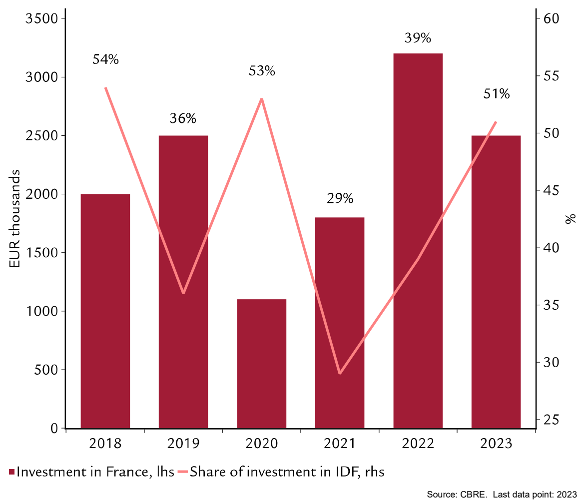
# Real Estate House View
## *France*

*First half-year 2024*

## Key takeaways

- **Office market tight but in a process of transformation:** Figures are below their ten-year averages in terms of take-up and investment. A growing divide between inner Paris and peripheral markets has been observed since the widespread adoption of hybrid working. Yield decompression should slow in 2024, with a new balance on *prime* yields. Paris and high-productive submarkets will drive long-term performance.
- **Residential with alternative response:** The increase in interest rates has led to an increase in developer default rates and insolvencies among some households. Consequently, block sales are on the rise, as are haircuts: now, genuine opportunities are mounting to develop the rental sector with alternative products.
- **Hyper-industrial logistics:** A turnaround in the industrial cycle has triggered a decline in take-up, although some figures, particularly for large platforms, are showing resilience. The sector still has high potential due to favourable megatrends related to reindustrialisation or last-mile logistics, which is benefiting from the climate transition.

## Chart in focus




In 2023, the French hospitality sector posted strong performance in terms of occupancy rates, average prices in real terms and revenue per available room. Admittedly, there are differences in performance between locations and demand type (leisure or business). Notwithstanding this, investors' appetite is not drying up as France remains a top destination, leading the world in terms of arrivals. The past two years have seen the highest average level of investment historically, as the shortage of product weighs on the potential level. The sector, which has benefited from societal changes including teleworking, is sought after by domestic and international investors due to its medium and long-term growth prospects.

Thanks to expansive fiscal policy, the economic downturn in France has not been as severe as elsewhere in Europe. However, the recovery in 2024 is likely to be less dramatic than in the neighbouring major economies. According to surveys, industrial orders have not yet stabilised. In addition, expenditure related to the staging of the Summer Olympics will no longer be present. However, a positive development of real wages should help France to avoid a recession, and below-potential growth rates will reduce inflationary pressure, thus supporting a reduction in the inflation rate towards 2%.

## Offices imbalanced

In Ile-de-France, take-up remains anchored below its ten-year average and investment continues to decline (-65% compared to its five-year average) due to a divided office market. Paris is the focus of the polarisation of both rental and investment demand *in contrast to* peripheral submarkets perceived as wastelands to be repositioned: the vacancy rate spread between Paris (approx. 4%) and the rest of Ile-de-France (more than 15%) serves to testify to this. In Paris, the *prime* rent has reached an all-time high of EUR 1000/sqm: its central location, access to infrastructure and the hybridisation of services and technical facility management remain key factors for tenants. In some secondary areas, rents (taking rent-free periods into account), are down by more than 30% to 40% on average in real terms compared with their peak. The effects of monetary policy tightening in H2 2023 continued to impact performance, with capital returns of -15% on average over the 12-months to Q3 for the pan-European funds tracked by MSCI. This average gauge masks major disparities: in peripheral markets, the price of liquidity is around 35%, higher than core markets and proof that some assets are obsolete, particularly in view of their carbon trajectory. The analysis of offers and transactions points to opportunistic behaviour from buyers through repositioning strategies, converting towards new uses (including residential, laboratories, hotels, mixed use and other alternative segments): haircuts are indeed very high on secondary assets in connection with transformability and decarbonisation costs. At the end of 2023, the *prime* initial yield fluctuated between 4.05% and 4.25%, in line with the volatility observed on ten-year OATs. Market data, especially on real interest rates, suggest that the new *prime* market balance could emerge at 4.60%. Expectations of potential ECB interest rate cuts in 2024 are set to favour a faster convergence of the market balance than previously anticipated.

