

Real Estate House View

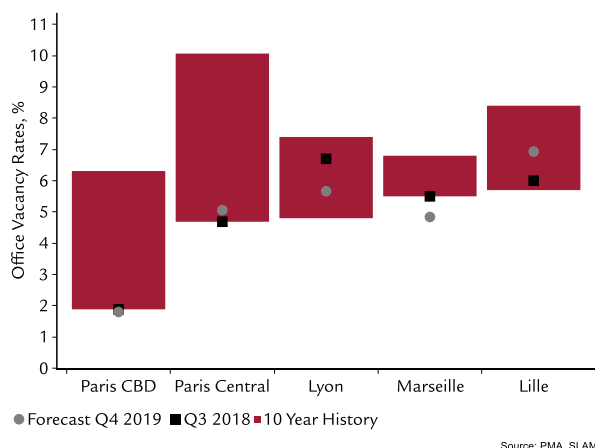
France

First half-year 2019

Key takeaways

- The French economy is supported by moderate reform progress, large infrastructure projects and its lower exposure to international trade, which could prove to be a driving force if the US-China trade dispute escalates.
- The French office market showed a strong performance over the first three quarters of 2018, especially on the demand side. Take-up in all main French cities was above the ten-year average and vacancy rates are falling in the context of a low volume of development projects.
- The retail environment is still challenging but new models are emerging. The winners of the new paradigm are the high-end retailers located in affluent and tourist locations, offering an integrated mix of physical store and online purchases.
- The hospitality real estate sector is becoming mainstream as investors are increasingly prone to investing in this sector. As tourism is booming, this sector is becoming more institutional, offering attractive yields.
- Residential prices in the top ten French cities are still increasing after an impressive 2017. However, performance varies greatly between submarkets as local dynamics are shaped by micro-level characteristics.

Chart in focus



All main French office markets are showing continuing low vacancy rates despite the slowdown expected in most markets. These figures are reinforced by the current low level of new additions within city centres, due to an increasing scarcity of land. New additions represent approximately 1% of the total stock, the lowest level for the past ten years. In addition, tenants have been relocating towards the inner cities, fleeing the once trendy suburban business parks. This puts even more pressure on available space, pushing vacancy rates downwards and rents upwards.

Private domestic activity is broadening in France with a combination of moderate reform progress and large infrastructure projects supporting business investment plans. 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 is triggering some relocation in the financial sector. Infrastructure spending ahead of the Olympic Games in 2024 will also contribute to growth. Compared with other continental economies, France is relatively less dependent on exports and thus less vulnerable in case of an escalation in the US-China trade dispute. The "export to GDP ratio" for France is only 30%, compared with more than 40% for countries like Sweden, Germany and Poland, or even over 60% for Switzerland, the Czech Republic and the Netherlands.

Dynamic office letting market

The letting market for office space in France has been very dynamic over the past few years and take-up levels are set to remain at high levels in the medium term. In the Paris CBD, take-up over the first three quarters of 2018 represented over 300,000 sqm, a 2% increase compared to 2017 over the same period. In central Paris overall, take-up rose by 5%, amounting to 784,000 sqm. In Lille, take-up was 125,000 sqm in H1 2018 – up 25% compared to the same period of 2017. In Lyon 138,000 sqm (up 20%) was let in H1 2018 and in Marseille 77,000 sqm was let (down 10% after an exceptional 2017 year). These figures are strong and show not only that the economy is expanding but also that regional cities are seeing their letting markets strengthen. Furthermore, net additions are in general lower than take-up levels, leading to lower vacancy rates. The low level of net additions is partly due to the increasing scarcity of available land within the cities, where competition between residential, office and hospitality buildings is fierce. Office occupiers tend to relocate within the city centres to attract talent and be closer to transport nodes, such as rail stations. This equation leads to lower vacancy rates – 5.7% in Lille (down 50 bps in one year), 5.6% in Marseille (down 70 bps), 6.8% in Lyon (flat, due to large developments in the Gerlan area) and 2.3% in Paris CBD (down 90 bps). Vacancy rates are at ten-year lows in most locations, and forecasts show they could decrease even further or stay at this level over the next 12 months.

