Real Estate House View

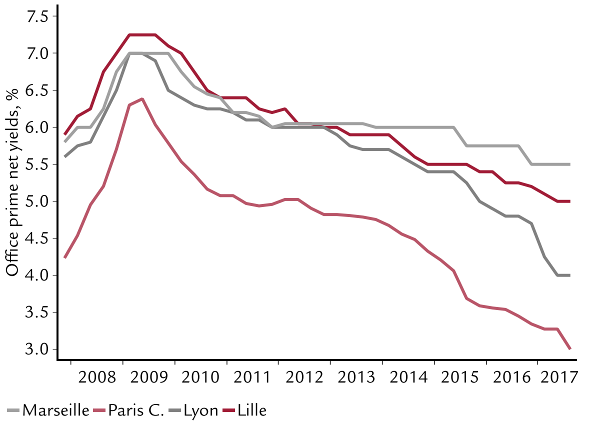
France

First half of 2018

Key takeaways

- The French economy is a laggard in the current global economic upswing. Rising business optimism should result in more capital expenditures and a broadening of domestic activity in the upcoming quarters.
- The French office market showed good tenure levels in 2017: rents are increasing, vacancy rates are falling, prime yields are stabilising and new construction remains modest.
- The retail asset class showed mixed performance: on the one hand high street retail and large shopping centres benefited from growing footfall and an upturn in retail spending, but properties in medium sized cities and medium sized shopping centres are struggling.
- In France, hotel performances in the main resort areas are excellent and in Paris occupancy rates and average daily rates (ADR) are recovering.
- House prices rose sharply in 2017 in large French cities (+7% in Paris). The increase was fuelled by low interest rates and a lack of properties for sale.

Chart in focus



Source: PMA, Cushman & Wakefield

Prime net yields in France in the office sector have fallen sharply over the past seven years to reach 3% in Paris CBD and 4% in Lyon. Yields are expected to stabilise at these levels in 2018 before a slight increase. Real estate will remain attractive to investors as rental growth is expected to continue whilst vacancy rates will remain low and moderate construction activity (1.5% of total stock in Paris, for instance) and improved economic conditions should also hold yields in check.

The French economy is a laggard in the current global economic upswing. While economic activity was supported by private consumption in the past, we expect a broadening of private domestic activity, with the corporate sector undertaking more capital expenditures in the quarters ahead. The 2024 Olympics and public transport infrastructure plans provide additional support in the medium term. Emmanuel Macron has achieved some initial results in his efforts to reform the labour market. The firm global economic momentum points to improving business and consumer sentiment and has also boosted Macron's approval ratings in recent opinion polls. We expect the reforms implemented so far to have a dampening impact on wage growth in the medium term. Inflation will reach around 1.5% in 2018 and 2019.

A smooth ride for offices

2017 proved to be a good year for the office asset class in France. This market followed the economic trend with higher rents, falling vacancy rates and increased investor interest in Paris and the main regional cities. Increased demand from companies for very central assets reduced vacancy rates to a historical low (below 3% in Paris CBD and 5% in Lyon CBD). Given the low levels of property development, vacancy rates are expected to fall even further, especially in non-central markets with potential to catch up on the CBDs. Given these circumstances, rents are on the rise, reaching EUR 800 in Paris CBD (+2.5% yoy) and EUR 300 in Lyon (+11% yoy). As a result, prices have skyrocketed and yields have dropped to 3% in Paris CBD and 4% in Lyon CBD. These yield levels are historically low and we expect that value creation will mainly be driven by rising rents over the medium term. This is generating keen interest in very central assets in the main French cities. In Paris, assets in peripheral business districts such as la Défense or South West Paris may see further growth. These districts benefit from good access by road and public transport and are well established in tenants and investors' minds, ensuring rental and investment liquidity. The current market is also characterised by the emergence of coworking spaces. These are creating fresh demand among freelancers who previously worked from home. Although the market impact is still difficult to assess, these new actors are putting pressure on the rental markets and stirring up rental values.

Good performance where footfall is high

Retail markets showed diverse performance across different locations and segments in 2017. High street retail in large cities performed well, as tenants are looking for maximum exposure in city centres where footfall remains strong. For example, footfall in the Champs-Elysées exceeds 10,000 pedestrians per hour. This trend is backed by a rapid population growth in larger cities along with the growth in retail spending from tourists in iconic locations. Hence, we expect the strong tenure of high street retail in prime locations in France to continue over the next few years. Yields fell to a record low of 2.50% in Paris, 3.85% in Lyon and 4.25% in Lille. Rents remained stable in 2017 but a slight increase is expected in 2018 and 2019. Large shopping centres are also performing well but remain specific to large listed REITs. In contrast, high street retail rents in medium sized cities and middle sized shopping centres were flat or even decreased in 2017.

Hotels recovering

The French hotel industry has had two unstable years following several terrorist attacks, especially in Paris and Nice. However, the industry has started recovering so occupancy and average daily rates (ADR) are expected to normalise. The investment market remained very active and prime yields fell to 4.5% in 2017. Investors now target secondary cities and the main resort areas where inbound tourists are increasing and performance is strong.

A diverse residential market

House prices in 2017 confirmed the dichotomy of the French market: while large cities are benefiting from improved economic conditions and a growing population, small and medium sized cities are suffering from a decrease in population size and economic activity. Central Paris prices per square metre rose sharply (+7%) whereas prices in France as a whole grew by 3.9%. This growth can be explained by a lack of residential assets for sale in large cities and an increase in real estate purchasing power from households as interest rates are at a historical low.

Chart 1: Stable retail rents where footfall is high

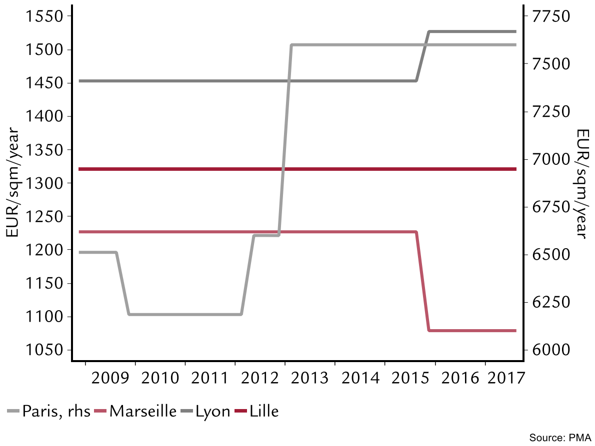
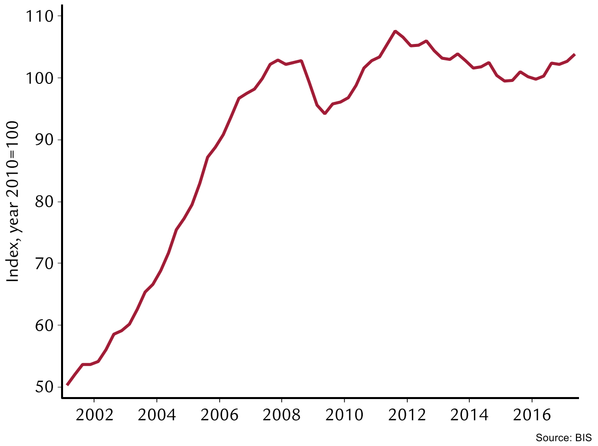


Chart 2: House prices rose 3.9% on average in France in 2017



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