

Real Estate House View

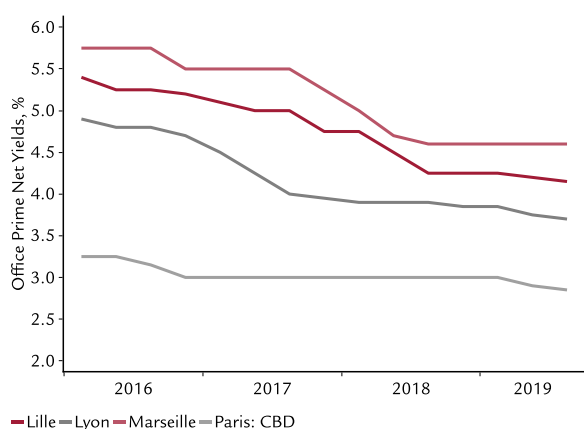
France

First half year 2020

Key takeaways

- **Prime yields in Paris at all-time low:** below 3% due to growing allocation of real estate in institutional investors' portfolios with fiercer competition for core assets.
- “Phygital” (physical & digital) strategy confirmed by large retailers to imbricate brick-and-mortar stores with an online presence. Physical stores are also drivers of digital sales and very visible locations are sought after by retailers.
- **Hospitality market continued to display growing Revenue Per Available Room (RevPAR), although mainly driven by 3- and 4- star hotels:** good performance despite social movements - threat of public protests might complicate visits to large French cities with touristic benefits for regional cities less impacted.
- **Continued increase of house prices in large cities in 2019:** credit rates below 1% and debt periods often beyond 20 years.

Chart in focus



Source: PMA

Prime office yields across France compressed further in 2019, reaching all-time lows in most locations. In Paris CBD (Central Business District), prime yields are now at 2.85%, falling 15 basis points (bps) in a year, and some ongoing transactions are reported to be below that level at 2.7% and even 2.5%. In Lyon, the same downward movement occurred, with prime yields falling to 3.7%. Lowering yields are concentrated in core locations whilst suburban locations with limited access to transportation are facing vacancy and limited liquidity.

In 2019, the French economy suffered less from global headwinds than other major European economies. A proactive fiscal policy stance provided strong support to the economy, compared to the situation in Germany. Yet, budget constraints set by the Maastricht criteria limit the potential for an additional fiscal boost in 2020. In fact, the fiscal impulse in France for this year is expected to be negative according to IMF (International Monetary Fund) projections. There are more reasons to expect a gradual moderation of economic dynamics in the quarters ahead. Labour market data suggest that the fall in France's unemployment rate is coming to an end. According to the French statistics office INSEE, the unemployment rate rose slightly from a cyclical trough of 8.2% to 8.3% in late 2019.

Paris prime yields below 3%

H2 2019 was another milestone in the recent yield compression movement. Prime yields in Paris CBD were down 15 bps, falling below 3% for the first time in history. And some transactions in the pipeline for 2020 are already reporting yields below this level. In Lyon, yields compressed again to 3.7%, down 30 bps in a year. Despite these low levels, competition between investors is fierce as institutional investors are in need of inflation-linked investments with initial yields higher than corporate bonds. Core locations such as inner-Paris, metro-accessible suburbs of Paris and Lyon benefit most, attracting not only investors but also tenants. Vacancy is falling again, reaching 1.7% in Paris CBD, down 20 bps in a year. In the meantime, take-up remains solid. For instance, over 1.1 million sqm were let in Lyon over the first three quarters of 2019. A 26% jump compared to the same period in 2018. Net new additions remain almost zero (<1% of total stock in Paris, <3% of total stock in Lyon), which will presumably reinforce tension of rents due to the scarcity of available space in the coming months.

Precious high street retail

Paris high street retail remains a top destination for “shopping therapy” in Europe. New retail openings related to flagship concepts or boutiques are on the rise. The wealthy catchment area as well as the tourist traffic are two pillars for high street success in Paris. However, “phygital” is paramount to optimise retailer's sales per shop and to provide a benign retail experience

for consumers. The Blue Chips are highly cost conscious and continue to rationalise their portfolio at the European level. The gentrification effect in Paris tends to favour mixed used developments, which is positive for retail over the medium term. The “Green” policy, including a cycling project, in Paris is set to benefit retailers by providing new pedestrian zones – a driver for leisure demand. The high street is the only market where investors are ready to get exposure: yields are now at a historic low. Conversely, the shopping centre market continues to struggle and remains unpopular for investments.

Tourism holds well

Tourism in France continues to hold well, despite a slowdown observed at the European level. In the nine months to September 2019 total nights spent in France rose by 1% compared to the same period last year. While foreign demand dropped by 6%, domestic demand increased by 3%. The year 2018 was a historic high despite the “yellow-vest” effect, with above 383 mn nights spent. Paris has stood well with +1.8% in RevPAR since the start of the year: high-end luxury hotels observed a fall of 10% in terms of RevPAR against an increase of 1% for 3- and 4- star hotels. December had an unfortunate start with new strikes triggered by the pension reforms: this will put pressure on demand over the end of the year given the ongoing paralysis of the traffic in Paris. In provincial areas, tourism held well (+2.9% RevPAR since January 2019). The investment market remains active as well: France is seen as a European key market over the long term. The Olympic Games are set to be a good opportunity, providing a comfortable diversification effect. Total returns from hospitality were amongst the highest in 2018 providing a total return of 11.7% as measured by MSCI.

Second hand is steady

In Greater Paris, transactions and prices per sqm are still on the rise (volumes are up by 9% while prices rose by almost 5%). Inner-city Paris prices per sqm rose by 6.1% in Q3 2019 (above EUR 10 000) compared to 4.7% for the entire city. Given the Grand Paris Express infrastructure scheme, prospects remain positive for the Paris region, especially in the inner and outer suburbs. However, outside of key cities, prices for new buildings are not showing any sign of a rebound.

Chart 1: Net new additions below 3% in all French office markets in 2019

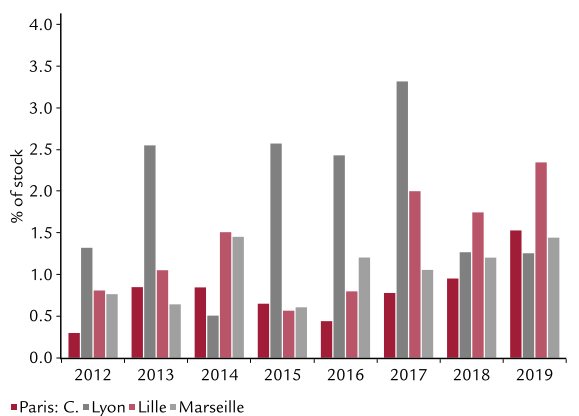
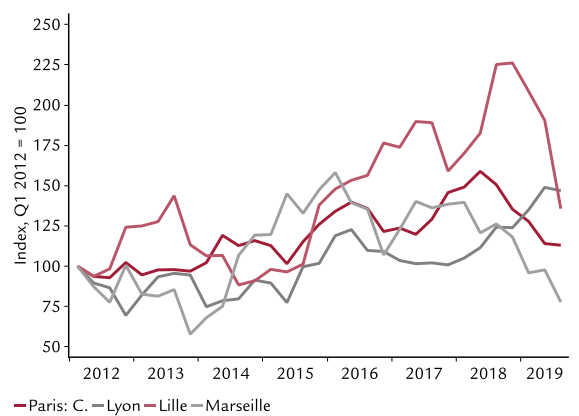


Chart 2: French office markets show strong take-up figures, above 2012 levels



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