From Development to Design: How Foreign Investors are Changing Luxury Real Estate

In Los Angeles' competitive real estate market, it's not uncommon for properties in desirable locations to sell for record-breaking prices. Yet at the higher end of the luxury market, fewer buyers are purchasing. Builders have begun selling their plans before they start new projects. And buyers are starting to reject the million-dollar views and modern design that have been so popular in recent years.

L.A. luxury real estate is shifting, no question. So what's causing it? Many of the emerging trends in development, pricing and design are stemming from changes in foreign investment.

Fewer foreign investors are choosing the U.S.

For years, the U.S. has been seen as an inexpensive, safe place for foreign investors to park their money and ensure a solid return. But the beginning of 2016 marked a shift: fewer foreign investors are putting their money into L.A. real estate. The $20 million and up real estate market, which has flourished in recent years thanks to international investment, has now started to cool.

The decrease in foreign investment is likely due to a variety of factors, including dropping oil prices, an international economic slowdown and investors having difficulty getting money out of their home countries and into the U.S. Significantly, the dollar has also become stronger, meaning that real estate prices have gone up. Compared to other locations, the U.S., and L.A. in particular, is no longer the cheapest investment option.

It's true that L.A. still has one of the most inexpensive real estate markets when compared to other international cities like London and New York. But we can't discount the fact that incomes are significantly higher in those cities. When we consider real estate prices relative to income, L.A. isn't such a bargain.

Builders are considering their risks

The decrease in foreign investment is now trickling down to development. In previous years, there has been a push to build bigger, more elaborate houses, with the idea that there would be more margin today. Trousdale is a good example of this. It's a neighborhood made almost entirely of one-story homes, and it drew a lot of interest and large sales when developers saw the potential for big money.

But as foreign investment slows down, builders are now wondering if they're taking a financial chance by building ultra-luxury homes in a market with fewer buyers. Many builders have tried to reduce their risk by selling plans, permits and renderings before they begin new projects. This allows them to retain some profit and move on to other projects that will be more in demand.

This is a smart move on developers' part. Only so many people can afford homes in the $20 million and up range. That market will always be small to begin with, and with the downward shift in foreign investment, that number is likely to shrink even more. Expect to see builders focusing less on over-the-top expensive homes.

Buyers are looking for homes in the mid-range "sweet spot"

In spite of decreasing foreign investment, or perhaps because of it, more buyers are seeking out homes in the $5 to $15 million range. This market is still very active among "move-up buyers," people who are second- or third-time homebuyers selling a less expensive property and upgrading to a more expensive one. Most of this activity is happening in the flats of Beverly Hills, rather than Santa Monica north of Montana.

The biggest challenge for these buyers is that there simply aren't many favorable properties available in their price range. Lots of buyers are finding that appealing homes are listed at exorbitant prices, while reasonably priced properties just aren't up to par.

With limited options, many homebuyers are choosing to wait the market out until better houses become available. One of my clients sold his home and is renting right now to buy some time, and I know of buyers who have negotiated leasebacks on sold properties. Regardless, the $5 to 15 million "sweet spot" remains one of the most active in the luxury market.

Buyers are prioritizing land over views and modern finishes

Views have been the darling of the luxury real estate world for some time. For many buyers, having a nice view made up for a small house or nonexistent yard. That trend isn't going away entirely, but buyers are recognizing that buying a property with land is typically a safer bet and a better long-term investment.

Historically, land appreciates more, and there will always be demand for land because of limited supply. Developers can't turn office space or apartments into a one-family with a yard—open space will always be valuable to them.

Land is also more appealing to many of those move-up buyers looking in the $5 to $15 million range. First-time homebuyers often prioritize views; however, once they start a family, couples realize that homes with views often have no outdoor space, pool or sidewalks, making them unaccommodating for children. When they decide to upgrade, land is a bigger factor.

In terms of design trends, the ultramodern style seems to have reached its peak. Open concept is still popular, so modern design won't die out completely because it's more conducive to that floor plan. But buyers are starting to get tired of seeing the same houses over and over again. I anticipate that we'll see modern design mellow out, with warmer finishes and furniture rather than concrete floors and harsh lines.

Foreign investment transformed the L.A. real estate market after the recession, and it's about to change it again. If you're watching the luxury market, whether you're a builder or a buyer, be on the lookout for these emerging trends.