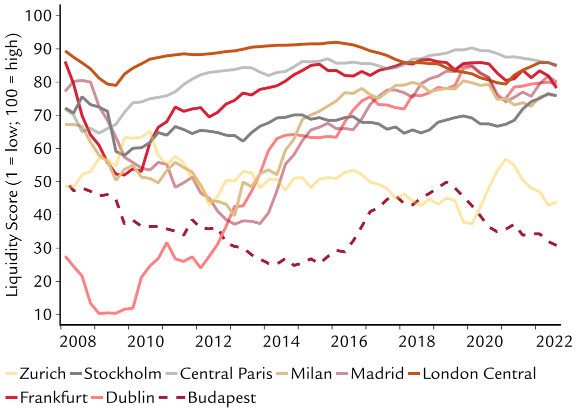
Real Estate House View
France

First half of 2023

Key takeaways

- **Tomorrow's office:** *In contrast to* markets fragmented by hybrid working, inner Paris and some satellite markets will remain strong. Demand will continue to polarise, supporting rental market growth, especially for more energy-efficient buildings.
- **Rethinking retail:** The *repricing* observed since the health crisis has facilitated a repositioning of assets. The price correction is making asset management more flexible in terms of use, rents and growth potential. The new modalities of the quarter-hour city are redefining strategies.
- **Stronger hotel industry:** Paradoxically, the sector has emerged stronger from the health crisis. The structural changes linked to hybrid work and the minimisation of distances are beneficial for French territory. The plurality of destinations and supply in France entails a lasting comparative advantage.
- **Hyper-industrial logistics:** Accelerated change, the need for storage and new industrial sovereignty are the factors supporting the sector in the medium and long term. Strategies involving more local energy production will be highly lucrative and strengthen the sector's *leadership* in terms of social responsibility.

Chart in focus



Macrobond, RCA

As the second-largest economy in the Eurozone, France will remain a location of preference for real estate investors. With equivalent returns, investors prefer to position themselves in markets considered to be more liquid, including the Paris office market, which is leading the ranking in the short and longer term. In the short term, the destructive effects of teleworking are continuing to increase polarisation to the benefit of inner Paris in rental and investment terms. The shortage of land in Paris is serving to boost the attractiveness of long-term capital returns in addition to the potential growth in rental market values: the low volatility of the liquidity index as drawn up by Real Capital Analytics should also strengthen, which is a significant asset for Paris and its investors.

Following economic stagnation in the final quarter of 2022, the data available for the first quarter indicate renewed optimism among companies, particularly in the services sector. We expect real GDP to grow by 0.5% in 2023. Higher financing costs and credit constraints due to the tightening of the ECB's monetary policy are hampering the willingness of the private sector to invest. Nevertheless, new jobs are being created, and the shortage of skilled labour remains a major concern for businesses. The peak of the inflationary cycle is behind us. Inflation is expected to fall from 6% in January to below 4% in the fourth quarter of 2023.

Tomorrow's office

Take-up will continue to shift geographically due to changes related to hybrid work and the acceleration of climate transition. The new momentum of the Île-de-France market that has emerged since the crisis is being strengthened with an agglomeration hub and satellite markets specialised in major types of innovation. The inner Paris agglomeration hub will be characterised by a strong polarisation of rental demand, boosted by a multitude of high-performance infrastructures. Satellite markets, especially in the west, which concentrate the R&D flagship in future-oriented sectors such as renewable energy, digital and artificial intelligence, will support take-up in the coming years. In both cases, office space will combine higher productivity with lower energy consumption, key variables for supporting potential rental growth over the medium to long term. However, offices located in secondary markets already fragmented by the effect of teleworking and *to all intents and purposes* obsolete will at best be candidates for a repositioning in terms of usage. The gap in initial yields between submarkets, which has narrowed significantly, is expected to widen substantially in view of the current momentum. Inner Paris and the surrounding innovation markets associated with the new momentum will essentially be safe havens, as they are characterised by stable rental income with an upward trend.

Rethinking retail

The strong *repricing* resulting from the retail vacancy rates observed since the health crisis has enabled certain segments to reposition with flexible uses, the *retail mix*, as rent levels have tended to become sustainable. These facts, coupled with the concept of a quarter-hour city providing access to essential goods and services, are facilitating a retail redensification in certain districts with the emergence of a new way of life, more sustainable in terms of carbon responsibility. The level of initial yields is becoming relative, the objective being to maximise the rental return. The sector remains synonymous with opportunities and repositioning.

Stronger hotel industry

The sector is one of the major winners of the health crisis in terms of its rebound from the low seen in 2020 and growth potential via domestic and international clients, particularly with regard to certain types, including *leisure* and *bleisure* (a combination of leisure and business), associated with clearly identified locations. The impact of domestic clients is growing, as hybrid work favours long weekends that smooth demand over the year for certain destinations and locations. There are also more *cross-border* clients, supported by less distant but more frequent travel. Prices for the most sought-after destinations are back to their pre-pandemic levels and in some cases are higher, as occupancy rates are not the only gauge of performance. With the Rugby World Cup and the Olympic Games, there is no shortage of supporting factors, with supply targeted at the different client segments in order to attract them. France remains the number one destination in the world and in Europe. The preferred strategy, excluding location and other underlying characteristics, is the active selection of providers to optimise asset performance.

Hyper-industrial logistics

Although the Ukrainian crisis has not called into question the accelerated change in consumption methods and the need for storage, it has strengthened production sovereignty strategies in some sectors. The changing industries located in the historical corridor, the European Backbone and the Atlantic Arc, will remain strong logistics hubs. Restructuring strategies due to the shortage of land exacerbated by the Tertiary Decree will also generate the most returns, especially if they utilise more local energy production to generate a reduction in costs and enhanced social responsibility, as the sector is one of the most problematic in terms of ESG issues.

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

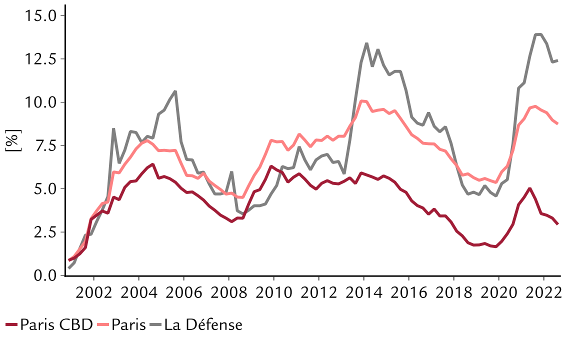
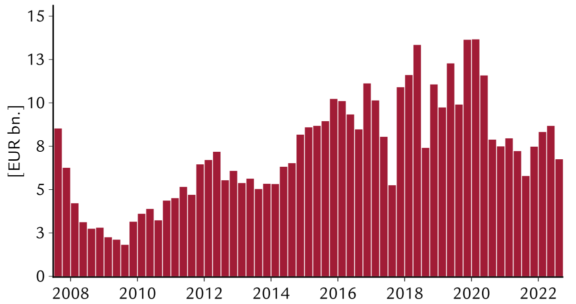


Figure 2: Amount invested in Ile-de-France, EUR bn



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