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# To Gauge Long-Term Health of a Real Estate Market, Look Beyond Sales Prices

Issues like inventory balances and infrastructure matter, too

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"Inventory is slim in L.A. because we're not really building any more", said Tami Pardee, CEO of Halton Pardee + Partners.

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When gauging the health of a real estate market, it's tempting to focus on sales numbers, and median and average prices. But to determine the resiliency of a location, and the potential for returns on investment, there are indicators beyond sales prices and supply and demand that should be factored into your calculus, experts say.

"Most observers of the luxury market have it wrong," said Jonathan Miller, chief executive of real estate appraisal firm Miller Samuel. "We had a red-hot luxury market nationwide in 2011 through 2013, and in 2014 we came to peak luxury." People tend to zero in on pricing, he said, but there are other factors to consider in order to make a smart investment.

Since then, luxury markets in the U.S. have suffered from an excess of inventory and a decline in sales, he said. Mr. Miller attributed a recent uptick in luxury sales not to a change in demand, but to sellers lowering prices to be more realistic.

To get a more holistic picture of the state of local markets around the world—and avoid being misled about its long-term prospects—investors must turn to other factors, like inventory, infrastructure and cultural attractions and the strength of the economy.

**A Balanced Inventory**

"Price trends are what happens when the dust settles," Mr. Miller said. "Really, when you're looking at the health of markets, you want to see balanced inventory."

Recently, he added, luxury markets have been struggling with excess supply, and buyers seeking deals at the high end are finding softness at the top of markets—that is, an increase in discounts and inventory. The latest Douglas Elliman market report, for instance, found inventory rising and the absorption rate slowing for Manhattan luxury real estate.

And this trend can be observed across the U.S. "A tremendous amount of product has been built over the last four to five years nationwide, and the steady pattern is that properties are significantly overpriced, well above what market conditions dictate," Mr. Miller said.

The outcome is that high-end listings languish for longer periods of time—until sellers come down in price. But an uptick in transactions as sellers offer discounts to buyers does not necessarily indicate that a market is improving. Rather, this can be seen as evidence that buyers have been patient and sellers are now pricing their homes more realistically.

However, the oversupply trend may be changing, some experts said, and certain markets are evergreen in their potential for delivering high returns on investments.

"Prices are rising strongly around the country, and in individual cities, the appreciation is even stronger," said Nela Richardson, chief economist at Redfin. "People may have concerns about buying at the top of the market, but if you can afford something in the Bay Area, you can't really go wrong buying it. And you can't go wrong in investing in a place with a great view–that's hard to replicate."

Buyers should also focus on the inventory of specific neighborhoods to get a fuller picture of the health of a luxury market, as this can vary from one area to another within cities.

"Inventory is slim in L.A. because we're not really building anymore," said Tami Pardee, CEO of Halton Pardee + Partners. "Especially in Beverly Hills and Bel Air, the supply will never be enough."

For homes with the potential to offer strong returns on investment, then, look toward markets with a limited amount of space for new development.

"Barriers to entry is the catchphrase," said Paul Habibi, a professor at the UCLA Anderson School of Management. "Dense cities where there is nowhere to go but up, and an inability to introduce new supply, will lead to more price insulation."

**Locations That Draw in Both Renters and Long-Term Investors**

Given a trend toward urbanization around, real estate markets that offer walkability and plentiful transportation and entertainment options, are strong bets for investors—particularly those who will rent out their properties.

“For younger renters, being close to transit, restaurants, bars, and coffee shops is very important,” Ms. Richardson said.

On the other hand, she noted that some markets that offer all these attractive features—like southern Florida and coastal southern California—also come with a greater potential for extreme weather events and flooding, and investors should weigh those risks when evaluating a location.

Local infrastructure should be another major consideration, said Philip White, president and chief executive officer of Sotheby’s International Realty Affiliates LLC.

“Investors want to see that a market has kept up with the times,” he said.

This is illustrated by the new interest in a number of Canadian cities, sparked by the strength of infrastructure, said Christopher Alexander, executive vice president of Re/Max Integra in Toronto. Windsor, Ontario, has received millions in federal and provincial funding to strengthen roads, local transit, and water systems, and other Ontario cities, like London, Kitchener, and Toronto, are similarly prioritizing infrastructure to support a high quality of life, attracting newcomers.

“The health of the Canadian economy is doing well, and the job market is the best it has been in a long time,” Mr. Alexander said. “If you can hold onto an investment here, you have a good shot at doing well.”

Soft infrastructure, too—like the availability of quality healthcare and education services—is also crucial to many buyers, particularly those from overseas. Mr. White pointed to Boston, for instance, as a real estate market that is particularly hot, due in large part to its respected college and university system.

There are also the intangibles, like a strong sense of community. Many investors, Ms. Pardee said, “just want a fabulous place to live. They want to see that the culture and community is strong, and they’re able to drop in and know the people there.”

For investors looking to buy in popular vacation markets like Aspen and Palm Desert, she added, consider what life is like during the off-season, and whether the location draws visitors year-round.

**A Strong Local Economy**

Buyers should take a broad view of a market’s economy to gauge an investment property’s potential for appreciation.

“A diversified economy is helpful in that the market area is not subject to one specific industry that can rise and fall,” Mr. Habibi said. Detroit, for example, has long struggled to recover from the decline of the auto industry on which the city depended.

Population growth is also a reliable indicator of a strengthening local economy. Buyers should investigate the number of people moving into a city and where consumer demand is coming from, Ms. Richardson said. Wherever Amazon HQ2 ends up, she added, would be a smart bet for investment.

Consider, too, which markets are drawing newcomers not just domestically, but from around the globe, another good indicator of that area’s long-term stability.

“Smart buyers are looking at the past 20 years, and the businesses that are coming in and those that are leaving,” Ms. Pardee said. “They should also look at the business tax situation to see if it’s a solid place to be in business, and what’s sustainable there.” Washington, for instance, is considered one of the most tax-friendly states in the U.S. for businesses, for levying neither personal nor corporate income taxes.

**Residency and Tax Issues**

Changes to the U.S. tax code may impact the calculus of would-be buyers as they gauge the health of markets. Property taxes on overseas homes are no longer deductible, for example, and the mortgage interest deduction has been lowered, presenting new consequences for investors to weigh.

“How much can you deduct in mortgage interest? Is the cap on the deductibility of state and local taxes meaningful to you? This is something to consider for an investment in a vacation or retirement home,” Ms. Richardson said. She pointed to Washington State, Florida, Austin, and North Carolina as markets that retirees are especially interested in investing in because of the breaks they offer on local taxes.

The question of tax consequences extends to overseas markets as well. Americans are responsible for paying taxes on their earnings from foreign investment properties, for instance, and in some markets with which the U.S. does not have tax treaties, they could face double taxation.

Some countries make it easier for investors to gain permanent residency status, which can help ease the bite of taxes. Portugal, for instance, offers a “golden visa” that fast-tracks the process of getting a residency permit—and the ability to travel more freely throughout the EU—to foreign buyers. Cyprus and Malta, too, offer similar programs.

Besides these more concrete indicators, whether a market is the right fit for a buyer will come down to what they’re seeking from an investment there.

“It’s a question of whether it’s a consumption item versus an investment good,” Mr. Habibi said. “For some, it’s a hybrid, something they want to enjoy and utilize. And if it gains value over time, that’s icing on the cake.”

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