France – September 2019

SPOTLIGHT

Savills Research

Investment France H1 2019

savills

A flourish first half of the year ● The intact charm of security ● Favorable outlooks

Economic context

Running like clockwork

The French economy is not entirely immune to the slowdown in growth that is taking place on a global scale, due to the decline in foreign trade and business confidence. However, France differs from most of its major partners in its strong resilience and solidity.

The international landscape has not changed since the beginning of the year, when the IMF called for a cooperative and rapid resolution of disagreements between states, as opposed to the steady accumulation of uncertainties and trade barriers. This was, in its view, the top priority for growth. The least we can say is that the IMF has not yet been heard. The Brexit deadline was postponed in extremis to October 2019, without the slightest progress having been made, and while many political hesitations persist on the part of both the EU and the UK. Transatlantic and transpacific trade tensions have exacerbated, and all future moves continue to be unpredictable. Fears over the oil price are linked to events in the Strait of Hormuz and announcements by the United States, which wants to turn off the Iranian tap completely. Logically, in this volatile environment, the global economy is treading water.

Over the months, the IMF [1] and the OECD [2] have revised down their growth forecasts. Both institutions now expect global GDP growth of between just 2.7% and 3.2% for 2019 and between 2.9% and 3.4% for 2020.

The eurozone is set to grow by just 1.3% in 2019 and by between 1.5% and 1.6% in 2020, as a consequence of poor results in Italy (0.1% in 2019 and 0.8%-0.9% in 2020) and the deterioration of the situation in Germany (0.7%-0.8% expected in 2019 and then 1.4%-1.7% in 2020).

For its part, the UK is suffering from the Brexit-related uncertainties, with GDP growth expected at between 1.2% and 1.3% in 2019 (temporarily inflated by inventory build-up by companies in anticipation of the country's withdrawal from the European Union) and then 1.4% in 2020 [3].

In this environment, it appears that France has been relatively spared. Growth forecasts are now 1.3% for 2019, with a stable outlook for 2020 (1.4%). Such results would place it in the eurozone average. This consolidation of the French outlook is explained by lower exposure to fluctuations in international trade than its main partners. It is also paradoxically due to the "yellow vests" movement, which, after having a limited negative impact at the end of 2018 and the beginning of 2019, led to measures boosting purchasing power [4]. The pick-up in household consumption is set to continue gradually, once the latency period needed to rebuild precautionary savings is over. Household confidence has also rebounded sharply since the start of 2019 [5]. This positive outlook will have logical repercussions for business investment.

The French economy should therefore continue to create an increasing number of jobs: INSEE forecasts 241,000 in 2019, following the 182,000 seen in 2018 [6]. Unemployment will continue on its downward trend (-0.4% in the first half of 2019), to end the year at a level close to 8.3%.

This economic resilience, added to political stability, means that France is running like clockwork. This is likely to be an appealing factor in the current context of international volatility.

[1] IFM, July 2019
[2] OECD, March 2019
[3] Forecasts based on an orderly Brexit followed by a gradual transition
[4] Les Echos, 30 July 2019/Les Echos, 17 April 2019
[5] Institut national de la statistique et des études économiques (INSEE), Monthly consumer confidence survey, 26 July 2019
[6] INSEE, Note de conjoncture, June 2019

