with a valuation of US$100mn and greater and compare the performance of these assets to properties valued below US$100mn. Their analysis includes 6,999 properties in the National Council of Real Estate Investment Fiduciaries (NCREIF) database from 1981-1999, of which they identify 285 "trophy properties."

While Ziering and McIntosh's analysis does not separate trophy residential property from trophy commercial property, it still demonstrates how property size affects risk and return. In fact, Ziering and McIntosh find that even in lower valuation bands—e.g. comparing properties worth US$40mn-100mn vs properties below US$40mn—larger property groups behave differently. In particular, they find that large properties outperform smaller properties on total return and price by an average of 228 and 294 bps respectively. Additionally, they find that large and small properties are correlated .85 ($p<.05$). They also discover that "trophy property" outperformance comes at the expense of higher volatility: 8.3% for "trophy properties" vs 6.09% for "non-trophy properties."

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15 Ziering, Barry, and Willard McIntosh. "Property Size and Risk: Why Bigger Is Not Always Better." 1999. *Property Size and Risk: Why Bigger Is Not Always Better*. Prudential Real Estate Advisors. Web.

Ziering and McIntosh take the analysis one step further and examine performance across 4 distinct phases of a business cycle: Growth (1981-83), Plateau (1984-88), Trough (1989-93), and Recovery (1994-98). They conclude that trophy properties outperform (with higher volatility, however) across the growth, plateau, and trough phases, while they underperform in the recovery phase. Their results are summarized in Table 1.

Table 1: Trophy Property Performance

Source: Ziering and McIntosh, "Property Size and Risk: Why Bigger is Not Always Better"

Growth Phase (1981-83)				
	Appreciation Return		Total Return	
	Non-Trophy	Trophy	Non-Trophy	Trophy
Average	3.7%	10.2%	12.0%	17.9%
Std. Dev	2.4%	8.9%	2.7%	9.2%
Risk Ratio	1.5	1.1	4.5	1.9
Plateau Phase (1984-88)				
	Appreciation Return		Total Return	
	Non-Trophy	Trophy	Non-Trophy	Trophy
Average	1.21%	6.36%	8.64%	14.10%
Std. Dev	2.41%	2.04%	2.71%	2.25%
Risk Ratio	0.5	3.1	3.2	6.3
Trough Phase (1989-93)				
	Appreciation Return		Total Return	
	Non-Trophy	Trophy	Non-Trophy	Trophy
Average	-7.38%	-4.8%	-0.22%	1.34%
Std. Dev	4.6%	6.83%	4.71%	7.00%
Risk Ratio	-1.60	0.7	N/A	0.2
Recovery Phase (1994-98)				
	Appreciation Return		Total Return	
	Non-Trophy	Trophy	Non-Trophy	Trophy
Average	2.19%	1.15%	11.67%	9.33%
Std. Dev	3.27%	5.25%	3.4%	5.59%
Risk Ratio	0.67	0.22	3.43	1.7

Table 1: Ziering and McIntosh discover that trophy properties performed the strongest during the growth phase and remain resilient during the plateau and trough phases. The recovery phase, however, is a weak period for trophy properties. Ziering and McIntosh attribute institutional reluctance to invest in property on the back of a trough phase to this underperformance. Furthermore, note that trophy properties exhibit higher volatility than smaller properties. Their inherent scarcity implies these properties are not the easiest assets to harvest.

Ziering and McIntosh's analysis has important implications for HNWIs. As they demonstrate in their research, large properties are able to outperform smaller properties in most real estate cycles, and if harvested appropriately, large properties can be useful tools of diversification. Although large properties exhibit higher illiquidity and volatility, HNWIs have the ability to manage such risk over their long-term investment horizons. In other words, HNWIs have the holding power necessary to whether through a real estate trough and recovery.

Additionally, HNWIs purchasing property outside of their primary domicile can also use property as a hedge or as a speculative bet on currency and inflation.

Part II: Current Events

The Safe Haven Concept: Seeking Shelter in New York and London

Since the Lehman Crisis, HNWIs have sought to invest their capital in **global cities**—i.e. cities that (1) have institutional and financial maturity, and (2) are able to attract people and businesses. In particular, HNWIs have identified New York and London as global "safe havens" [16] due to their financial maturity and "global appeal". Furthermore, given that HNWIs finance these purchases through a mix of cash and borrowing, low interest rates in these markets have lowered acquisition costs. As a result, prime property prices in New York and London have remained stable and have started to appreciate since 2007. Furthermore, during this period, demand has fallen across exclusive non-urban residences, such as beach houses and ski chalets.[17]

Since more than half of the world's population now lives in cities, which generate more than 80% of world GDP, it is no surprise that urban areas have and will continue to attract investment from businesses and individuals.[18] As a result, real estate investment in robust urban areas offers HNWIs not only financial and institutional security, but also a unique and exciting quality of life. Data suggest that of the various factors that make cities competitive—ranging from economic factors to cultural factors—HNWIs prefer cities that are "globally appealing"—i.e attractive to individuals and businesses. (See Exhibit 1, Appendix).

HNWIs, around the world, have identified New York and London as the most "globally appealing" cities. These cities provide not only a quality lifestyle, but also

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16 Bailey, Liam. "Prime Numbers" *The Wealth Report 2012*. Knight Frank and Citi Private Bank, 2012. Web. Nov. 2012. p. 28

17 ^*ibid* p. 33

18 Economist Intelligence Unit. *Hot Spots: Benchmarking Global City Competitiveness*. Rep. The Economist and Citigroup, Jan. 2012. Web. Jan. 2013.

insulate property prices given their ability to consistently attract tourists, talent, and commercial activity.

Property in New York and London is extremely unique and, consequently, scarce. While demand for exclusive property has always kept property prices high in these cities, the Post-Lehman era has witnessed extra demand from HNWIs—especially from emerging markets.

