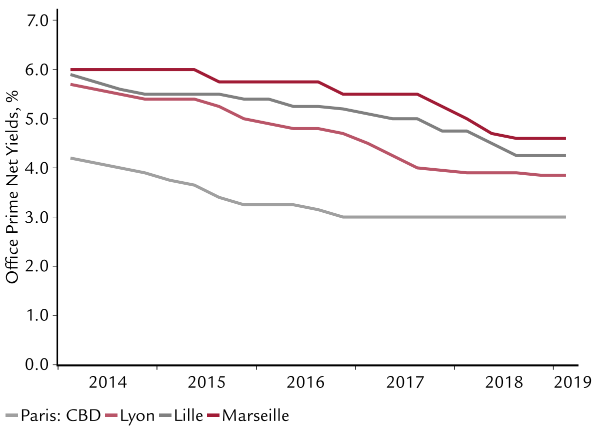
Real Estate House View
France

Second half-year 2019

Key takeaways

- Office markets in France are characterised by an increasing lack of supply, fuelled by strong rental activity and low levels of net new additions. Although prime rents growth remains modest, a strong decrease in incentives given to tenants was observed, improving economic rents for landlords.
- Retail is performing well in high-street locations within large cities such as Paris, given the effect of digitalisation in boosting traffic. Elsewhere retail continues to show mixed performances given the high supply. The shopping centres submarket is struggling in secondary cities.
- The prospects for hotels remain positive, as inbound arrivals are on a positive trend with an increase in the average stay per visitor. The "Gilet Jaunes" effect has not impacted demand from foreign tourism although in some places a discount policy might have avoided a notable drop in arrivals.
- House prices continued to increase in large cities in Q1 2019 given the combination of imbalances between demand and supply and the low level of interest rates. Paris and Ile-de-France are the hot spots in terms of demand and forthcoming public infrastructure projects.

Chart in focus



Source: PMA

Prime office yields across France have compressed steadily over the past few years. Paris CBD seems to have bottomed out at 3% (prime yield). In regional markets, though, the yield compression is still ongoing. These markets are showing good rental figures – decreasing vacancies, rental growth and moderate net new additions. Additionally, regional cities are experiencing a demographic boom and becoming more and more attractive to companies. In that context, investors are increasingly eager to invest in these markets. This is pushing yields down below 4% in Lyon and below 5% in Lille.

The French economy is less affected by global headwinds than neighbouring countries like Germany, Switzerland or Italy. Data from the latest composite Purchasing Managers' Indices show that new orders received by French firms have recovered to above the critical 50 points expansion mark over the past two months. France's comparably more domestically-oriented business cycle seems more affected by home-made political developments than by the trade conflict between the US and China. Therefore, the impact of President Macron's reform agenda and the Gilets Jaunes movement's opposition to it seems to be of greater relevance for current growth dynamics in France. Both the INSEE consumer confidence indicator as well as a broad series of business sentiment surveys have recovered strongly from their lows seen in December 2018, when the Gilets Jaunes protests had a hugely disruptive impact on economic activity. Meanwhile, labour market reforms are showing first results in the form of improving labour market data and growing optimism among consumers about their individual job prospects.

Lack of office supply is set to last

Once again, the main office markets in France showed a strong performance, with high take-up levels and decreasing vacancy rates. Take-up in Central Paris amounted to 211,000 sqm in Q1 2019, a slight decrease compared to Q1 2018. In the Paris CBD, take-up was 99,000 sqm, similar to the previous year. Vacancy rates dropped again, to reach 1.8% in the Paris CBD and below 5 to 6% in regional markets. This confirms the increasingly short supply of office space in central areas. This lack of supply is set to last as net new additions of office space have failed to pick up: in 2018 they amounted to 0.5% of office stock in the Paris CBD and below 1.5% in regional markets. Net new additions are expected to stay below 2% per year over the medium term. This is due to an increasing scarcity of land in city centres and increasing competition between asset classes (office, residential, hotels…). Rents were stable in Q1 2019, but incentives are decreasing, improving economic rents for landlords.

High-street retail holding up

Paris remains an anchor for both retailers and shoppers: the high level of purchasing power and tourism continue to sustain turnover growth although digitalisation is key in driving performance. The gentrification effect in Paris is spreading across all districts, boosting letting activity in the medium term. On top of that, the "placemaking policy" undertaken by the council is favouring leisure demand. The shopping centre market continues to struggle in non-prime areas in France. Apart from Paris, high-street retail should hold up well in large cities with gradual rises in rents: yields are now at a historic low.

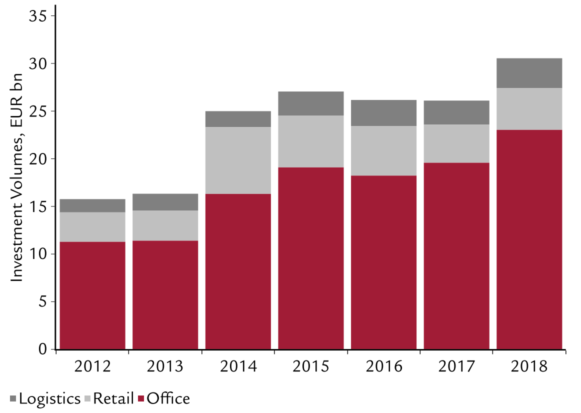
Tourism is not fading

Foreign tourist arrivals remain in a good shape, and more specifically in hotels: almost 5% growth since the beginning of the year compared to the same period last year. The "yellow-vest" effect has definitely not dampened the taste for France, as the share of non-residents is also increasing slightly in term of arrivals (31% of total) and nights (37% of total). Conversely, domestic tourism has not shown any increase, due both to the Gilets Jaunes and to erratic weather conditions. American and Asian (more specifically Chinese) arrivals are the most active across all segments: from palaces down to 3-stars hotels, Paris continues to see a rise in international visitors (+6% in terms of arrivals and +7% in nights, with Paris accounting for 48% of international demand related to night spent). Average Daily Rates (ADR) are well positioned across all locations: Paris benefits the most from the high purchasing power of international spenders. Total returns from hospitality have shown one of the highest performances in 2018 (11.7% as measured by MSCI), driven by falling cap rates. Investor appetite remains strong, as reflected in the fall in prime yields below 4.5%.

Second hand in good shape

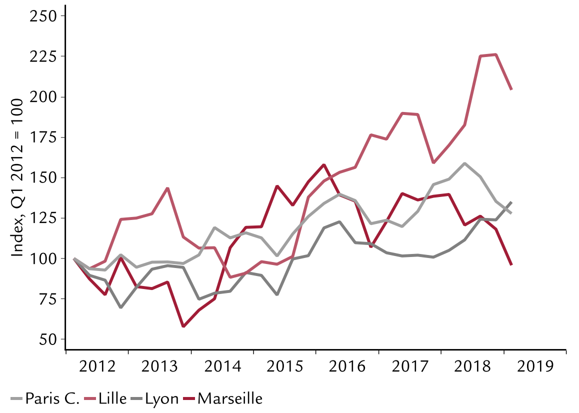
House prices in the largest cities remain on a positive trend given low interest rates, income growth and strong demand. Inner-city Paris prices per square metre increased at a steady pace, reaching 6.4% in Q1 2019 compared to 4.6% for the Paris region as a whole. Prospects remain positive in the Paris region and specifically in the inner and outer suburbs, given the Grand Paris Express infrastructure scheme. However, prices for new buildings outside the key cities are on a declining trend.

Chart 1: Investment volumes in France in 2018 were the highest ever recorded



Source: PMA

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



Source: PMA

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