## Alternative residential

The rise in interest rates weighed heavily on the solvency of households (-20% on average) and that of developers. The immediate consequence was a drop in sales and building starts by 25% on average in 2023, that weighed even more heavily on an already acute imbalance in marginalised areas. With regards to different intergenerational needs, an alternative residential strategy by type of tenant with the development of services appropriate to their socio-demographic profile is set to facilitate a tangible social impact strategy.

## Logistics with potential

As the industrial and logistics sectors are highly correlated with the economic cycle, the impact of the turnaround was immediate, with take-up almost 20% below its five-year average. However, in terms of rental values, some geographic segments are showing a certain degree of resilience linked to a lack of supply, particularly in Paris, Lyon, Marseilles and the north. The national vacancy rate remains low at 4.10% although monetary policy tightening has not spared performance in terms of capital returns: -14% over one year according to the pan-European funds tracked by MSCI as of Q3 2023. While yield decompression has been faster than for other sectors, it seems to be slowing down with a *prime* yield estimated at between 4.40% and 5.50%, depending on whether the assets concerned are *Grade A* (so-called last-mile) or more industrial underlying. The price of liquidity continues to fluctuate between 15% and more than 30%, potentially more for obsolete assets requiring repositioning. The regulation related to ZNA (zero net artificialisation) in conjunction with the Climate and Resilience Law offers opportunities for investors able to reposition certain assets in line with the new requirements concerning reindustrialisation and new industries, in particular renewable energy, artificial intelligence and last-mile logistics.

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

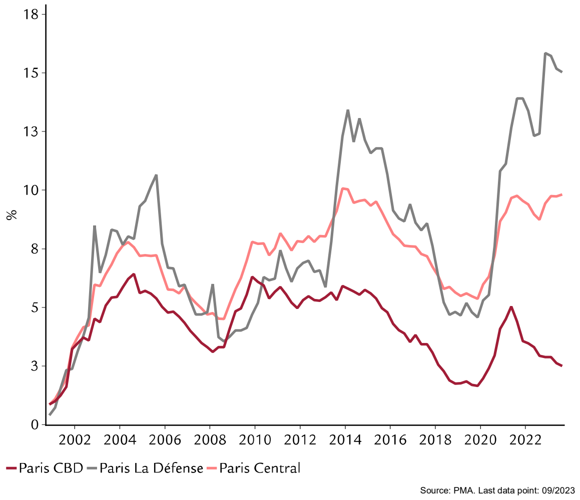
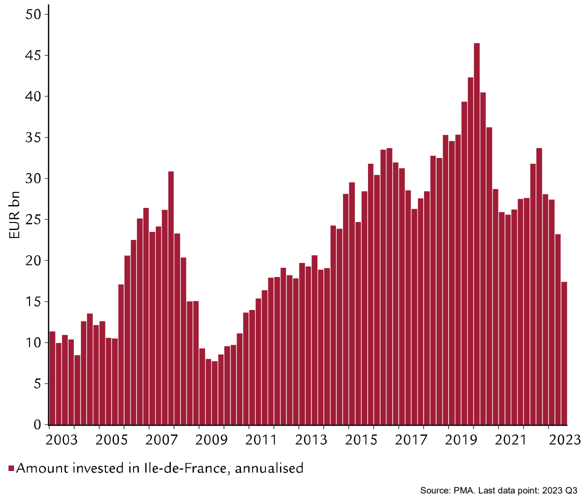



**Chart 2: Amount invested in Île-de-France, annualised, in EUR bn**

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