Retail divergences

The retail markets show wide divergences in performance. The high street submarket is definitely the most resilient and adaptive to e-changes in the largest cities. Retailers are optimising their logistics through an efficient last mile delivery policy: more "click and collect" points have appeared in the various schemes. On the Champs-Élysées, the retail mix has changed noticeably over the past few months, with more fashion and luxury brands opening on Sundays. Some retailers are reporting that 60% of their turnover is from tourist shoppers. In such a context, the downside might be negative effects triggered by the "yellow vests" movement on tourism in the months ahead. In gentrified areas, rental values are gaining momentum. At the other end of the spectrum, small-to-medium shopping centres have seen a significant negative impact from the changes in consumer behaviour.

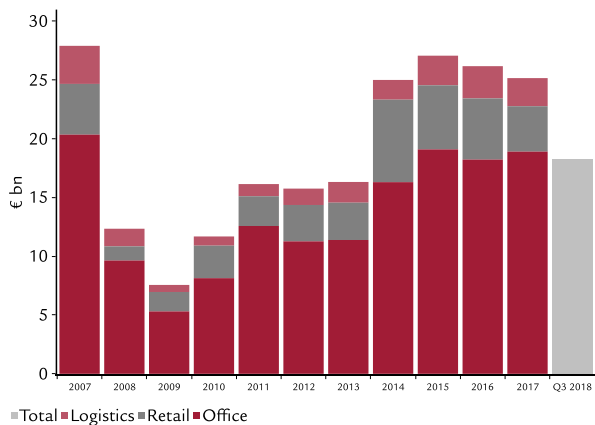
The tourist bonanza

France remains one of the top tourism destinations worldwide, with 89 million visitors – up 2.5% compared to 2017. 2018 is set to see a new historic high with a net EUR 17.5 bn in spending. Average Daily Rates (ADR) in the hospitality sector are on the rise due to increased spending from Germany, Japan, the US and Belgium. In this environment, the hospitality sector is becoming mainstream for investors. The diversification effect and the high risk-adjusted return ratio explain the strong appetite for this asset class.

Housing on the top

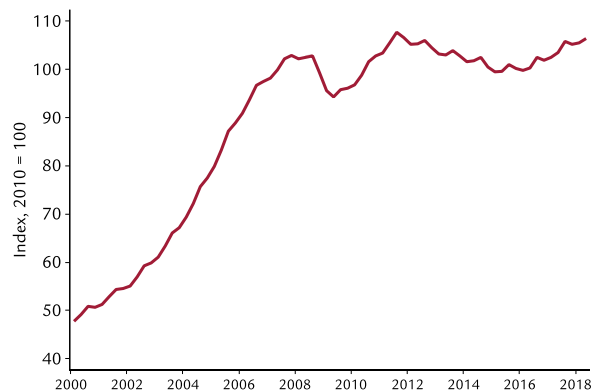
Housing prices in the top ten cities are still increasing, given imbalances between supply and demand from wealthy households. Conversely, prices for new dwellings in medium-to-small cities are not showing any momentum. In central Paris, prices per square metre have continued to increase and have reached EUR 9,500 per sqm, driven by an urbanisation effect. In the Paris region as a whole, prospects remain positive given the Grand Paris Express infrastructure scheme. However, investors need to be aware that the local dynamics vary widely according to the submarket: moving the yield curve upwards requires strong expertise and a solid track record.

Chart 1: 2018 investment volume is set to equal the 2017 level



Source: PMA

Chart 2: Housing price index for France



Source: BIS

Authors

Swiss Life REIM France

Béatrice Guedj

Head of Research and Innovation

beatrice.guedj@swisslife-reim.fr

Charlie Jonneaux

Investment Analyst

charlie.jonneaux@swisslife-reim.fr

Swiss Life Asset Managers

Francesca Boucard

Economist Real Estate

francesca.boucard@swisslife.ch

Marc Brüttsch

Chief Economist

marc.bruetsch@swisslife.ch

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