

# Real Estate House View

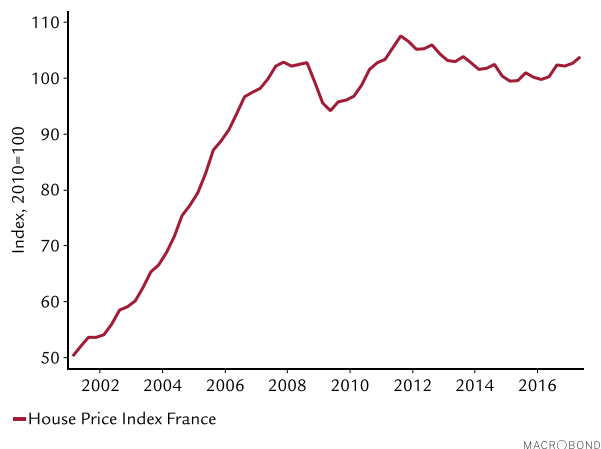
## France

Second half-year 2018

## Key takeaways

- The French office investment market started strongly, with more than EUR 2.9 billion invested in Q1 2018. This dynamic is supported by strong rental activity and historically low vacancy rates. Inner-city business districts and already established peripheral business districts are expected to benefit most from the economic upswing.
- Retail is showing mixed performance. Medium-sized shopping centres are struggling whilst high-street retail in large and coastal cities is holding up well. This is because purchasing power is higher and tourism is having a strong positive effect on retailer turnover.
- The prospects for hotels are positive, as inbound arrivals showed an increase of +9% in 2017 compared to 2016. Paris is the main beneficiary from this trend but secondary cities are also attracting plenty of tourists.
- House prices rose sharply in 2017 in large French cities and this trend is set to continue in 2018 at a faster pace than expected. The increase is fuelled by low interest rates, but a big shortage of newly built properties is also creating more pressure in the market.

## Chart in focus



Due to low interest rates and strong imbalances between supply and demand, house prices have been rising steadily for the past three years. As at Q1 2018, the index reached 107 against 103.2 in Q3 2017. This trend is visible mainly in large cities as a result of rapid urbanisation, which is expected to gain momentum over the next few years.

Private domestic activity is buoyant in France. A combination of moderate reform progress and large infrastructure projects are supporting business investment. Firms are willing to hire more staff, according to the most recent Manpower employment survey. The move of Europe's Banking Authority (EBA) from London to Paris has triggered some relocations in the financial sector. Like elsewhere in Europe, inflation has risen recently due to higher energy prices. We see this as a temporary phenomenon, as crude oil prices seemed to have peaked by the end of May. In light of similar measures elsewhere, we expect labour market reforms to have a dampening impact on wage growth. Thus inflation in France should peak in the second half 2018 before slowing towards an average rate of 1.5% in the medium term.

## Strong office fundamentals

2018 started strongly in the office market with more than EUR 2.9 billion invested across all locations, 45% above the 10-year average. As usual 50% of office investment volume was directed towards inner-Paris markets. Investors are attracted by the current low vacancy rate (below 3%) and rising rents – these are reaching EUR 825 per square metre for prime assets, a rise of EUR 35 in just one year. Like in 2017, new additions are expected to remain relatively modest at 1.5% of total stock per year during the next three years. Investors are showing interest in regional markets as rents are on the rise and yields have been decreasing. Overall, we expect value creation to be driven mainly by rising rents over the medium term rather than by further yield compression. We expect performance to be mainly concentrated (i) in city centres (central Paris, the Part-Dieu district of Lyon, etc.) and (ii) within already established suburban business districts that are easily accessible, such as La Défense. The reasons are various. On the one hand, new generations are keen to work in the cities. Companies find it difficult to attract and retain talent when they locate to remote suburbs. The relocation of the SFR campus within Paris for highly skilled workers is a case in point. On the other hand, given the rise in rents, companies tend to relocate to suburban areas but do not compromise on accessibility by public transport and road. Hence, having a metro station nearby is a major benefit for investors. Assets next to the metro in Levallois or Neuilly can be seen to be performing well, contrary to other assets located slightly further away.