1.3%

Forecast GDP Growth for France in 2019

+2.4%

Upswing in permanent job creation in April 2019

8.3%

Forecacst unemployment rate in France in Q4 2019

+1.3%

Rise in the total number of new business registrations in March 2019

Trends in the investment market in France

A success story

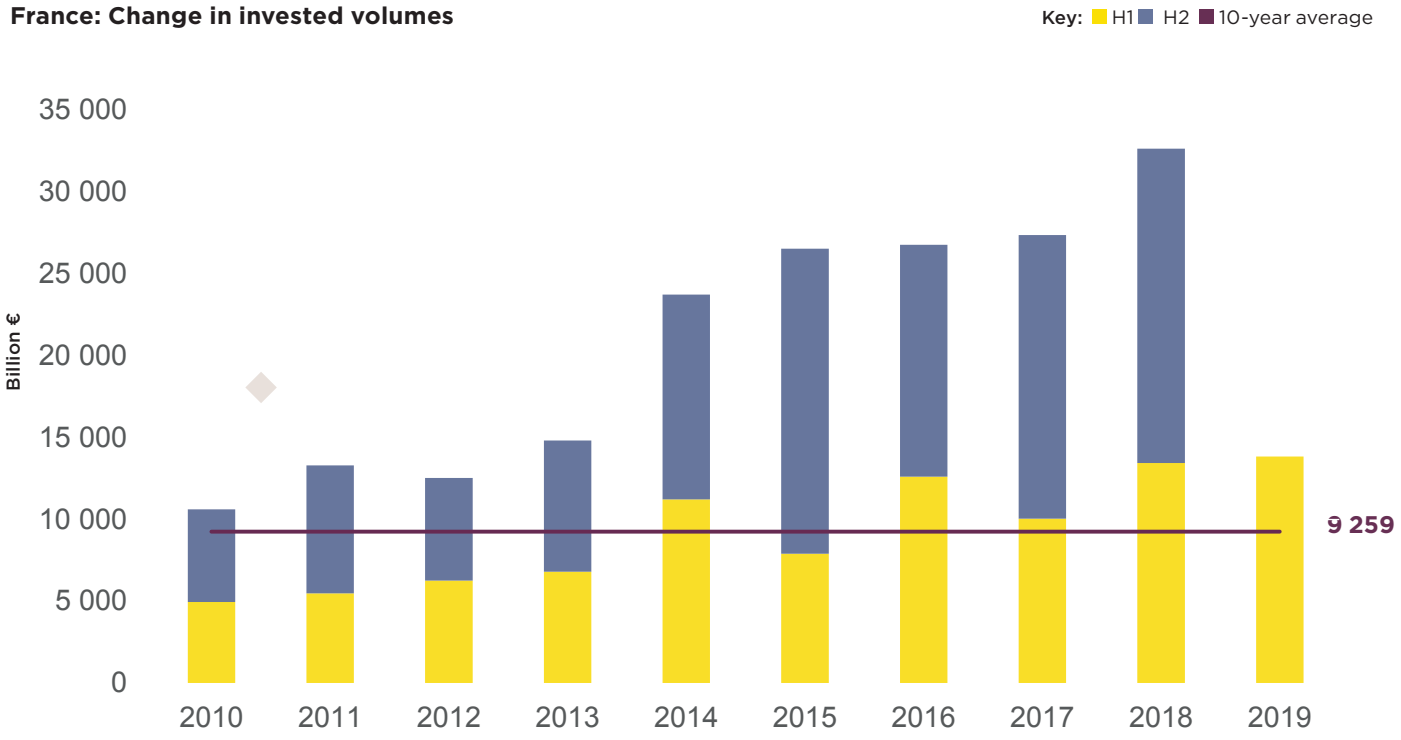
France seems to be on track to repeat its success in 2018, when its investment market reached an unprecedented level (€32.8 billion nation-wide). This performance is even more commendable in an international environment that appears far more sluggish.

Invested volumes: Race to the top
Investment activity accelerated in the second quarter of 2019, allowing the market to near the €14 billion mark in the first six months of the year, 3% more than the figure observed one year ago (€13.8 vs. €13.4 billion) and 48% higher than the 10-year average. The French market stands out from its neighbours for its momentum. The European market is expected to end 2019 with investment volumes of €219 billion, which while 22% higher than the 10-year average, is down 13% compared with 2018. This performance is commendable, including as a member of the "Big Three" (the UK, Germany and France): at the end of H1 2019 the UK market recorded a 34% fall, while the German market was also down (-12%).