Wealth creation has grown rapidly in emerging markets—especially in Brazil, Russia, India, and China—over the last decade. HNWIs from these regions favor the "established" order that developed economies offer—from infrastructure to lifestyle to institutional stability—as their wealth can be a target to corrupt governance. Moreover, these HNWIs tend to think generationally and aspire to migrate to developed markets to provide their children with a more cosmopolitan lifestyle and education. As a result, these HNWIs have taken advantage of a weakened British Pound and US Dollar amidst the Lehman and Eurozone crises to acquire property in London and New York. As a result, they have been the core drivers of appreciation of prime real estate prices in the post-Lehman era.

Prices of large condominiums—i.e. 4+ bedrooms—in Manhattan increased, on average, 3.15% annually from 2007-2012 due to increased demand from emerging market HNWIs.[19] New York continues to attract international wealth for not only its lifestyle and global "safe haven" status, but also because it has a critical mass of global HNWIs.

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[19] Miller Samuel. Manhattan Property Prices. 2012. Raw data. http://aggregate-data.millersamuel.com/, New York City.

Figure 1 illustrates the spike in demand in the Luxury Manhattan Market, while Figure 2 illustrates the price performance in Manhattan's luxury home segment.

Figure 1:
Average Number of 3 & 4+ Bedroom Co-ops and Condos sold per year, Manhattan
Source: Miller Samuel

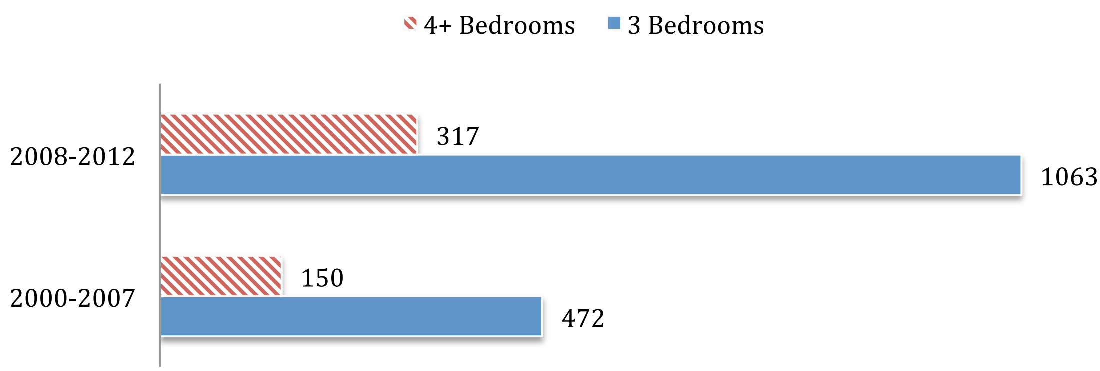

Figure 2: The average number of 3 and 4+ bedroom Co-ops and Condos sold per year in Manhattan spiked post-Lehman. In particular, the volume of luxury urban properties sold in the prime markets has increased as financial asset performance has struggled. HNWIs have been the primary driver of this trend

Figure 2:
Manhattan Prime Property Performance
Source: Miller Samuel, Case Shiller, Knight Frank

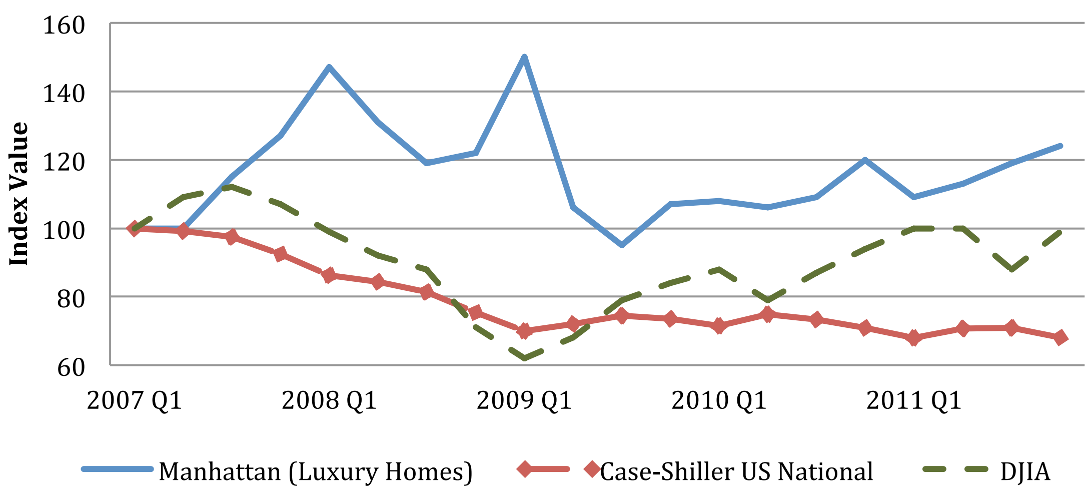

Figure 1: Luxury home performance in Manhattan has performed well in Manhattan. While the Manhattan market is down from peaks in 2008 and 2009, property values have remained relatively stable since 2007—unlike mass housing and equities.

Increasingly, buyers of condominiums in New York are foreign and represent 30% of total residential condominium sales.[20] Foreigners have shown the most demand in the US$20mn+ range and are also beginning to exert pressure in lower price ranges—Chinese buyers, for instance, are actively targeting the US$1-3mn Manhattan market.[21] Furthermore, austerity and taxation threats from Europe also bode well for the prime market in New York. While data on nationalities buying property in New York is scarce, EB-5 visa data suggests that emerging market wealth from Asia drives sales volume. (See Exhibit 2, Appendix).

With New York, London is also one of the most sought-after destinations for high net worth capital migration. Figure 3 illustrates how London's prime housing segment has remained virtually stable, as mass housing and equities have struggled to perform.

