Real Estate House View

France

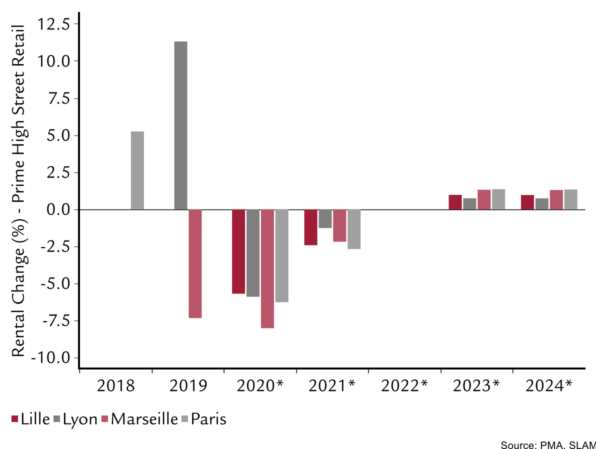
SwissLife Asset Managers

Second half-year 2020

Key takeaways

- **Core office locations are expected to outperform:** The structural changes in the way people work and travel will impact real estate. Submarkets with weak fundamentals including high vacancy rates, an over-supply of new development and a lack of efficient transportation are expected to underperform.
- **The digitalisation of retail is accelerating:** The integration of offline and online retail sales will become the norm for physical retailers. Shopping centres will continue to experience falling demand.
- **The hospitality sector has been the worst affected by COVID-19**: Most forms of hospitality have been forced to close during the lockdown and the sector is not expected to recover to its 2019 levels before 2022.
- **Residential property sector remains robust:** Residential property prices have held their value well despite a sharp slowdown in transactions. We expect the sector to remain stable.
- **Disparity within industrials:** There has been a polarisation in performance between geographies and industries. New regulations are likely to increase volatility.

Chart in focus



Prime high street retail rents are expected to decline in 2020 and 2021 and not recover until 2023. In Paris, the fall in the number of international tourists has lessened demand for luxury brands including those in core locations. Those stores that are strategically located in core locations will likely outperform those in weaker locations. Marseille has a relatively weak economy and an oversupply of retail floorspace. As a result, it is expected to absorb stronger rental declines. Lyon and Lille have growing populations and should experience relatively modest ERV (Expected Rent Value) reductions. No significant increase in ERV is expected in the medium-term as retailers explore new business models to tackle online competition.

According to our current projection, real gross domestic product is likely to fall by -8.3% in 2020. The most recent consensus estimate of -9.9% published by London based Consensus Economics means that our forecast is comparably optimistic. High frequency data published by the French statistics office INSEE suggests that economic activity recovered particularly quickly in France during June, from a comparably deeper collapse from March to May during which activity almost came to a standstill across the country. As the French economy has a high exposure to the services sectors and inbound tourism, we do not expect pre-crisis levels to be reached before 2022.

Targeting core-located assets

France lockdowns started in mid-March, ending booming investment volumes in Q1. The lockdown paused the momentum rather than stopping it entirely. Core products saw marginal repricing of approximately -5%. Non-core product was discounted by 10-15%. A limited number of transactions could limit upward pressure on yields as buyer appetite remains. A bigger unknown is the strength of occupier demand, as companies are downsizing or trying to limit real estate cost. Non-core markets are at risk due to surplus supply. Vacancy remains low in core markets. The pandemic has reinforced some key trends, such as remote working, cycling to work, war for talents, a focus on innovation and the economic domination of large technology companies. Core office space meeting these new demands could experience a price premium.

High-street retail in free fall

Retail has seen large performance declines due to the lockdown. 80% of units were closed for 3 months. Turnover fell from March to June by around 75% on the previous year. On a positive note, online retail gained momentum during the lockdown pushing retailers to accelerate their mutation to a more digital business model. Convenience stores have performed better given changing household behaviours. Lockdown easing is supporting the high street segment at the expense of shopping centres. The lack of tourists in Paris remains an issue, especially for luxury brands. National consumption could fall as savings rates increase due to fears of potential redundancies and further financial pain. Vacancy rates should increase, especially in shopping centres. Rents could continue to fall until 2022. Given current sectoral challenges the French government will deploy a fiscal package, starting with €5 bn, to sustain the high street and mitigation competition from e-commerce. Online penetration rates in France which represents 10% of sales is much lower than in the UK. Appetite for retail should remain limited until investors seek out opportunity plays through adaptive reuse mixed-use schemes.