Origin of invested funds: Greater internationalisation
This momentum owes much to interest from international investors. France is profiting from the fall in the European currency against most international currencies, which gives its real estate a competitive advantage and allows for a potential upside in the event of monetary normalisation. It shares this advantage with the other eurozone countries, but benefits from it more: Germany, which is the only other country in the eurozone able to boast considerable market depth, offers a risk/return trade-off that has become less attractive. In addition, France appeals due to its economic strength, the resilience of its rental market and its institutional stability, which is especially appreciated in a turbulent international environment. The share of international players has therefore risen in the space of a year from 40% to 53% of invested volumes nation-wide. Such a level has not been seen since before the 2007/2008 crisis.

The first six months of 2019 were particularly marked by the emergence of South Korean investors, who generated more than €2 billion, i.e. 21% of the amounts invested in the Paris region (through the acquisition of the Lumière building in the 12th district for more than €1.1 billion, as well as the CBX and Europe towers in La Défense and the Cristalia building in Rueil-Malmaison). A year ago, these investors accounted for only 3% of the Ile-de-France (greater Paris) market. This sudden surge is in no way random: over the past two to three years, there has been an increase in South Korean investors' interest in the French market. This interest has now materialised in major deals and is expected to last, with, for example, the acquisition of

France: Change in invested volumes



Source Savills Research

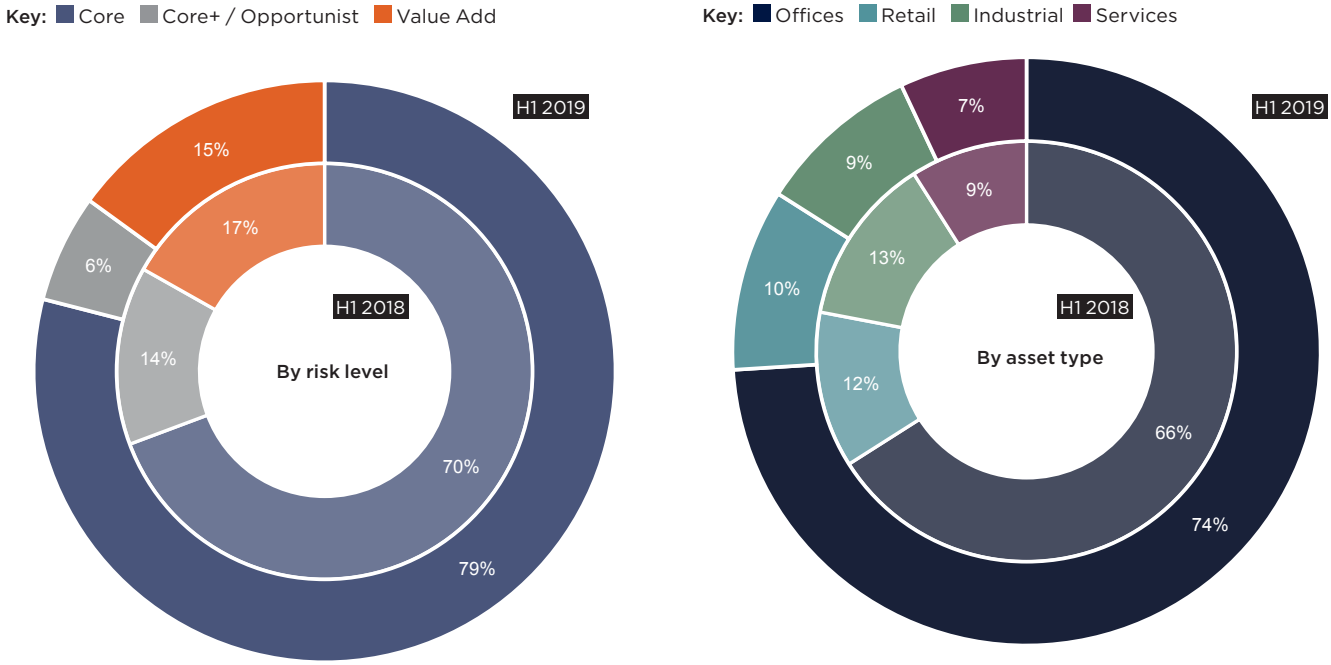
the Majunga tower in La Défense for nearly €850 million, and almost half of the Eqho tower, also in La Défense.
In the wake of the South Koreans, Asian funds (in China and Singapore in particular) are on the lookout and should also conclude several significant acquisitions before the end of the year. Much closer to home, and with a long-standing presence on the French market, German investors are also showing increasing interest in France: year on year, their share in invested volumes national-wide has increased from 15% to more than 19%.
The French market's success with international investors has been at the expense of domestic buyers. While they dominated their market for several years, their share has fallen sharply, down from 60% to 47% of invested volumes in one year. However, although this is a sharp decline, it should not be interpreted as a sign of a lack of interest or distrust in the market, or of these investors' weakness. They continue to hold a key place, and the second half of 2019 is likely to see a rebalancing in their favour. In fact, many French investors, notably SCPIs and OPCIs (real estate investment companies and funds), have even more capital to invest after staying in the background for the past few months. Faced with fierce competition, domestic investors have been reluctant to overbid in the most competitive transactions. They have also sought to prioritise alternative assets. Listed real estate companies, for their part, have prioritised the creation of value from their existing assets, by launching numerous building restructuring or construction programmes, which appeal to users due to the under-supply on the rental market.