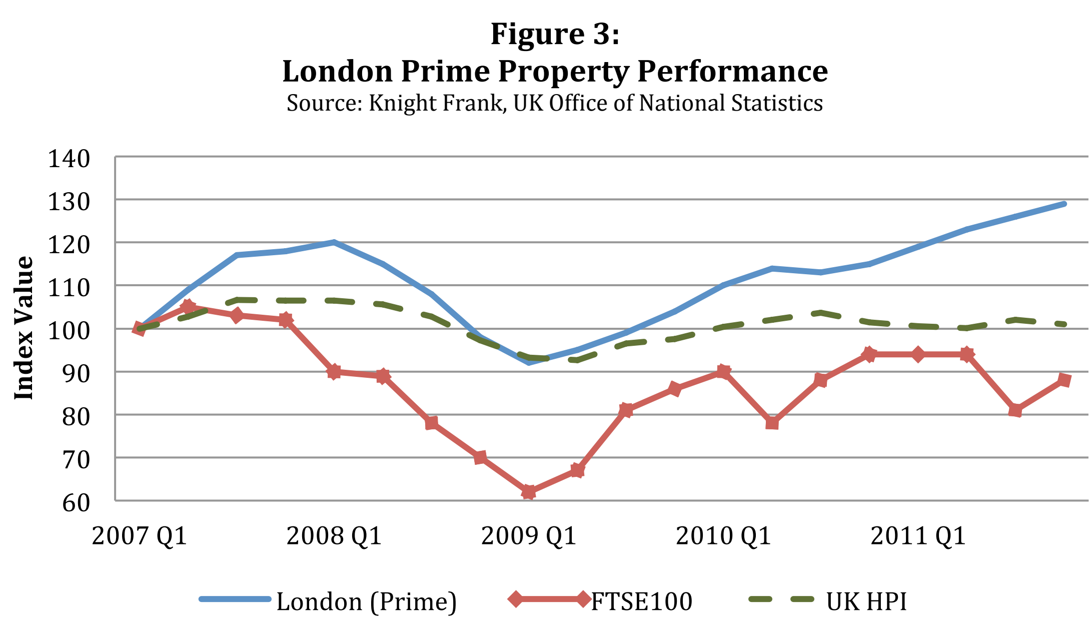

Figure 3: Prime Property in London has outperformed equities and the mass housing market. As with the prime Manhattan market, emerging market wealth has buoyed the London market.

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[20] Stribling. *The State of the Market November 5th, 2012*. Rep. Stribling, Nov. 2012. Web. Dec. 2012. p. 1-4

[21] ^*ibid*

London's strategic geography, cosmopolitan image, and core financial depth has made it a lucrative destination for all investors, especially from emerging markets in Asia and the Middle East. Furthermore, historical ties between the UK and many emerging markets have also made London a lucrative destination for capital. As in the US, HNWIs have taken advantage of a special fast-track immigration visa: the UK Tier-1 Investors Visa. Data suggest that Chinese and Russian HNWIs are driving volume high net worth immigration—highlighting the importance of emerging market wealth. (See Exhibit 3, Appendix).

Overseas buyers have been the most aggressive purchasers of prime property in London, and have pushed prices up by 40% since 2009 and account for more than 60% of luxury home purchases above £2mn.[22] A 30% devaluation in the British Pound from 2009-2011 has complemented this rally.[23] Furthermore, many European HNWIs have started to flee to London amid continued economic and political uncertainty in the EU. Figure 4 illustrates that (based on a price) non-British HNWIs are acquiring the most exclusive properties.

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[22] Warwick-Ching, Lucy. "Moscow's Rich Buy £1m Entry into UK." *Financial Times*. Financial Times, 30 Nov. 2012. Web. Feb. 2012. <http://www.ft.com/intl/cms/s/0/a0d6be06-3aff-11e2-b3f0-00144feabdc0.html>.

[23] Bailey, Liam. "Prime Numbers" *The Wealth Report 2012*. Knight Frank and Citi Private Bank, 2012. Web. Nov. 2012. p. 32

Figure 4:
Average Price paid for Single-Family houses in prime London
Source: The New York Times

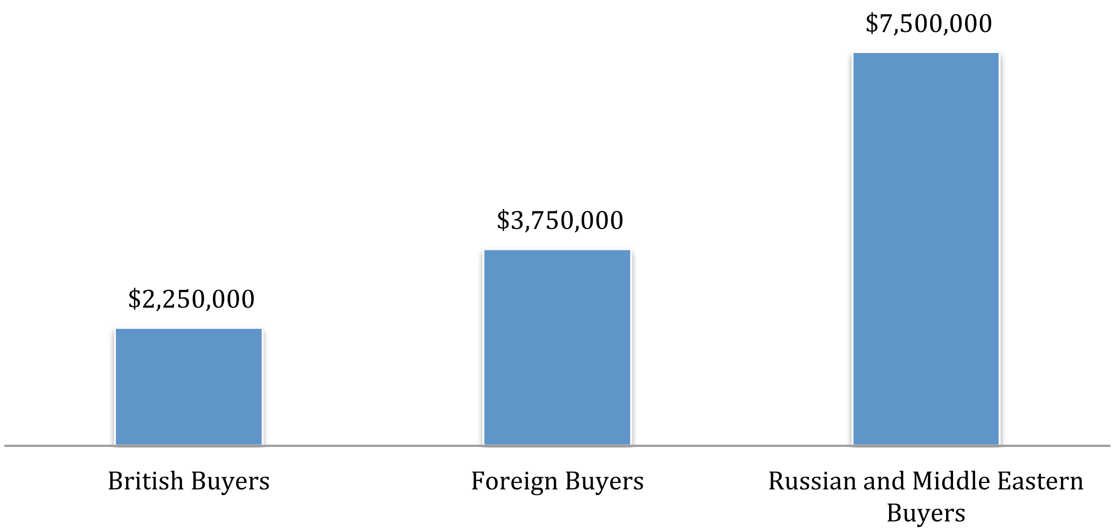

Figure 4: HNWIs from across the world have been acquiring property in London. In particular, Russian and Middle Eastern buyers are buying the most exclusive properties—illustrating the diversity in prime global markets and the importance of emerging and growth market wealth.

