

MARKETBEAT

INVESTMENT

FRANCE

H1 2023

July 2023

Investment H1 2023

KEY FIGURES

€6.3 bn

*Investments
(provisional)*

321

Transactions

3.75%

*Prime yield
(office)*

57%

*Proportion of
offices*

Endlessly on a knife edge

End of the crisis: a glimmer of light at the end of the tunnel?

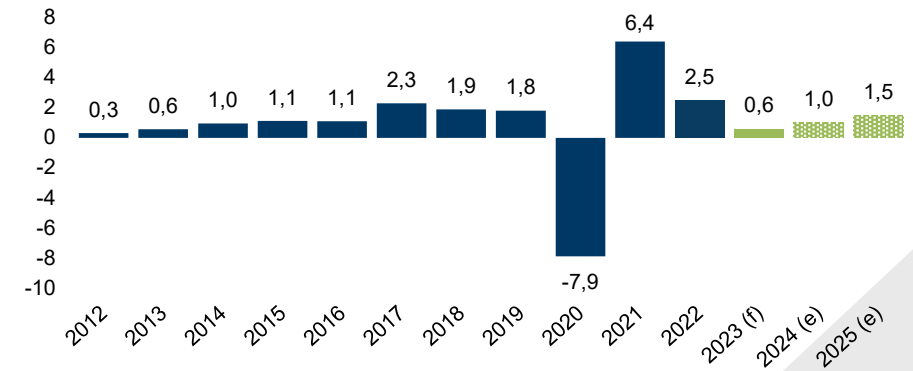
Still on a knife-edge, the French economy is close to recession but remained in positive territory over H1 2023 with +0.2% in Q1 and +0.1% in Q2. Business activity was penalised by persistently high inflation, which is hampering domestic demand (the key driver of growth) and a worsening business climate (down 7pts on average year on year). The year is set to end in a similarly sluggish manner, with +0.2% expected in Q3 and +0.1% in Q4. INSEE is therefore forecasting growth of +0.6% for 2023; this is below expectations (1%) and also lower than last year's performance, which was bolstered by the compensatory effect of post-Covid gains due to soaring prices from spring 2022.

Inflationary pressures appear to have slowed since April when levels reached +5.9% year-on-year, with a rise of "only" 4.5% in June due to recent fall in energy prices (oil and gas) and, more recently, a slight lull in the food sector (+7.4% expected in December vs +15% in April). The lull in prices for these two strategic household expenses should stimulate purchasing power (which was also muted at -0.6% over Q2 2023), and breathe some life into consumption (-0.2% estimated in 2023). INSEE is therefore forecasting that inflation will stand at 4.4% by the end of the year, a high level which could continue for several months. The timid reduction in underlying inflation from the April peak (+6.3%) is also prompting caution over the medium term.

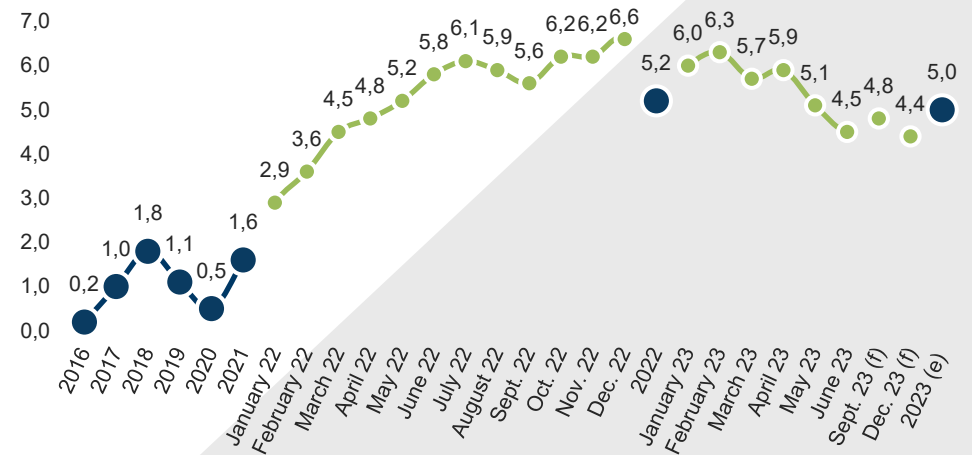
The state of public finances remains worrying, with debt still running at 110% of GDP and the public deficit at 5%, well below the government's 2.7% assurances to Brussels. However, the desire to bring a definitive end to temporary State aid is also confronted by the current social tension and the real estate crisis triggered by interest rates hikes that are also amplifying factors weighing on household confidence.

There are some signs of a slowdown in the job market: in addition to the growing number of business failures (+45% year-on-year at the end of June), job creations have slowed with INSEE estimates for 2023 at -60% compared with 2022. Most of these losses are in construction, hospitality and retail - the sectors most affected by rising costs and which are suffering from falling demand. However, due to a proportional reduction in the active population, the unemployment rate is expected to remain at around 7.1% this year.