Type and quality of assets purchased: Newcomers in search of safety

The internationalisation of the French market through the arrival of new international investors is partly responsible for another phenomenon: the rise in the share of core assets in invested volumes, which increased from 70% to 79% in one year. Logically, these newcomers are focusing on safe acquisitions to break into a market that is new to them.
This resurgence of core assets also stems from the high concentration of the market on a few flagship deals. Half of the volumes invested during the first half of 2019 were concentrated on 19 deals: in the first half of 2018, it took the 25 main deals to reach the same proportion. In addition to the sale of the Lumière building (€1.1 billion), another recent major event was the acquisition of the Terreis portfolio (28 prime buildings mainly located at recognised addresses in Paris) by Swiss Life for nearly €1.8 billion. These two deals alone accounted for 21% of invested volumes in France, and had a huge effect on the market's profile. The coming quarters should see a reduction in this concentration on a small number of deals.

Lastly, market concentration explains another phenomenon: the sharp increase in the share of office assets, from 66% to 74%. This asset class was therefore the only one to grow in terms of volumes invested national-wide (+15%). All the other classes were down compared with the first half of 2018: industrial and logistics assets fell by 23%, retail by 20% and services by 17% (despite the strong activity in hotel assets, which absorbed nearly €700 million in 2019 vs €200 million previously). The underperformance of the retail segment is probably a one-off: the second half of the year should allow it to catch up thanks to the completion of several large deals, such as the sale of the Italie 2 and Passage du Havre shopping centres in Paris for an amount close to €600 million, and the sale of a new Casino portfolio for €470 million.