A Note on Asia

Robust economic growth in Asia over the last decade has led to rapid wealth creation. As a result, consumer demand has buoyed top-tier residential markets in Asia (illustrated in Figure 5). 2011 vacancy rates for apartments and condominiums in Singapore have fallen below 7% since 2008[24], based on robust local and regional demand. Meanwhile, luxury real estate in Hong Kong has appreciated as much as 30% since 2007, due to high demand from locals and Mainland Chinese buyers, who make up 25% of the market.[25]

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24 Emerging Markets Direct. *Singapore Industry Research Property Industry*. Rep. Emerging Markets Direct, 2012. Web. Mar. 2013. p. 8

25 Bailey, Liam. "Prime Numbers" *The Wealth Report 2012*. Knight Frank and Citi Private Bank, 2012. Web. Nov. 2012. p. 30

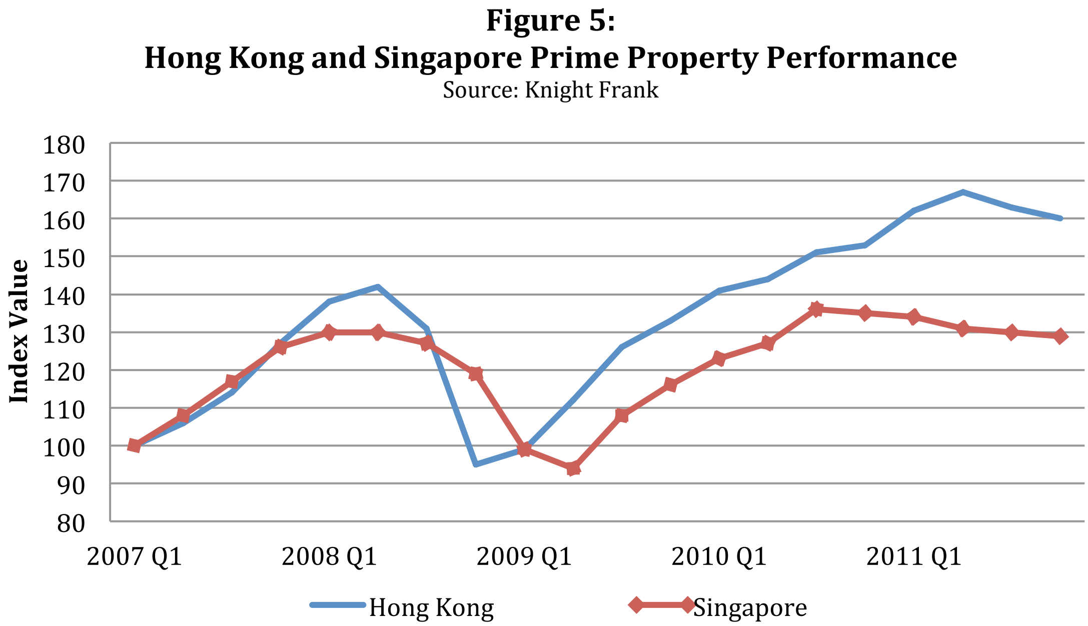

Figure 5: High wealth creation in Asia has led to robust demand for luxury properties in Singapore and Hong Kong. Much of the international demand in these prime markets stems regionally, like from China and India.

Nevertheless while Hong Kong and Singapore are globally competitive, they face regional risks. Prime housing markets in Asia are susceptible to speculative booms and regional economic performance. Post-Lehman gains in residential prices across emerging markets have coincided with global equity bull markets in 2010. Continued global economic turmoil and lower growth in Asia, however, has led to a subsequent market correction in 2011 and residential prices have adjusted to the possibility of lower regional demand. While the effect has been more pronounced in mass-tier housing markets, top tier markets, especially in Hong Kong and Singapore, have started to cool from recent peaks.

Furthermore, while Asia will be a core area of global wealth creation, regional economies often have capital mobility restrictions in place to prevent mass capital migration. As a result, smaller HNWIs lack the flexibility to purchase property in developed markets and, instead, acquire property regionally or locally. For instance, international demand in Singapore's prime housing market is mostly regional, with Chinese, Malaysian, Indonesian, and Indian buyers leading the way.[26] Thus, in effect, the global "safe haven" concept has essentially been played out on a regional and local scale in Asia.

Indian HNWIs, for instance, are acquiring property in exclusive local areas within major metropolises. Prices in Mumbai, for instance, have appreciated 64% over 2007-2011.[27] In Delhi, Indian HNWIs have started to flock to "Lutyen's Delhi"—an upscale and exclusive quarter of the city where large houses fetch upwards of US$40mn.[28] While these properties are not nearly as "polished" as they would be in developed markets, a lack of developed infrastructure and institutional depth implies that prime housing is an even scarcer commodity in these markets. Furthermore, corruption and undeclared cash implies that the bulk of such purchases are made "under the table" to avoid tax.[29]

The Political Threat

Despite being in demand, prime property in global cities is not a riskless asset. These assets are exposed to local and international markets risks. Prime property in New York, for instance, experienced a rapid appreciation followed by a quick slump shortly after 2007 due to a cooling off in the banking sector—a core producer of HNWIs. This trend illustrates how crucial HNWIs are to the stability of the prime real estate asset class.

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[26] Savills. *Insights World Cities Review*. Rep. Savills, Spring 2012. Web. Dec. 2012.