## Effect of tourism on retailing

Retail markets continued to exhibit variable performances across different locations. Large cities are benefiting from the economic recovery in France while medium to small cities are still suffering. Paris remains a strong performer for retailers with the high level of purchasing power and tourism sustaining turnover growth. Allowing stores to open on Sunday in tourist locations has driven domestic “retail therapy” upwards since last year. Apart from prime locations such as the Champs-Élysées, the Left Bank is performing well with retailers taking new premises near the famous flagship department store Le Bon Marché, which is owned by LVMH Group. Apart from Paris, we expect high-street retail to hold up well in large cities as rents are forecast to gradually rise in line with economic growth.

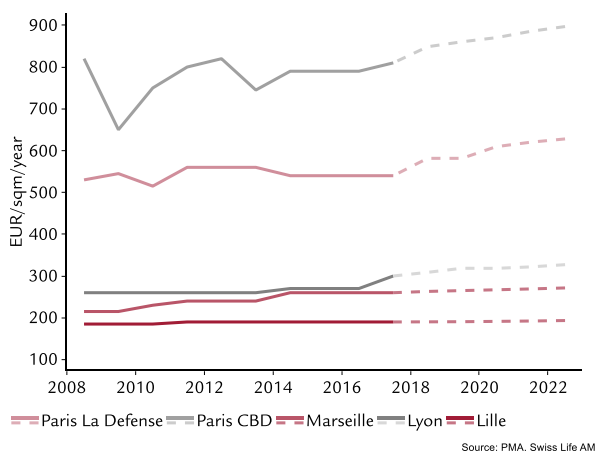
## Ever more inbound tourism

Tourist arrivals were up by almost 9% to 209 million overnight stays in 2017. The strong rise was driven by both America (+6%) and Asia (+6%, including +16% increase from China). As a result, Average Daily Rates (ADR) are on the rise across all locations: +10% in Paris, +3% in other historic cities and +4.5% in seaside locations. Public authorities have been successfully promoting the cachet of many secondary French cities. Investor appetite remains strong, as reflected in prime yields falling below 4.5% in the first half of 2018.

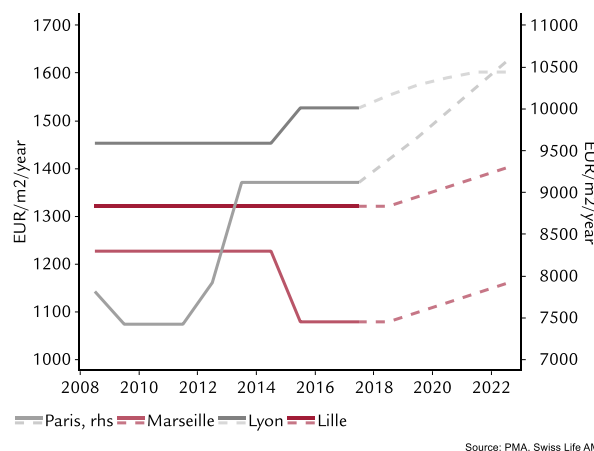
## Key cities are booming

House prices in key cities are still increasing as a result of low interest rates, income growth and imbalances between supply and demand. Conversely, in small and medium-sized towns prices are stable or declining. For instance: Inner-Paris prices per square metre increased at a steady pace of +7% while prices for new construction in France remained flat. Prospects remain positive in the Paris regions and specifically in the inner and outer suburbs, given the Grand Paris Express infrastructure scheme. However, we believe that current imbalances in prices among submarkets in the Paris regions will not endure for any considerable time.

**Chart 1: Office rents still holding up**



**Chart 2: High-street retail prime rental values expected to rise**



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