Real Estate House View
France

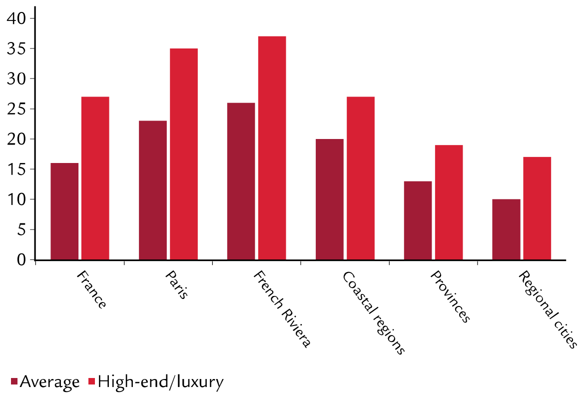
Second half-year 2023

Key takeaways

- **Divided office market:** decline in take-up and polarisation in Paris. The outer suburbs remain severely affected from a rental and investment perspective. The continued risk premium is driving yield decompression in secondary markets. The Île-de-France market will inevitably be tighter given the structural backdrops. Paris and high-productivity submarkets will drive long-term performance.
- **Hospitality – a rising star with strong potential:** the sector rebounded in 2022 and had a very good start to 2023. Yield decompression has not been as significant as in other sectors. In the medium term, the sector will continue to benefit from strong European and domestic demand. Diversity, in terms of both destinations and offering, makes France a preferred choice for institutional investors.
- **Hyper-industrial logistics:** decline in take-up impacted by a turnaround in the industrial cycle. While yield decompression is impacting some premises more quickly and severely, logistics platforms are resilient. The sector offers high potential due to megatrends related to reindustrialisation and last-mile logistics, which is benefiting from the climate transition.

Chart in focus

2022 and 2019 price comparison in %



Macrobond, In-Extenso, Swiss Life Asset Managers

In 2022, the French hospitality sector rebounded and performed well on the back of domestic and international demand. According to In-Extenso data, while the occupancy rate remains 6% below the 2019 average, the average price is 10% higher in real terms. Performance, in terms of average room prices, is positive for all segments, although the differences between the segments are significant: the high-end and luxury segment recorded an average price increase of 27% compared to 2019 – a contrast to the increase of 15% in the mid-range and 10% in the budget segment. Overall, all regions are prospering and France's performance is amongst the best in Europe.

Inflationary pressure continues to ease. According to a publication by the Banque de France, an increasing number of companies are lowering their prices. The inflation rate can be expected to return to below 2% in the course of 2024. This is due to the easing of supply chain problems as well as the tightening of monetary policy by the European Central Bank. The latter is driving down demand in large parts of the economy. The construction sector is making a negative contribution to economic growth in 2023.

Divided office market

In Ile-de-France, take-up remains more than 15% below its ten-year average, impacted by hybrid working and the economic slowdown. As a result, the Île-de-France market is polarised, with high-resilience pockets such as Paris on the one hand and submarkets with vacancy rates above 20% on the other. In Paris, rents remain stable in real terms and, in the case of small and medium-sized transactions, have even increased, as central locations and mixed-use developments become a *must* for tenants. In some secondary markets that have seen a declining population since 2020, rents have fallen by more than 30% on average in real terms, taking account of rent-free periods. In the investment market, the effects of monetary tightening became more pronounced in the first half of 2023 and indexation was not able to systematically compensate for declines in values. Initial yields continue to decompress at varying speeds depending on the market: in the first half of 2023, prime initial yields fluctuated between 3.50% and 3.75%, indicating that the market has not yet settled with a return to liquidity. Current data suggests that the long-term risk premium is being maintained in the context of inflation, between 3.15% and 3.50%, but the ECB is sticking to its 2% inflation target. A low point could be reached faster in prime segments given the proposed discounts on some peripheral assets. The magnitude of these discounts, seen in the prices offered, points towards opportunistic buying behaviour and/or a strategy of repositioning assets for uses other than office (residential, laboratories, hotels, mixed use) in addition to the decarbonisation plan: the market is tight but in a process of transformation. By way of illustration, 33% of the supply in Ile-de-France has been available for at least four years (48% in the outer suburbs). We must therefore remain alert to opportunities, but remember that “not all that glitters is gold”.

Hospitality industry – a rising star

This asset class is now increasing in popularity, featuring in the new long-term allocations of French institutional investors (17% target). Not only has there been a rebound in tourism across the country, the figures are impressive too: prices in real terms are above their 2019 level in Paris and other urban and coastal centres, while new *bleisure* concepts (combination of leisure and business) are optimising performance in terms of RevPAR. In 2022, capital returns remained positive at 2.9% in contrast to other commercial property sectors: large interest rate disparities remain, depending on positioning (up to 250 bps on average), contract type and even energy-saving *capex*. Price opportunities remain scarce despite rising investment volumes. Institutional investors are very active as supply remains below demand. Outdoor hospitality is the new Eldorado due to its more attractive profitability. The preferred strategy is still an active selection of providers in order to optimise asset performance over the long-term.

Hyper-industrial logistics

With the industrial and logistics sectors closely correlated with the business cycle, the impact of the turnaround was immediate. On the rental market, take-up is falling sharply, rental growth is slowing and even declining in some submarkets where speculative supply is failing to attract tenants. On the investment side, yield decompression is faster than in other sectors, but seems to be slowing down. The price of liquidity is now fluctuating between 15% and 30%, and even more for obsolete assets. Most opportunities are to be found in the industrial segment in the strictest sense. The approach must be tactical but also strategic, as the sector is driving economic growth in the medium term through reindustrialisation and the development of new industries, from renewable energies to artificial intelligence.

Figure 1: Development of office vacancy rates on the key markets in Île-de-France

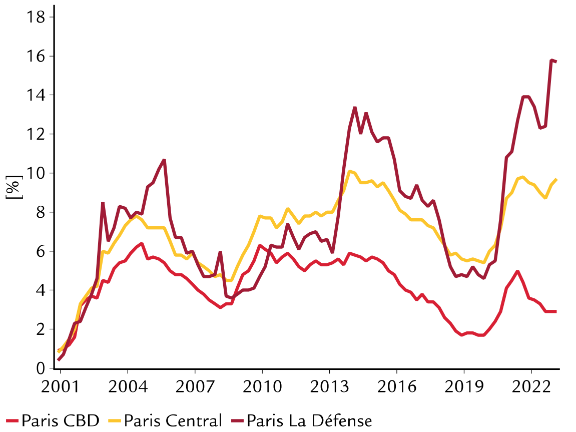


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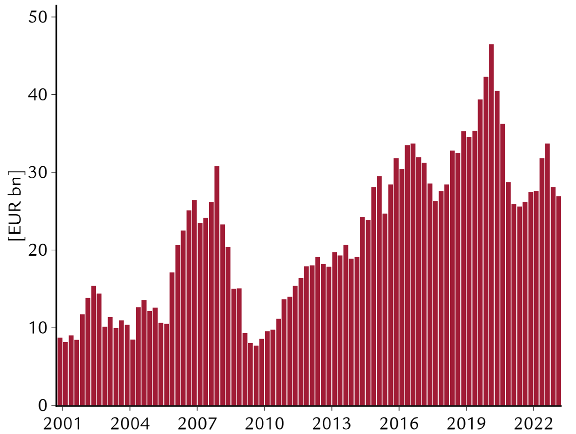
Figure 2: Amount invested in Île-de-France, in EUR bn



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