[27] Bailey, Liam. "Prime Numbers" *The Wealth Report 2012*. Knight Frank and Citi Private Bank, 2012. Web. Nov. 2012. p. 60

[28] Yardley, Jim. "Think New York Is Costly? In New Delhi, Seedy Goes for 8 Figures."*The New York Times* 2 Mar. 2013: n. pag. *The New York Times*. The New York Times, 2 Mar. 2013. Web. 3 Mar. 2013.

[29] ^*ibid*

On the whole, the largest threat HNWIs face is political. This risk manifests in two ways: (1) economic and (2) ideological. The economic aspect of political risk focuses on tax policy and capital restrictions for economic purposes. In emerging markets, such taxes and restrictions are often put in place to cool rapidly appreciating markets in an effort to maintain broad-based affordability.

In Shanghai, for instance, the government has stepped in to prevent runaway price appreciation in an effort to maintain broad-based affordability. In particular, it has placed restrictions on second-home purchases and requires resident permit holders to have lived in city for at least three years before allowing second home purchases.[30] Similarly, In Hong Kong, the city government has decided to tax foreign residents (and companies) 15% for property purchases to maintain broad-based affordability for its citizens. Singapore has also sought to impose cooling measures on its property market, through loan tightening and the Additional Buyer's Stamp Duty (ABSD).[31]

Economic risk in emerging markets can also be a by-product of rampant corruption and arbitrary law changes. While such governance can benefit well-connected HNWIs, it is inherently fickle and unreliable. In other words, a valuable social connection today might not be worth anything tomorrow. Consequently, high net worth assets are exposed to the risk of poor governance. In Mumbai, for instance, the state government, in 2012, enacted a retrospective 5% valued-added tax on residential property sold between

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30 Bloomberg News. "Shanghai Eases Home Purchase Restrictions." *Bloomberg*. N.p., 21 Feb. 2012. Web. Feb. 2013. <http://www.bloomberg.com/news/2012-02-22/shanghai-eases-home-purchase-restrictions.html>.

31 Hui, Ong Teck. "Singapore Residential Market – Moderation Expected After Latest Government Measures « Asia Pacific Real Estate Blog." Weblog post. *Jones Lang LaSalle*. Jones Lang LaSalle, 18 Jan. 2013. Web. Feb. 2013.

June 2006 and March 2010.[32] The tax prompted many HNWIs to reorganize their portfolios in order to have the cash ready at such short notice, illustrating the difficulty to plan long-term.

Economic risk—i.e taxes—in developed markets is often a by-product of a short-fall in national revenues. The threat of taxation and government intervention has affected high net worth behavior in developed markets. In the US, 406 people on average, have expatriated per quarter since 4Q09[33], while Britain has seen its millionaire tax filers plunge from 16,000 in 2009-10 to 6000 in 2010-11 as the top rate increased from 40% to 50%.[34] In London, a 15% stamp duty on homes over £2mn has started to have a negative effect on the prime central market, as this duty closes a loophole that allowed buyers to bypass the old 5% duty and estate tax through a corporate vehicle.[35] As a result, sales in £2mn-5mn range have fallen 53% in 4Q12 (compared to 4Q11).[36]

Nevertheless, it must be noted that taxation is not the "be-all, end-all" decision that shapes high net worth residential investment. Rather, taxation forms only one aspect a personal and financial decision for HNWIs. For instance, sales in the £5mn and £10mn range in London have surged 88% and 35%, respectively, over the same quarter in 2011

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32 Times of India. "Pay 5% VAT for Flats Bought from 2006-10." Online Article. *The Times of India*. The Times of India, 24 Aug. 2012. Web. Feb. 2013. <http://articles.timesofindia.indiatimes.com/2012-08-24/mumbai/33365326_1_flat-buyers-flat-sales-vat>.

33 US Treasury Department. Number of Published US Expatriates per Quarter. 2012. Raw data. US Treasury Department, n.p.

34 Wood, Robert W. "Brits, Yanks And French Show Fleeing High Taxes Is Universal." *Forbes*. Forbes Magazine, 04 Dec. 2012. Web. Feb. 2013. <http://www.forbes.com/sites/robertwood/2012/12/04/brits-yanks-and-french-fleeing-high-taxes-is-universal/>.

35 PropertyWire. "New 15% Stamp Duty on UK Property over £2 Million Bought through a Company." *PropertyWire*. N.p., 21 Mar. 2012. Web. Feb. 2013. <http://www.propertywire.com/news/europe/uk-stamp-duty-foreigners-201203216328.html>.

36 ^*ibid*

since the introduction of the higher stamp duty.[37] This trend illustrates that wealthier HNWIs remain unfazed by higher costs of living and care more about long-term stability. Moreover, HNWIs can often mitigate financial risk through careful tax planning and corporate vehicles. HNWI behavior since Lehman has also illustrated that HNWIs are willing to accept higher costs of living (in places like New York and London) in exchange for stability.

While HNWIs can manage political economic risk, political ideological risk is a more serious threat. In effect, ideological risk represents a shift in attitude towards wealth and wealth creation, and hence uses taxation to penalize inequality.

In recent times, European HNWIs have fallen victim to ideological risk. Switzerland, once a global-safe haven for private wealth, has come under intense scrutiny from global regulators. In addition to revealing names of American clients to the IRS, the Swiss government has voted on a referendum that limits CEO compensation.[38] From a lifestyle point-of-view, the referendum implies that living in Switzerland will become increasingly unattractive for top earners, who will seek other global cities.

This effect has been most pronounced in Paris, which has witnessed one of the largest HNWI pullbacks due to changes in government policy and social attitudes towards wealth. While the city remains globally appealing, its ability to attract wealth and become a center for innovation has taken a severe hit since Francois Hollande's government proposed a 75% top income tax rate and 60% capital gains rate. While the move has already prompted several high-profile HNWIs, such as Bernard Arnault,

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37 Sikimic, Simona. "Exclusive: Why London's Prime Property Market Is in Gridlock."*London Business News*. N.p., 30 Nov. 2012. Web. Feb. 2013. <http://www.londonlovesbusiness.com/property/residential-property/exclusive-why-londons-prime-property-market-is-in-gridlock/4084.article>.