GDP Growth France (%)



CHANGE IN INFLATION France (%)

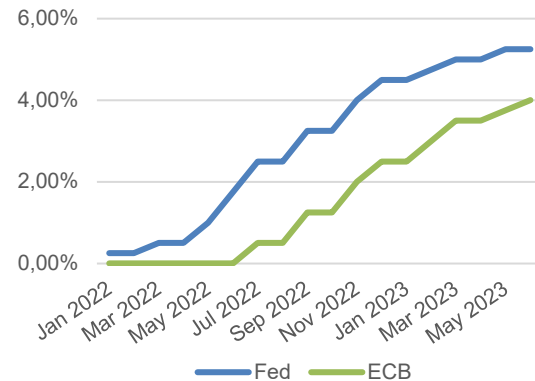


Sources: INSEE, Banque de France

Rising interest rates: a 'slow burn' effect

Peak or high plateau? Conflict between hawks and doves

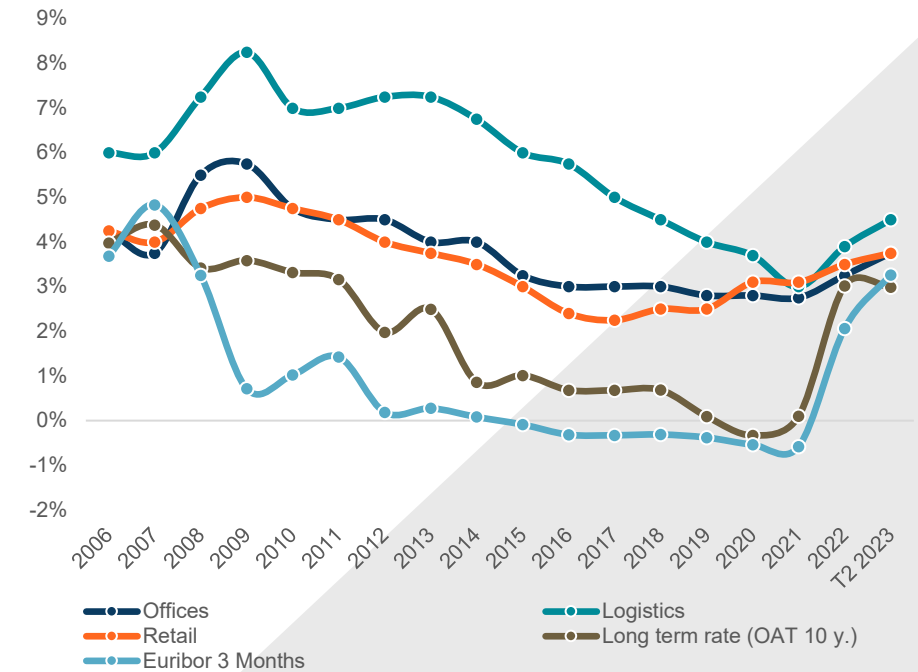
MONTHLY CHANGE IN KEY RATES (REFINANCING)



Following a further increase in June (to 4% for the refinancing rate, its highest level for 2 decades), ECB governors appear to be divided over whether or not to continue their policy of raising key rates. The threat of "over tightening" could heighten the risk of recession, whereas inaction could cause inflation to pick up again, driven by rising wages (+5.3% in the Eurozone). While consensus is moving inevitably towards an end to the upward cycle, the issue of timing remains unclear: quickly, so that its effects on economic performance can be measured, or not before a firm and definitive fall in inflation to the 2% target - a level which is increasingly being called into question? The debate remains open at the ECB, while the Fed temporarily suspended its rate hike cycle in June following a slight stabilisation in prices.

Monetary tightening has had an impact on all players in the financial system, sparing neither households nor businesses, both of which have significantly reduced their expenditure and recourse to credit. This financial procrastination, coupled with strong macroeconomic uncertainties, has accentuated volatility in long-term government borrowing rates. After having peaked at over 3.25% in Q1, the 10-year OAT has fallen back to around 3%, recreating a de facto spread with yields in the real estate market, which have continued to rise due to a lack of liquidity and tighter financing conditions. The competitiveness of the French real estate market (which has sharply eroded in recent months), is gradually returning to its former glory, thanks to asset repricing which is now underway and the outlook for income growth brought about by rent indexation, which acts as a buffer against currency erosion in times of inflation. The prospect of interest rates reaching a peak should therefore boost investor confidence and transactional activity over the medium term.