France: Invested volumes by asset type and risk level



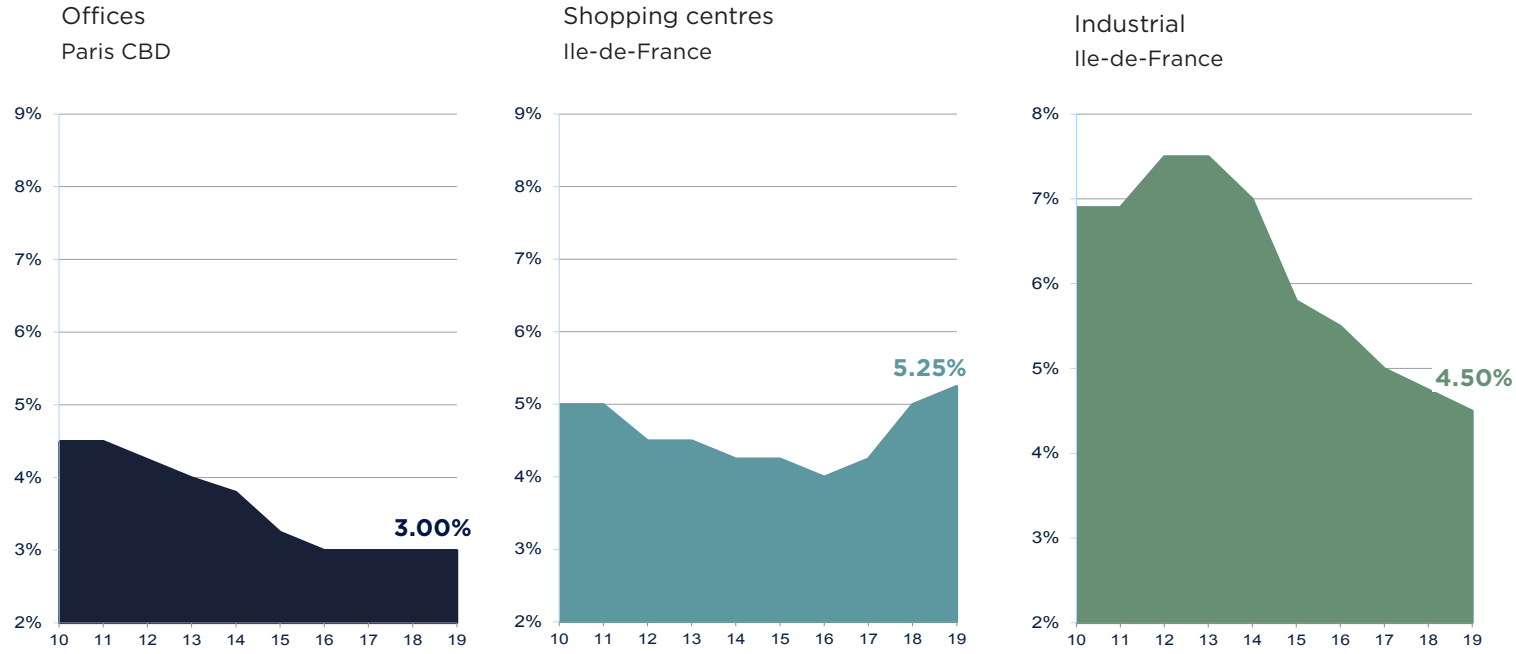
Source Savills Research

Yields: Reinvention of the yield structure
In such an active market, in which the appetite for core assets remains intact, prime yields remain at historically low levels. In the Paris CBD, for example, the yields on attractive office buildings remain at 3.0%. They have not moved since the end of 2016. These levels are not at all irrational: in addition to the prospect of a reversion linked to rent growth, they give real estate assets the advantage of high returns. The spread with the bond yield therefore stood at 229 basis points at end-June 2018. One year later, it has risen to 291 basis points, well above its ten-year average (205 bps).

The stability of prime rates is not an indicator of general immobility. The vacancy rate is so low in central Paris and the shortage of Grade A supply is so pronounced that the rental risk has become relative. An asset whose value can be boosted, whether it is a sub-let building, a building requiring restructuring, or one that is only let short term, can therefore provide a real opportunity for value creation and a safe investment. This is the concept behind core + or value added assets, which needs to be qualified as it attracts investors who are traditionally specialised in core assets. Logically, this leads to a narrowing of the yield spread with prime assets. As well as being driven by asset quality, this narrowing can also be seen between areas. Opportunities arising in outskirts close to major traditional business districts, in the emerging Paris markets (on account of the potential of the Greater Paris project), and even in regional cities, are in fact drawing a great deal of attention from a growing number of potential buyers.

The yield structure quietly began to change in 2018 and is continuing to reinvent itself in 2019.

France: Prime yields by type of asset



Source Savills Research

Geography of invested volumes
Paris, the French star
The Paris region has a prominent place in this flourishing French investment market.

The Ile-de-France attracted €9.9 billion in the first six months of 2019, representing 71% of the volumes invested in France. This makes it the market's true star, whose position is in no way being challenged, despite the opportunities that may arise in the various regional cities: the Ile-de-France region recorded a 4% increase in invested volumes in the first half of 2019, slightly higher than the increase observed nation-wide. It has exceeded its usual results, with a 2019 result that is 57% higher than the 10-year average. Even better, Paris is now the only true rival of the London market in Europe.

