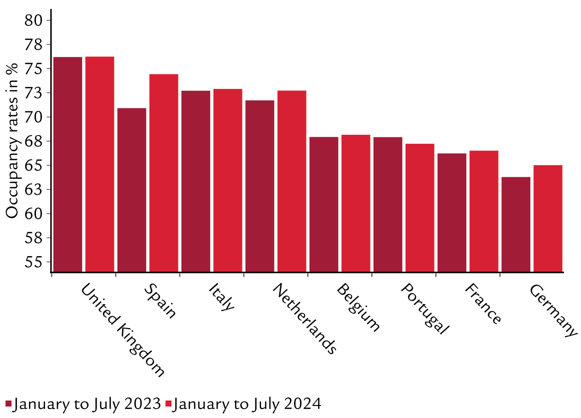
Real Estate House View
France

Second half-year 2024

Key takeaways

- **Structural dislocation in the office market:** take-up and investment figures suggest that a new cycle has begun at the expense of some locations and assets. Inner Paris continues to polarise rental demand, supported by the growth of market rental values. By contrast, double-digit vacancies in some suburban locations reflect a highly discounted level due to technical and usage obsolescence.
- **Hospitality in Olympic shape:** positive figures supported by good long-term sales. The sector has strong fundamentals in terms of European and global demand. Supply is sufficiently diversified in the country for mixing strategies according to risk profiles.
- **Logistics benefiting from new industrial cycle:** following sharp falls in capital returns, initial yields have stabilised, significantly supporting investment since spring 2024. The sector continues to grow due to megatrends related to reindustrialisation and last-mile logistics, which are benefiting from the climate transition and regulations associated with zero net artificialisation.
- ***Prime* initial yields, the crucial question**: increased volatility of French long-term yields could spill over to initial yields in connection with the opening of the new legislature and uncertainty surrounding economic policy.

Chart in focus



Sources: MKG, Macrobond, Swiss Life Asset Managers. Last data point: 2024

Appetite for the European hospitality sector has remained very pronounced in 2024. This resilience is due to the growth of RevPAR and relatively defensive valuations compared with traditional services sectors. In operational terms, the first half of 2024 points to good momentum, with occupancy rates and average prices above those recorded in 2023, especially in southern European countries and Germany, host of Euro 2024. The United Kingdom stood out with the highest occupancy rate, while the non-core members of the eurozone such as the Netherlands and Belgium were also characterised by an increase in their occupancy rates above the level of 2023.

The cyclical recovery has continued over the past few months on the back of a rise in real wages, while companies have benefited from improving lending conditions. However the absence of a parliamentary majority could weigh on the will to consolidate fiscal policy and on the future direction of economic policy. As a result, the scenario of greater ten-year French government bond yields off the back of increased uncertainty is not ruled out in the quarters to come. As a reminder, the presidency of Emmanuel Macron has initiated long-awaited reforms on the labour market and has also been supportive of the tech sector. According to the IMF, France remains better equipped than the EU average in the application of artificial intelligence. Last but not least, according to the World Bank, France has received the most foreign investment, exceeding that of the United Kingdom and Germany.

Dislocation of the office market

Over the first half of 2024, take-up in Île-de-France reached 855 000m², still -18% below the ten-year average, while investment volumes recorded a new low (-80% compared to the five-year average). The Parisian market is settling into a structurally lower demand dynamic compared to previous cycles, owing to pandemic-related disruptions. However, the lettings market is polarised: while demand for central Paris locations is buoyant, some peripheral markets are stagnating. In Paris, prime rents have increased to EUR 1100/m² driven by demand for well-connected locations with strong access to infrastructure and hybrid services. By contrast, rents remained 40% below their peak in some secondary areas where the vacancy rate is above 20%. In these areas, the price of liquidity fluctuates between 40% and 80%, enabling obsolete assets to be repositioned towards new uses. The acceleration in the sectoral rotation of publicly traded vehicles and portfolios, traditionally very broadly exposed in offices, offers real opportunities.

