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REAL ESTATE

Rising interest rates could contribute to luxury market slowdown

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Luxury homebuyers are finding Nevada more affordable. Image credit: Redfin

By SARAH RAMIREZ

With the Federal Reserve raising interest rates four times in 2018, most recently this December, it is too soon to know how much of an impact this will have on the luxury real estate market. The risk is real.

Raising rates is usually seen as sign of confidence in a strong economy, though many – including United States President Donald Trump – have argued that interest rates are increasing too quickly. There are also indications the Fed is planning at least two more rate hikes in 2019, further impacting affluents looking to purchase property.

"Luxury buyers always consider interest rates," said Kristen Riffle, luxury realtor with Urban Nest Realty, Las Vegas. "My luxury buyers are usually the most savvy, but because they have more skin in the game and most of the time have cash to park, you won't see too much of a change.

"Things are sitting longer if they are overpriced currently but the buyers are still out there and they are buying," she said.

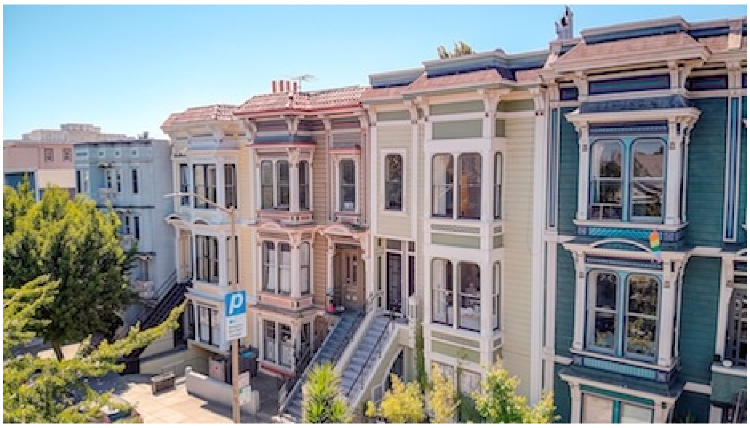
Growth slows

Although the Fed itself does not set mortgage rates, its decisions do influence mortgage lenders. With the interest rate increase on Dec. 19, the central bank's lending rate shifted to a range of 2.25 percent to 2.50 percent.

While the United States' luxury real estate market continues to perform well, the rate of growth has begun to slow.

According to Redfin, the most expensive homes in the U.S. reached an average price of $1.7 million in the third quarter. This is a jump of 3.2 percent year-over-year, the lowest growth rate since the fourth quarter of 2016 (see story).

The real estate market is one of the more delicate ones that luxury consumers deal with, as it is highly susceptible to the fluctuations caused by changing laws, regulations and the status of the economy.



The San Francisco metro area is seeing the highest net outflow of residents. Image credit: Redfin

With the passing of the sweeping tax reform late last year, it was inevitable that the real estate market would eventually feel the effects.

The Republican-approved tax plan from 2017 lightened the tax load for many of the country's wealthiest people while placing a heavier burden on poor Americans, potentially contributing to an upswing in luxury real estate purchases as the richest Americans will have even more money to play with (see story).

Affordability is the main driver behind today's migration trends. In addition to interest rates, prospective and current homeowners evaluate the average local tax burden, or the relative measure of a county's average sales, income and property tax rates.

Research from Redfin shows that 24 percent of home searchers were looking to move to another metro area in the second quarter of 2018, up 3 percent from the second quarter of 2017. People are looking to leave metro areas that have an average tax burden three times higher than the areas attracting new residents (see story).

Luxury buyers benefit from having more buying power, including better credit and more cash available. Image credit: Keller Williams

Despite the most recent increase in interest rates, Freddie Mac reports that 30-year fixed-rate average fell to 4.55 percent from 4.62 percent a week ago. Since briefly hitting a seven year-peak at 4.94 percent in early November, the 30-year fixed-rate average has dipped even as the Federal Reserve has continued to hike short-term interest rates.

"The mortgage rates lately have been extremely volatile due to big money mutual funds, bond markets and other outside factors moving and shaking," said Brittany Nettles, realtor at Keller Williams Realty, Philadelphia. "Rule number one with the economy and predicting the future is it's impossible to predict.

"I think if the interest rates remain low then the luxury market will continue to rise, especially in appreciating and gentrifying cities," she said.

Luxury impact?
Real estate experts expect the real estate market to undergo a correction in the near future, but believe impact on luxury homes will be minimal.

Realtor.com reported that as demand for luxury homes grows amid faster marketing times, the entry level for these homes has been pushed upwards. Forty-nine of the 91 counties surveyed have an entry point of at least $1 million.

Two-thirds of markets have seen real estate marketing time decrease. The combined median age of inventory in all of the luxury markets examined is down 9.3 percent year-over-year, from 119 to 108 days (see story).

“Potential fallout [of interest rate increases] will be longer days on the market and a small devaluing in price,” Urban Nest Realty's Ms. Riffle said.

Homebuyers who are purchasing second homes are increasingly looking at these investments in the hopes of earning rental income, as opposed to using the properties solely for leisurely retreats.

Research from real estate adviser Savills shows that two-thirds of owners rent out their second homes for at least part of the year in an effort to cover part, or all, of the expenses behind maintaining multiple properties. As today's technology simplifies the home rental process and expands the pool of potential renters, more than a third of all additional homes are bought as solely rental properties (see story).

“Oftentimes, luxury buyers buy with ROI in mind,” Keller William's Ms. Nettles said. “[In Philadelphia] many luxury buyers are coming in from major cities and purchasing luxury assets with cash, [and] interest rates become irrelevant.

“Buyers will continue to buy,” she said. “The only time that would stop is if interest rates reach a rate that the ’07-’08 market experienced.”