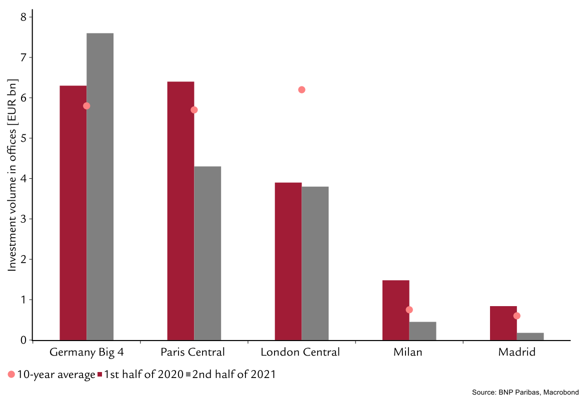
Real Estate House View
France

Second half-year 2022

Key takeaways

- **Office: change of course in the wake of the Ukrainian crisis.** Although rental demand remained buoyant in the first half of the year, a slowdown was generally observed. The stalemate in the conflict, downturn in the economic scenario and upward trend in interest rates are weighing on the rental and investment markets. The polarisation is set to continue and increase.
- **Retail: uppercut of consumer prices.** The downturn in consumption is weighing on the sector's potential without any distinction between high streets, shopping centres and business parks.
- **Residential: contrast between segments.** The assets are geared to strategic plans, be they social, affordable or alternative. Although investors are aware that indexation will not actually reach 100% in 2022 and may not do so in 2023, the attraction of the sector continues to persist.
- **Logistics: the star is taking a break.** For lack of good performance and sustained medium-term prospects, the sector recorded a certain degree of downturn, particularly on the investment market. The increase in financing costs is automatically weighing on profitability.

Chart focus



At the start of 2022, office transactions in Europe as measured by Real Capital Analytics recorded a rebound to almost EUR 24 billion. On the more mature markets such as Paris and London, the upturn in large transactions materialised despite erratic movements. Germany, particularly its four largest cities, remains a focal point due to its good fundamentals. The Ukrainian crisis and the associated problems for the supply of gas in Europe, the risk of a recession in 2023 and the monetary normalisation contributed strongly to a revision of investor expectations. Volumes in the office segment, the most reactive market, declined after the first quarter, limited to *Core* investments.

The economic indicators for France suggest a downturn in economic momentum in mid-2022. The French economy is benefiting from positive stimulus thanks to the virtual absence of containment measures for combating the pandemic. The services segment, especially tourism, has profited from this. The domestic economy is also supported by the good state of the labour market. The reforms carried out during President Macron's first term in office are bearing fruit. Unemployment in the second quarter of 2022 was at its lowest level in more than 20 years. Notwithstanding this, France will not escape the threat of recession weighing on the Anglo-Saxon countries and on Germany over the next twelve months.

Offices at the forefront

While rental demand remains concentrated on Paris, the effects of the Ukrainian crisis are visible on the leases and investment volumes on the French market (EUR 6.1 billion in the first half of 2022, 55% of the total volumes invested in France). The increased inflation is leading to pressure on margins and uncertainties for tenants. The upward trend in interest rates serves to underline the potential falls in value. The risk of a recession in 2023 may possibly result in a wait-and-see attitude among both tenants and investors: take-up and investment volumes will recede. The polarisation will increase on both the rental and investment markets. The risk premiums are becoming more fragile, with a faster *repricing* on the markets that are already vulnerable. Inner Paris will remain a safe haven, supported by the market fundamentals in the medium and long term.

Retail under pressure

On the rental market, the significant adjustment in rents and the return of tourists held promise of a city centre upturn, but annual average inflation of 6% eroded the prospects. The surplus savings accumulated during the health crisis quickly melted away. Although the price umbrella kept inflation below the average for the eurozone, there has been a genuine loss of purchasing power. The savings trend will weigh on the solvency of retailers, various sectors and potentially all segments, from shopping centres to business parks. The *multichannel strategy*, aimed at enhancing revenues per square metre, could be impacted by the rise in energy prices affecting the logistics equation and not just that of the last mile. The disenchantment with investors could continue and lead to a new *repricing* (despite EUR 2.6 billion invested in the first half of 2022).

Residential in limbo

The residential share has become substantial in terms of investment volumes (intermediary, *co-living*) now considered invulnerable to crises since the pandemic and the structural changes associated with teleworking. The rise in inflation led to a cap on rent indexation at 3.5% for the second quarter. The problem of purchasing power in France is exposing the sector to potential new caps in 2022 and 2023 in line with the rise in the consumer price index. The development of services could be an alternative to capping rents. Institutional investors see France as a location of preference for *build to rent*, particularly among small developers. The downside remains the lack of available supply, which could theoretically prompt a repositioning of assets, but the upturn in BT01 and its components is providing headwind.

Logistics on its toes

The increase in the pace of activity, particularly in investment, has slowed down (EUR 2.8 billion), although the Ukrainian crisis is not placing any question on the accelerated change in consumption methods and the need for storage. On the contrary, this crisis has given rise to new requirements associated with the sovereignty of production means. For investors, however, the rise in financing costs is weighing on *pricing*. A slight dip in capitalisation rates is perceptible for some property types and locations. At the same time, the restructuring strategies of some existing assets due to the shortage of land exacerbated by the Tertiary Decree are necessitating a higher risk premium. The growth potential of rental values could be undermined for certain sectors and tenants sensitive to the rise in production costs and deterioration of the order books.

Figure 1: Development of vacancy rates on the main markets of Ile-de-France

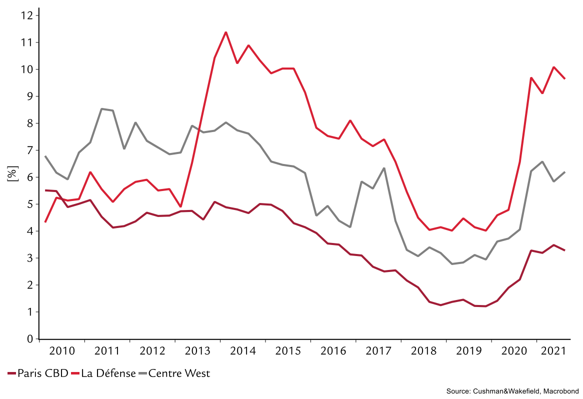
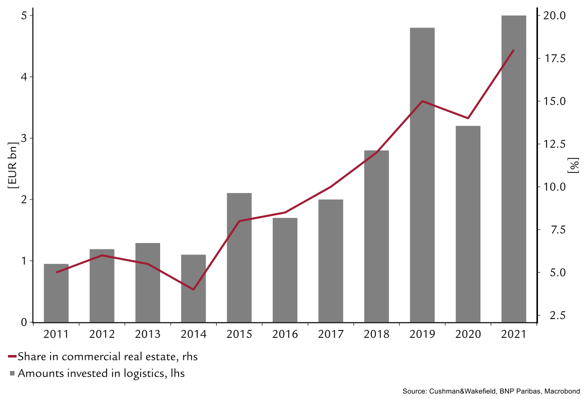


Figure 2: Amount invested in logistics in France, in EUR billion and share of commercial real estate (%)



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