Hotel is a sleeping giant

Turnover in the hospitality sector is estimated to decline by -40% and -70% in the short-term, depending on location. Locations that normally experience high levels of inbound tourism, such as Paris and the French Riviera, have been most adversely affected by the pandemic. Other European-centric destinations have fared better, along with 3 and 4-star hotels. Although investment volumes have declined, France remains attractive for long-term investors. Deals which have transacted have done so with only marginal pricing adjustments.

Residential still robust

In Greater Paris, transactions and prices per sqm have remained stable despite a slowdown in volumes. Prices per sqm in Inner Paris grew by +8.2% over H1 2020, compared to 7.5% in Paris as a whole. Price growth is expected to slow given the depth of the recession. Affordable housing and private rental sectors attracting strong investor interest with Greater Paris being the focus. The sector is perceived as being more resilient given increasing occupier demand.

Industrial success

Last mile delivery has seen significant demand growth since the lockdown began due to rising e-commerce usage and new household behaviours. Divergence is emerging within the logistics sector, depending on the exposure of occupiers to industries and geographies. Supply chains have been disrupted, exposing threats and creating opportunities. Investors are taking a cautious approach given the volatility of the sector and the unexpected nature regulations.

Chart 1: Net new additions below 3% in recent years

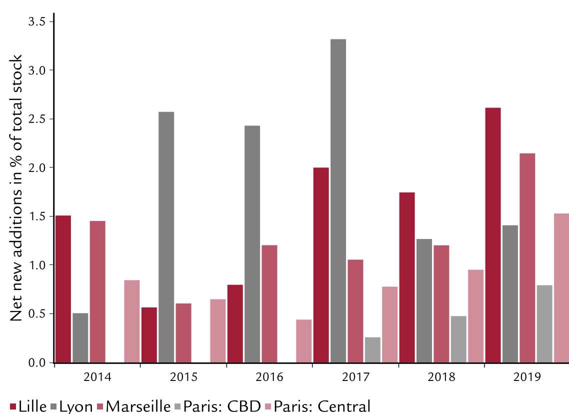
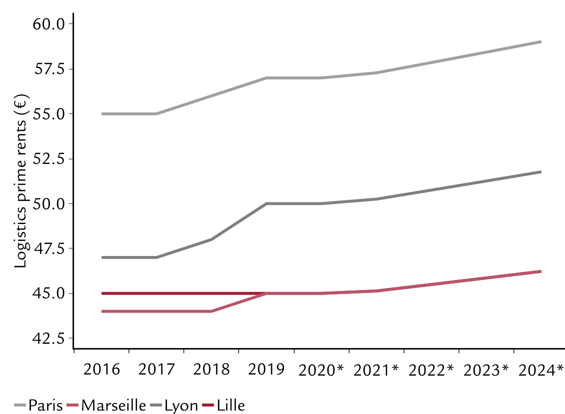


Chart 2: Logistics Prime rents are expected to continue to rise in the coming years



Authors

Swiss Life Asset Managers France

Béatrice Guedj
Head of Research & Innovation
beatrice.guedj@swisslife-am.com

Charlie Jonneaux
Investment Manager
charlie.jonneaux@swisslife-am.com

Swiss Life Asset Managers

Francesca Boucard
Senior Economist Real Estate
francesca.boucard@swisslife.ch

Marc Brütsch
Chief Economist
marc.bruetsch@swisslife.ch

Do you have any questions or would like to subscribe to this publication?
Please send an email to: info@swisslife-am.com.
For more information visit our website at: www.swisslife-am.com/research

Released and approved by the Economics Department, Swiss Life Asset Management Ltd, Zurich
Swiss Life Asset Managers may have acted upon or used research recommendations before they were published. The contents of this document are based upon sources of information believed to be reliable but no guarantee is given as to their accuracy or completeness. This document includes forward-looking statements, which are based on our current opinions, expectations and projections. We undertake no obligation to update or revise any forward-looking statements. Actual results could differ materially from those anticipated in the forward-looking statements.
France: This publication is distributed in France by Swiss Life Asset Managers France, 153 rue Saint Honoré, F-75001Paris to its clients and prospects. **Germany:** This publication is distributed in Germany by Corpus Sireo Real Estate GmbH, Aachener Strasse 186, D-50931 Köln; Swiss Life Asset Managers Luxemburg, Niederlassung Deutschland, Hochstrasse 53, D-60313 Frankfurt am Main and Zeppelinstrasse 1, D-85748 Garching b. München and BEOS AG, Kurfürstendamm 188, D-10707 Berlin. **UK:** This publication is distributed by Mayfair Capital Investment Management Ltd., 55 Wells Street, London W1T 3PT. **Switzerland:** This publication is distributed by Swiss Life Asset Management Ltd., General Guisan Quai 40, CH-8022 Zurich.