38 Willsher, Kim, and Phillip Inman. "Voters in Swiss Referendum Back Curbs on Executives' Pay and Bonuses." *The Guardian*. The Guardian, 03 Mar. 2013. Web. 05 Mar. 2013.

Gerard Depardieu, and even former president Nicholas Sarkozy, to expatriate, it has also touched a raw nerve with local entrepreneurs, who have taken an online stance against the 60% capital gains rate.[39] Prime residential prices in Paris have fallen as a result of such policies, with 400-500 homes flooding the market since the introduction of the 75% top rate.[40]

Closing Thoughts and Forward Remarks

The post-Lehman environment has benefitted prime global cities as they have been able to attract wealth from all corners of the world due to their established institutions and perceived stability. Additionally, this environment has also shown that HNWIs do not want to be isolated from the world, rather, they want to live in cities that can attract people, talent, commerce, and capital. Furthermore, HNWIs are willing to accept premiums on property prices and living costs in exchange for this "safety." In particular, New York and London are likely to remain as the most attractive luxury housing markets given their abilities to attract commerce and tourism.

In light of the Lehman and Eurozone crises, the attractiveness of owning houses and hiding capital in remote, tax-friendly islands has faded. Rather, HNWIs want to be in global financial hubs that have diversified economies, large capital pools, and financial liquidity. Additionally, from a lifestyle point-of-view, owning prime property in cities like New York and London is an ego-boost in a time of panic. The 2012-2013 crisis across financial institutions in Cyprus serves (to-date) as the loudest indicator of these shifting attitudes amongst the world's wealthy.

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39 The Economist. "Angry Pigeons." *The Economist* 13 Oct. 2012: n. pag. *The Economist*. The Economist, 13 Oct. 2012. Web. Jan. 2013. <http://www.economist.com/node/21564609>.

40 Charcossey, Christian. "Rich Businessmen Pulling out of France as Tax-hit Looms." Inquirer Business. October 7, 2012. Accessed March 2013. http://business.inquirer.net/85886/rich-businessmen-pulling-out-of-france-as-tax-hit-looms.

Cyprus failed to recover from the Lehman crisis in the US as its tourism and shipping industries experienced contractions. As a small and relatively isolated country, the Cypriot economy had few other industries it could rely on for a major recovery. Coupled with a large exposure to Greek Debt, the economy fast became illiquid. As part of its bailout deal, the Cypriot government placed levies on all savings accounts in Cypriot banks. Russian investors had long been using the island as tax haven—and a money-laundering hub—due to its lenient policies. As a result, nearly half of all deposits in Cypriot banks can be traced to Russian HNWIs and corporations.[41] The wealthiest Russian investors—who were able to withdraw their capital before the bailout terms—have fled to Manhattan real estate.

Thus, the real key for a tax friendly state rests on its global appeal. In Asia, Singapore is the best example of a globally appealing tax friendly state. Widely ranked as one of the most competitive countries (and cities) in the world, Singapore has the additional distinct advantage of being a tax haven: it taxes top earners 20% of their income and does not charge a capital gains tax.[42] Thus, HNWIs from around the world are drawn to the city-state and believe it is one of the best places in which they can invest their capital. Facebook cofounder, Eduardo Saverin, took advantage of Singapore's tax friendly laws when he gave up his US citizenship just before the company's IPO. Saverin has been residing in Singapore since 2009 and claims he made the move strictly on his

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[41] Hanke, Steve H. "Little Island, Big Problem." *The Daily Beast*. Newsweek/Daily Beast, 22 Mar. 2013. Web. Apr. 2013. <http://www.thedailybeast.com/newsweek/2013/03/25/it-s-up-to-putin-now-cyprus-looks-to-russia-for-love-and-money.html>.

[42] Tulshyan, Ruchika. "Why Eduardo Saverin Moved to Singapore." *Forbes*. Forbes Magazine, 11 May 2012. Web. Jan. 2013. <http://www.forbes.com/sites/worldviews/2012/05/11/why-eduardo-saverin-moved-to-singapore/>.

desire to live and work in Singapore—underscoring the importance of lifestyle in his decision.[43]

In conclusion, continued economic uncertainty in Europe and the US has benefitted the luxury housing markets in New York and London. With the absence—or lack thereof—of resilient financial assets, HNWIs have preferred to invest their capital into real luxury assets. As a result, prime housing in New York and London has remained stable through the Lehman Crisis and continues to appreciate through the on-going Eurozone crisis.

The inherent scarcity of luxury housing in these cities implies that luxury homes are attractive from financial and lifestyle points-of-view. As uncertainty around the Eurozone crisis continues to affect financial asset performance, luxury housing in New York and London provides HNWIs with a psychological—and physical—safe haven. Furthermore, with deeply entrenched capitalist and plutonomic cultures, and as global hubs of commerce and tourism, New York and London will continue to attract wealth. New wealth from emerging markets like Russia, China, and India will drive this trend as they seek to announce themselves and establish more comfortable and cosmopolitan lifestyles for themselves and their children. Similarly, the US is likely to remain the engine of innovation and global growth and also contribute to global wealth creation.

Thus, as these economies create wealth, global demand is likely to grow and, with supply inherently scarce, luxury urban housing should be a prudent investment.

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[43] Antunes, Anderson. "Eduardo Saverin Finally Opens Up: 'No Hard Feelings Between Me And Mark Zuckerberg'" *Forbes*. Forbes Magazine, 27 May 2012. Web. Jan. 2013. <http://www.forbes.com/sites/andersonantunes/2012/05/27/eduardo-saverin-finally-opens-up-no-hard-feelings-between-me-and-mark-zuckerberg/>.