Over the first half of 2024, the rate of yield expansion slowed, with prime initial yields stabilising at 4.50%, not including atypical transactions at lower rates. Since July, the market has been confronted with a renewed wave of uncertainties resulting from the rise in the yield spread between ten-year German and French government bonds – up 20bp compared with the long-term average. Although the financial markets have been lenient as parliamentary radicalism has subsided, volatility of French government bonds could persist. Consequently, prime initial yields, modelled against French government bonds, could drift outwards to between 4.7% and 5.0%, all else being equal.

Hospitality in Olympic shape

France, a top global destination, remains a target market by virtue of the strength of performance in Paris and its urban and coastal centres. Average prices in 2023 rose by 12% in Paris, 7% on the Mediterranean coast and 6% in the provinces, while occupancy rates gained an average of four points, pushing up RevPAR. Investment volumes since 2023 have reached EUR 6 billion. The active management strategy of optimising turnover, aiming to establish the best asset operating model, has proven to be significantly lucrative, particularly for the most popular locations and/or concepts such as *bleisure* and *lifestyle*. However, other operating models, such as variable rent agreements, are possible for the more economical or midscale segments. The ability to adapt strategy based on the location across France and type of asset is a source of performance and diversification for investors. The resorption of initial yields between the acquisition of "assets" and of "assets and operating business" reflects this new investor appetite. Acquisition expertise remains key for a specifically granular segment. The effect of the Olympic Games, beyond the double-digit growth of the average price, lies in goodwill over the medium and long term.

Logistics benefiting

Stabilisation of valuations, low vacancy rates and a significant shortage of supply in Paris, Lyons, Marseilles and the north: prime initial yields are estimated at between 4.40% and 5.50%. The prospects for reindustrialisation in France, last-mile logistics and those associated with artificial intelligence entail long-term strategies in line with the Climate and Resilience Act (and zero net artificialisation of the land). Nevertheless, with the sector very closely correlated with the economic cycle, the strength of performance will depend on French growth and inevitably on the future economic policy stance of the new government.

Chart 1: Development of office vacancy rates on the key markets in Île-de-France (%)

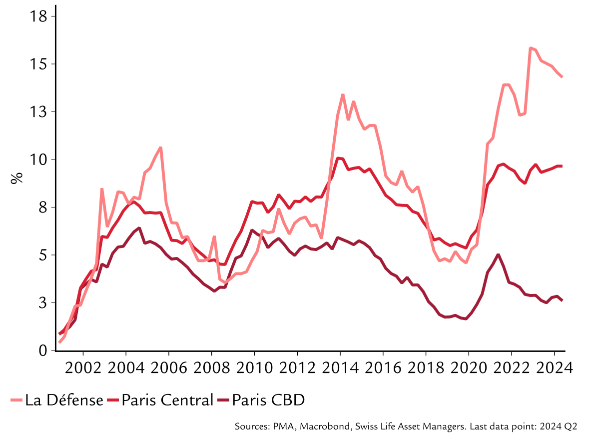
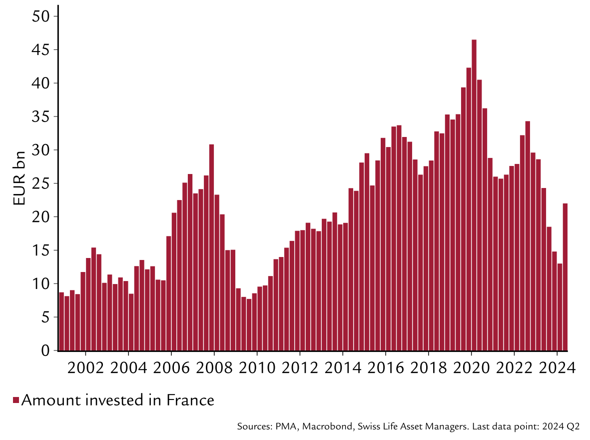


Chart 2: Amount invested in France, annualised, in EUR bn



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