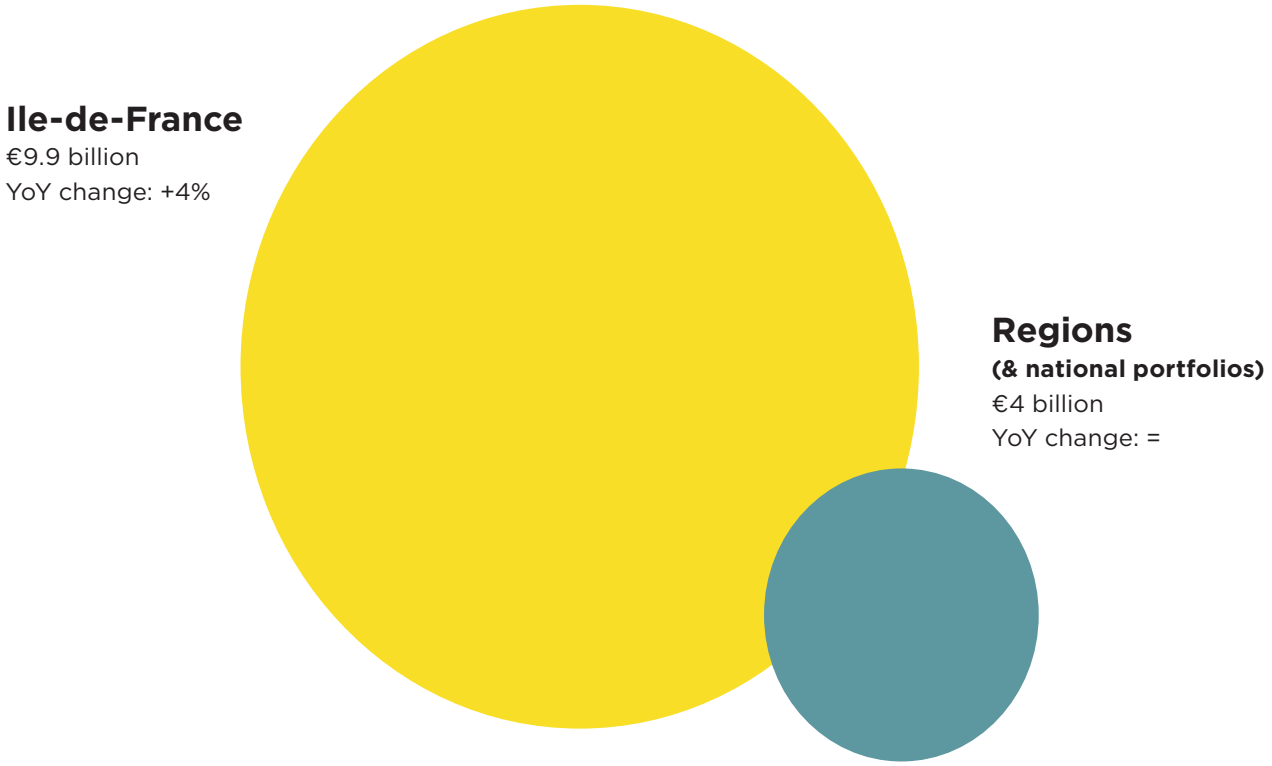
The Ile-de-France is the preferred gateway to the French market for international investors. For the whole of the first half of 2019, the share of non-domestic funds there was significantly higher than for the rest of the country, at 56% of volumes invested in the Ile-de-France.
Very large deals have driven activity since the beginning of the year. Deals of more than €500 million accounted for 30% of the volumes invested in the Paris region in the first half of 2019, compared with only 17% in 2018.
In the segment below (€100 to €500 million), activity remains relatively stable from one year to the next: €4.1 billion were invested, representing a slight fall (-8%), despite a slightly higher number of deals (23 compared with 21 in 2018).

The stability of this segment, in addition to the strong growth in very large deals, reflects the increasing concentration of the greater Paris market. This concentration was also reflected in the underperformance of sales of a unit amount of less than €100 million. In this segment, invested volumes were down sharply from €3.4 billion to €2.8 billion in one year (-16%), attributable to the significant reduction in the number of sales (101 compared with 129 in 2018).