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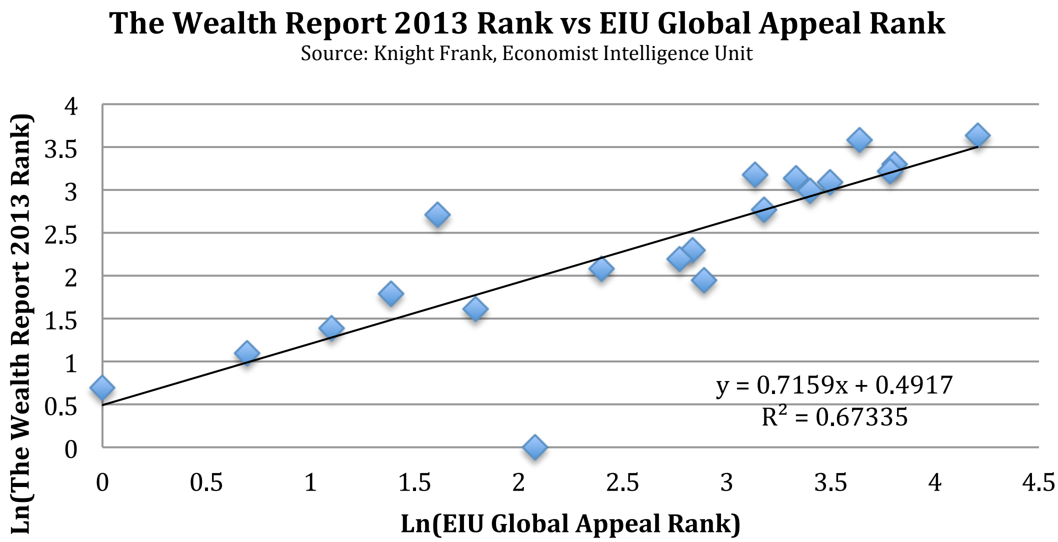
Appendix

Exhibit 1: Global Appeal Rank Regression

To get a better understanding of what HNWIs value most in global cities, I have chosen the top 20 cities with HNWI populations and regressed the overall rank Knight Frank assigned these cities in “The Wealth Report 2013” against the Economist Intelligence Unit’s (EIU) 8 City Competitiveness factors. Knight Frank calculates an aggregate rank based on how cities score under the following four categories: economic activity, political power, quality of life, and knowledge & influence.

In particular, the result that stands out the most is The Wealth Report 2013 Rank vs EIU’s Global Appeal Rank.

EIU calculates the global appeal score by assigning a score to a city based on factors such as: The number and presence of F500 companies, the number of international flights to and from the city, the number of international conferences and conventions held in the city, the number of university programs in technology, engineering, and business. Thus, a city’s “global appeal” score is dependent on its ability to attract businesses and individuals.



HNWI Population Rank[44]	City	The Wealth Report 2013 Rank[45]	EIU Global Appeal Rank[46]
1	New York	1	8
2	London	2	1
3	Tokyo	4	3
4	San Francisco	25	44
5	Los Angeles	20	30
6	Beijing	15	5
7	Mumbai	38	67
8	Hong Kong	5	6
9	Sao Paulo	36	38
14	Shanghai	24	23
15	Chicago	16	24
16	Paris	3	2
18	Washington DC	8	11
20	Toronto	9	16
21	Zurich	10	17
23	Singapore	6	4
24	Sydney	7	18
27	Geneva	27	45
28	Melbourne	22	33
29	Frankfurt	23	28

[44] Knight Frank and Citi Private Bank. *The Wealth Report 2008*. Knight Frank and Citi Private Bank, 2008. Web. Nov. 2012. p. 9

[45] ^*ibid.* p. 22

[46] Economist Intelligence Unit. *Hot Spots: Benchmarking Global City Competitiveness*. Rep. The Economist and Citigroup, Jan. 2012. Web. Jan. 2013. p. 7

Regression Results

Linear Regression

Regression Statistics	
R	0.82058
R Square	0.67335
Adjusted R Square	0.65521
Standard Error	0.59158
Total Number Of Cases	20

Ln (The Wealth Report 2013 Rank) = 0.4917 + 0.7159 * Ln (EIU Global Appeal Rank)

ANOVA

	d.f.	*SS*	*MS*	*F*	*p-level*
Regression	1.	12.98573	12.98573	37.10526	0.00001
Residual	18.	6.29946	0.34997		
Total	19.	19.28519			

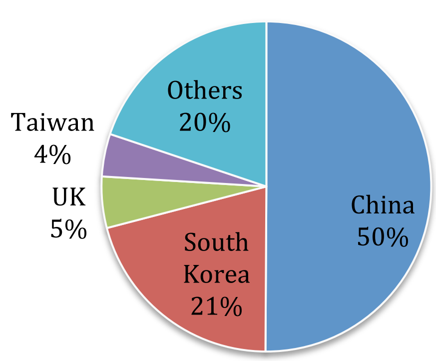
	Coefficients	*Standard Error*	*LCL*	*UCL*	*t Stat*	*p-level*	*H0 (2%) rejected?*
Intercept	0.49165	0.33042	-0.35172	1.33502	1.48794	0.15408	*No*
Ln (EIU Global Appeal Rank)	0.71587	0.11752	0.41591	1.01583	6.09141	0.00001	*Yes*
T (2%)	2.55238						
LCL - Lower value of a reliable interval (LCL)							
UCL - Upper value of a reliable interval (UCL)							

This result is significant ($p<.05$) and illustrates that of all the factors that make cities competitive, HNWIs appear to value “global appeal” the most. This is an important insight as it supports a trend witnessed in the post-Lehman market for luxury real estate: HNWIs are flocking to real estate in diversified cities like New York and London over homes in remote, isolated locales.

