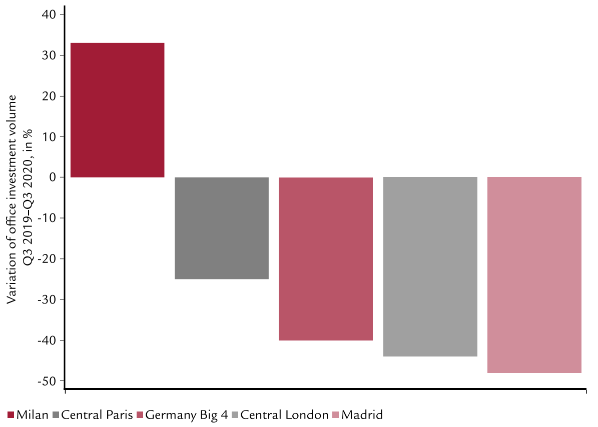
Real Estate House View
France

First half of 2021

Key takeaways

- **Major discrepancies across office submarkets:** largest fall in rental values on volatile markets such as some districts in La Défense. Vacancy rates will be on the rise for a while alongside commercial incentives.
- **The digitalisation of retail is accelerating:** the integration of offline and online retail sales is the “new normal” generating a rationalisation of spaces. Shopping centres to continue experiencing falling demand.
- **The hospitality sector is most affected by COVID-19:** the worst seems to be over and the vaccine is a good omen but the sector is not expected to reach its 2019 levels before 2022.
- **The residential property sector remains healthy:** slowdown in transactions and prices, increasing demand in the rental sector.
- **Investors’ appetite for logistics remains strong:** prices continuing to rise for core assets combining strong covenant strengths in key locations.

Chart in focus



Source: BNP Paribas RE

The scale of the impact on office investment due to the pandemic varies greatly among the major European markets. Milan is the only market displaying growth in terms of volumes invested over the first three quarters of 2020: this outstanding performance is primarily the result of exceptional transactions and cannot be taken as the real tone of investor sentiment. Conversely, investments in Madrid were cut by half as the country was worst hit by COVID-19. Germany’s main cities and London sustained a 40% decrease, while the Central Paris market exhibited a minor downturn in view of the lack of core products. Overall, comparing Central London and Central Paris, it seems that Brexit uncertainties have restrained investors’ appetite for the British capital.

The French economy recovered remarkably quickly from the most severe recession in decades. Business and consumer confidence surveys suggest that the impact of renewed measures to contain the second wave of the pandemic will have a less dramatic impact on economic activity than those in the first wave. In our base case scenario, we expect the economic recovery to resume in the first quarter of 2021. The speed and magnitude of the rebound will depend on the success of the vaccination campaign and the ability to reopen France's services sector. As the long-term legacy effects of the pandemic come under discussion, political uncertainty is likely to resurface. Past major pandemics elsewhere in the world have often led to a significant increase in social unrest. For France there is therefore a risk that street protests may resurface in the run-up to the presidential election scheduled for 2022.

Dichotomy of office destinations

Take-up in the Paris region has decreased by 46% to 913 000 sqm since the start of 2020. This poor performance is explained by the wait-and-see approach of corporates and the increased negotiation periods driven by the economic environment and businesses' reviews of their real estate strategies. Prime rental values remained stable in Paris due to low levels of availability and speculative space underway. A June 2020 letting transaction to Goldman Sachs serves to confirm the possibility of a resilient 'super-prime' segment. Paris La Défense is likely to fare worse due to a large amount of speculative space underway (the highest in Europe as a proportion of stock). Paris Western Business District (WBD) might fare best in these circumstances as rents remain affordable and demand has been sustained by a buoyant pre-let market.

High street retail in the doldrums

Retail continues to be hit hard by the second lockdown and the precautionary stance of households as mirrored in the high level of saving rates. The situation remains challenging in key locations relying on inbound tourists. Most thoroughfares and luxury districts have experienced a huge increase in vacancies and decrease in rents. Capitalisation rates have risen throughout retail. However, this is less pronounced than in peer European markets and concentrated in submarkets with lower supplies. The French government has already deployed an emergency package to sustain the high street submarket. The online sales penetration rate is hovering at around 10% following the marked slowdown of online shopping in H2 2020. Investors' appetite remains on hold as they seek out opportunity scenarios through adaptive reuse of mixed-use schemes.

Hotel – the sleeping beauty

Opening rates increased slightly in H2 2020, while occupation rates averaged around 50%. Large discrepancies prevail across locations and three and four-star hotels continue to show more resilience. Occupation rates in Paris are far lower, although a bounceback is expected in H2 2021 due to the vaccine effect. No distressed sales have been observed, in turn decreasing investor hopes of benefiting from good opportunities. France remains in the focus of long-term investors due to its top European ranking in terms of travel arrivals. On the positive side, COVID-19 has also accelerated the digitalisation of many services within the hotel industry.

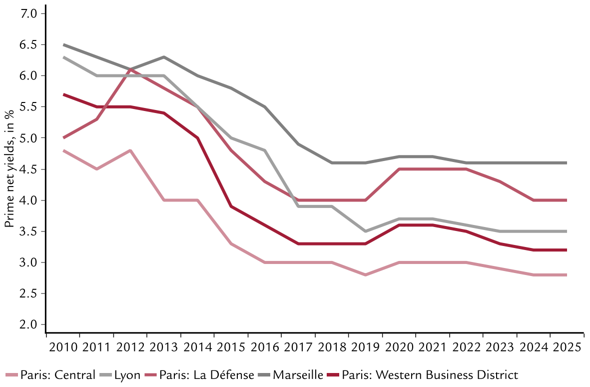
Residential still healthy

In Greater Paris, transactions and prices per sqm have slowed down and housing construction starts have fallen noticeably. Interestingly, a major shift has been observed here towards a rise in transactions in outer suburbs in anticipation of increased opportunities to work from home. Investors are primarily targeting affordable housing and the private rental sector, with an emphasis on the Greater Paris area due to increasing occupier demand. The emerging trend towards co-living has been reinforced by COVID-19 due to the need to combine flexibility and new services.

Investors craving for logistics

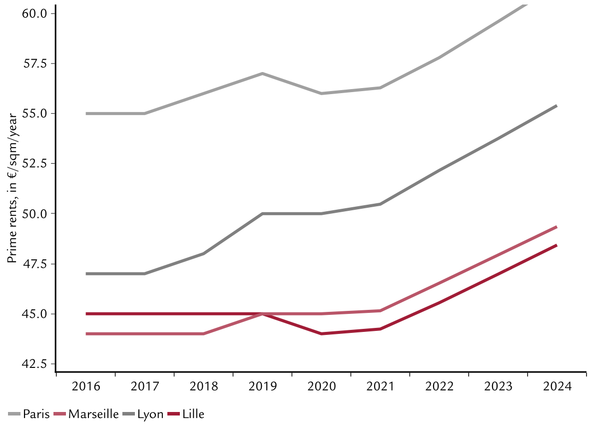
As a subsector, logistics continues to grow, representing 17% of the total investment volume in 2020. Sale-and-leaseback transactions are gaining pace and account for one third of the volume transacted since the start of the year. The prime yield dropped again in Q3 2020, falling below the 4% threshold, a clear indication of investor interest.

Chart 1: The magnitude of movement for office prime yields usually depends on submarkets



Source: Cushman & Wakefield, SLAM

Chart 2: Logistics prime rents are expected to continue rising in the coming years



Source: PMA, SLAM

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