This state of affairs negatively affected the CBD, as this area has few very large buildings. The CBD therefore recorded a 42% decline, with €1.1 billion invested during the first six months of the year. Although this fall is impressive it must nevertheless be put into perspective: not only was the base the exceptional first half of 2018, but the drop was further amplified by the material share represented by the portfolios. The amounts invested through the sale of the Terreis portfolio, for example, are difficult to locate geographically, while the majority of its buildings are located in the CBD.

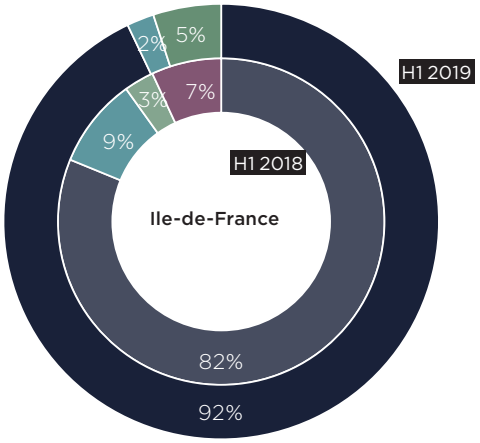
Conversely, the rest of central Paris (+26%, with €2.6 billion), the Inner Suburbs (+60%, with €1.5 billion) and, above all, La Défense (+604%, with €790 million), performed very well.

H1 2019: Geographical breakdown of invested volumes



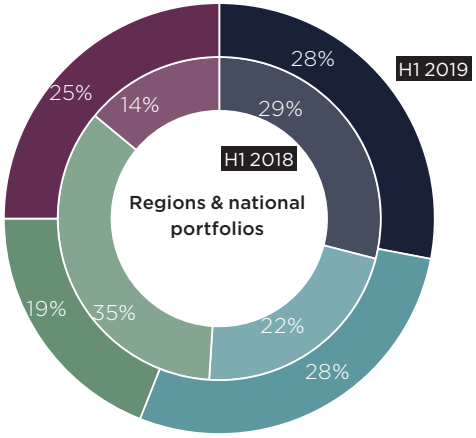
Specific characteristics of the Ile-de-France compared with the French regional markets

Ile-de-France vs the Regions: Invested volumes by asset type

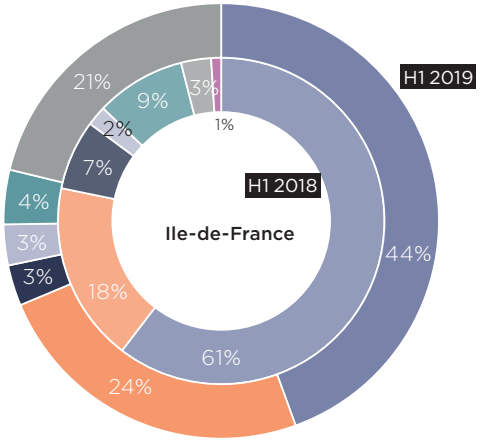


Key :

- Offices
- Retail
- Industrial
- Services

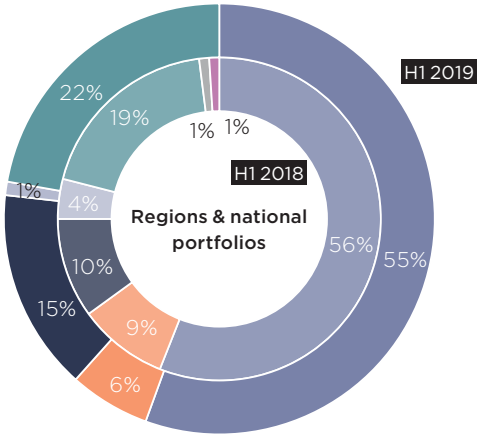


Ile-de-France vs the Regions: Source of invested funds

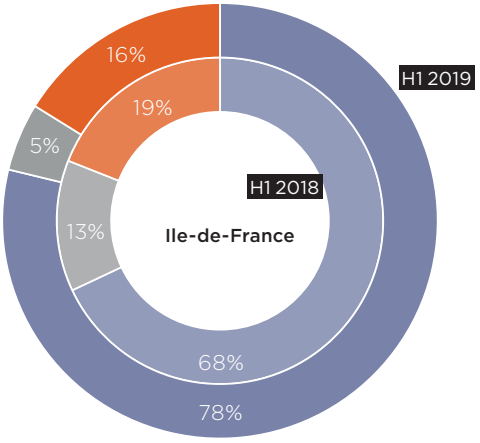


Key :