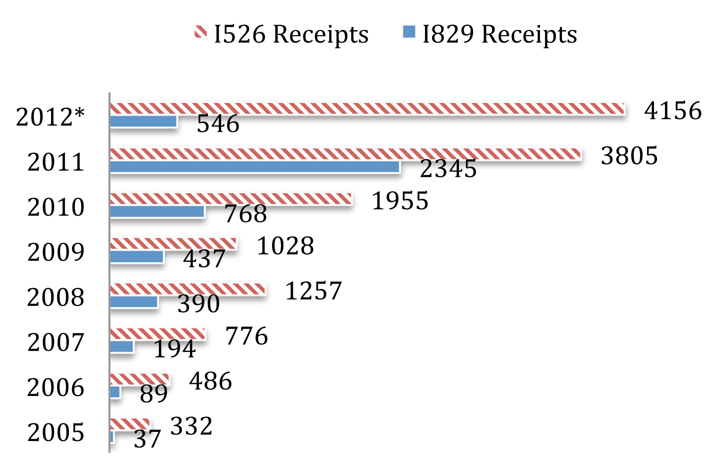
Exhibit 2: US EB-5 Visa Data[47]

Established in 1990, the EB-5 visa is a fast-track application to a green card for wealthy foreigners. Individuals that invest at least US$1,000,000 ($500,000 in "targeted employment areas) in a project in the US that creates at least 10 jobs can obtain US residency. The process involves three-steps: (1) Immigrant Petition (Form I-526) (2) Conditional Permanent Residence Status (I-485) and (3) removal of conditional residency (I-829). Individuals that receive US approval on Form 1-829 receive a permanent residence status—i.e. a green card. For the most part, this program has been under-utilized since its inception due to the lengthy nature of the process. However, applicants (particularly from emerging markets) have steadily grown and reached a record peak of 3,804 (I-526 forms) by then end of 2011, when USCIS simplified the progress to a degree. EB-5 applications have surged since 2009, indicating a higher volume of wealthy foreigners seeking entry into the US, with Asia—particularly China, South Korea, and Taiwan—accounting for more than three-quarters of applicants.

Top Countries that apply for US EB-5 Visas (2006-2012)
Source: IIUSA



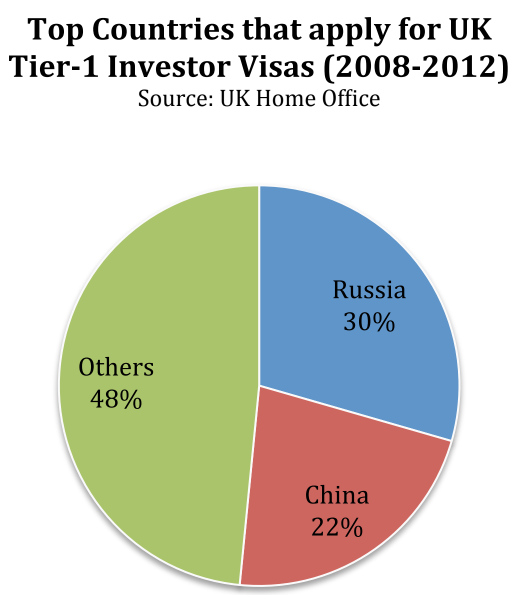
EB-5 Visa Applications
Source: IIUSA

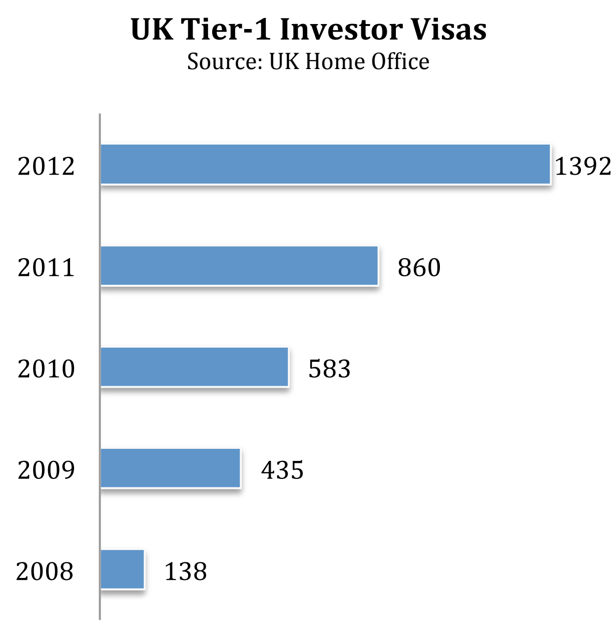


47 USCIS. "USCIS - EB-5 Immigrant Investor Process." USCIS.gov. <http://www.uscis.gov/portal/site/uscis/menuitem.eb1d4c2a3e5b9ac89243c6a7543f6d1a/?vgnextoid=8bf89ea1c35be210VgnVCM100000082ca60aRCRD>.

Exhibit 3: UK Tier-1 Investors Visa Data[48]

The UK Tier-1 Investors Visa guarantees residency for non-Commonwealth and non-European individuals that invest at least £1mn in the UK on a long-term basis. Unlike the EB-5, applicants are not required to create jobs in the UK, and can allocate the corpus entirely to financial investments. Furthermore, the visa allows up-to £250,000 of property to qualify as an investment, which lowers the cost of entry for prospective applicants. Russian and Chinese immigrants have accounted for 30% and 22%, respectively, of all applications since 2008—underscoring the importance of emerging market wealth.





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48 "Tier 1 Investor Visa." *Commonwealth Contractors*. N.p., 7 Apr. 2012. Web. Mar. 2013. <http://commonwealthcontractors.com/uk-visas/tier-1-investor-visa/>.