

Real Estate Strategic Outlook: France

What are the macroeconomic drivers?

Public spending cuts to weigh on short-term growth

While current economic growth in France remains sluggish, there are some signs of a pickup, with services PMIs recovering in the first quarter of 2024. Inflation figures are clearly trending down, allowing for a potential summer interest rate cut and an improvement in the outlook for real wage growth. However, the surprise parliamentary elections at the end of June and early July are likely to raise short-term uncertainty and delay further economic recovery. In addition, the public sector in France is still in contraction mode after several high-spending years in response to the Covid-19 pandemic and energy crisis. This is likely to weigh on medium-term economic growth as public spending comprises over half of France's GDP.

Strategy: what and where?

Southern France logistics availability at record lows

Regional French logistics hubs are promising destinations for investment. Logistics vacancy, at present, trends down from North to South, from over 10% around Lille to below 2% in the Marseille region. Regulatory constraints around building on greenfield land are likely to prevent the development response that such low vacancy rates and strong rental growth would usually precipitate. Rental outperformance is therefore likely in the medium term.

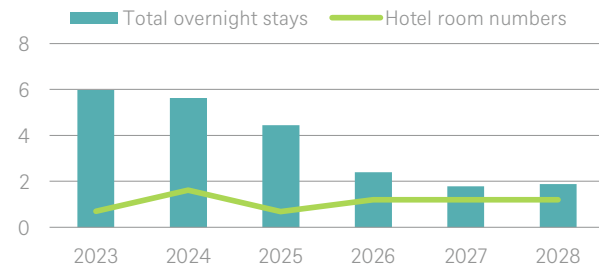
For existing assets, capturing this rental growth will only be possible by asset management initiatives to shorten leases granted and ensure that leases are renewed at market, rather than passing rental levels. The other area of opportunity is in targeting repriced core investments. Capital seeking core-plus and value-add opportunities is relatively abundant leaving limited competition for core assets. Given the expected high levels of rental growth in Lyon and Marseille, our forecasted gross total returns for prime logistics are still over 10% per annum over the next five years. These returns are dependent on crystallising an entry yield close to 5%. As it is unlikely that prime yields will be at this level in a year's time in the context of falling interest rates, this window of opportunity is time limited.

Hotel sector goes for gold in Olympic year

The outlook is bright for hotels in 2024, with many operators in Paris expecting close to full occupancy as tourists flock to the city in anticipation of the summer Olympic Games. The hotel market in Paris is also likely to sustain strong

performance beyond 2024. New permits to convert furnished apartments to AirBnB rentals will no longer be granted under the new Paris urban plan set to be enacted in September 2024. This will limit competition and support occupancy for existing hotels. In addition, the supply of hotels is expected to grow at 1.2% on average per year over the next five years, compared to growth in overnight stays of 3.2%,¹ so demand should comfortably exceed supply.

Paris Hotels: Forecasted Demand and Supply (% change y-o-y)



Source: PMA, April 2024

Hotel yields have not moved out to the same extent as offices, logistics, or residential over the past two years, so the entry point is less attractive at present, but with a management agreement in place, this is likely to be compensated by strong expected income growth.

Opportunity remains in value-add strategies for office sector

There are currently two opposing opportunities in the Paris office market at present. The first is to upgrade poor-quality existing offices to meet the latest occupier standards in CBD or CBD-adjacent locations to benefit from the centralisation of occupier demand, a deficit of the right supply, and a slump in capital values in what is usually an expensive market.

The second strategy is to convert obsolete office space to residential, hotel, or student housing use. Conversion to housing is most likely to be viable in the Western Business District where structural vacancy in the office sector has been high for many years and residential property is highly sought-after.

¹ PMA, April 2024

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