- France
- Germany
- the UK
- Other EU countries
- the US
- Asia Pacific
- Other

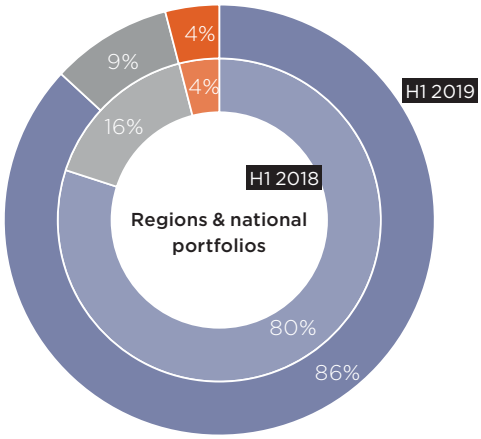


Ile-de-France vs the Regions: Invested volumes by risk level



Key :

- Core
- Core+ / Opportunist
- Value Add



Source Savills Research

Outlook

Music to the ears

The figures for the first half of 2019 are good, if not very good. They augur strong outlooks for the whole year and probably beyond.

The figures for the first half of 2019 are good, or even very good. They suggest a strong outlook for the full year and beyond.
The recently announced continuation by the European Central Bank of its monetary policy "bazooka", and new bank refinancing operations, designed to encourage banks to leave the credit tap running, will help to maintain an environment of low interest rates and easy financing conditions. This is a big change from expectations just six months ago.
This adjustment of the ECB's monetary policy is linked to the weakening of the economic outlook and international instability, which is weighing on foreign trade. These factors are also worrying investors who control significant amounts of amounts and must identify the best investments. They are therefore likely to continue seeking safety above all. Such an environment is traditionally favourable to fixed income and real estate investments.

In these conditions, France has become attractive again, particularly thanks to its economic and institutional stability. Its real estate market should therefore remain a preferred destination for international investors in Europe. This is particularly the case for Germans investors: as they are currently under-exposed to France, they will continue to try to increase their presence there, as has already been the case in the first half of 2019. Value added and opportunistic funds, often originating from English-speaking countries, are attracted by the lack of supply, the resilience of the rental market and the reversion potential of French real estate. They will therefore continue to look for opportunities. But this interest in the French market is also spreading to more unusual players. The recent breakthrough of South Korean funds has largely demonstrated this. There is every reason to think that newcomers are likely to continue trying to carve a place for themselves.

These factors, combined with the strong upturn in fundraising by French SCPI and OPCI funds, suggest that the market is set to remain at historically high levels, probably close to €33 billion.

This market environment will not be without consequences for yields or their structure. Last year, it seemed logical to expect a slight increase in yields, echoing expectations for fixed income investments. This increase is no longer on the cards. As the spread between real estate and fixed income yields is extremely favourable for the real estate sector, a further squeeze could even be seen in 2019. This is true in some emerging greater Paris markets and in the regional markets, as well as for certain types of assets that are easily able to generate value. However, this can no longer be ruled out for certain prime Paris assets, particularly in the CBD, which represents a significant change. The 3.0% floor could therefore be temporarily pushed down in the coming months.

Savills team

Please contact us for further information

Boris Cappelle
CEO
Savills France
+33 1 44 51 77 17
bcappelle@savills.fr

Thomas Canvel
Managing Director
France Investment
+33 1 44 51 77 16
tcanvel@savills.fr

Cyril Robert
Head of Research
France Research
+33 1 44 51 17 50
cyril.robert@savills.fr

savills