FINANCIAL CLIMATE AND PRIME REAL ESTATE YIELDS



Source: Cushman & Wakefield, Banque de France

BROAD CONTEXT

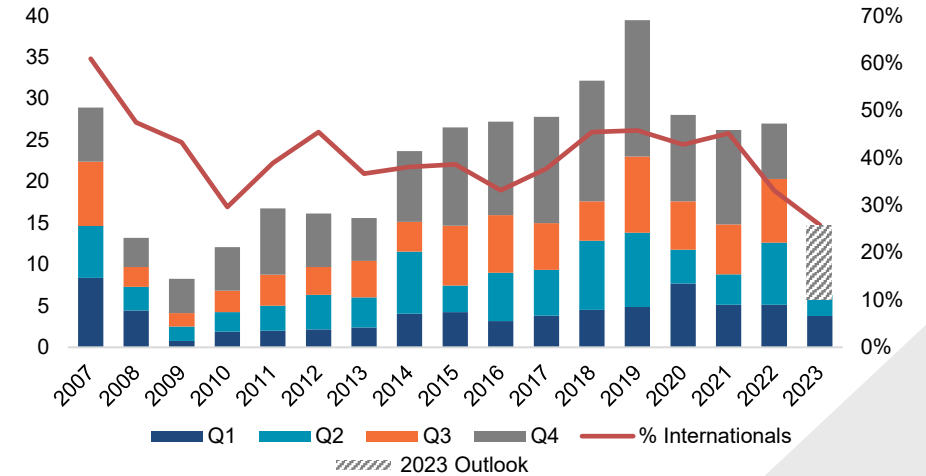
Widespread falls...

After the undeniable resilience seen in the French commercial property investment market over Q1 in compared with our main neighbours, the downturn in activity has gained pace: with €6.3 billion in investments recorded (according to provisional figures), H1 2023 was down -50% year on year, with a sharp reduction of over -65% in Q2.

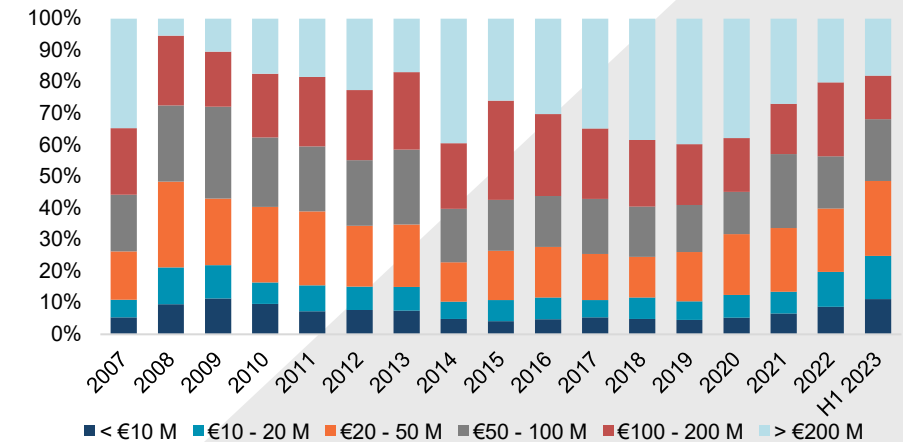
The market is facing an unprecedented lack of available capital in the Core segment due to the low competitiveness of property yields compared with the levels of return now seen for financial assets and to the marked deterioration in credit conditions (availability, cost). Large transactions, which are particularly exposed to these financing issues, remained in short supply, with lot sizes >€200 million accounting for just 18% of activity (40% in 2019). Reduced activity from international investors, such as British and German investors, continued as they focus on rapid deterioration in their local markets. While the various asset classes are not totally aligned in terms of correction timing, none of them are currently running against the cycle: logistics continues to fall sharply and even retail is seeing volumes below its long-term half-year performance.

Faced with this loss of attractiveness in the real estate spread, but also with uncertainty about the extent of the correction and the timing of a normalisation in financial rates, investors are finding it hard to plan ahead. However, it should be remembered that a significant proportion of the correction process has already happened: according to the most likely scenario, after a peak expected in late 2023/early 2024, the OAT should fall back to stabilise at around 3 - 3.5% over the course of 2024. A new market equilibrium should then be established, based on a convergence of the various prime yields at around 4.5% - 5%, which would gradually revive transactional activity. In an environment where the frictional effects of changes to our economic model are likely to fuel inflationary pressures, France as a destination and real estate assets that generate index-linked cash flows will continue to be attractive medium- to long-term investments for surplus savings and liquidity that will continue to be generated both locally and internationally.

INVESTMENT VOLUMES BY QUARTER, € billions



INVESTMENT VOLUME BY LOT SIZE



OFFICES

Crisis amplifying asset-class uncertainty

For 3 years now, the office market has been suffering as investors seek to diversify: the market share has fallen from 70% (pre-2019 average) to 55% (average 2022 - H1 2023). Covid, with the advent of hybrid working, clearly marks a shift having raised fundamental questions about the long-term need for office space, and therefore about the possibility of retaining values for this asset class - these questions have now been further amplified by the current financial crisis. With €3.6 billion recorded over the last 6 months, H1 2023 office investment was comparable to the volume seen in 2010 (in current euros)...

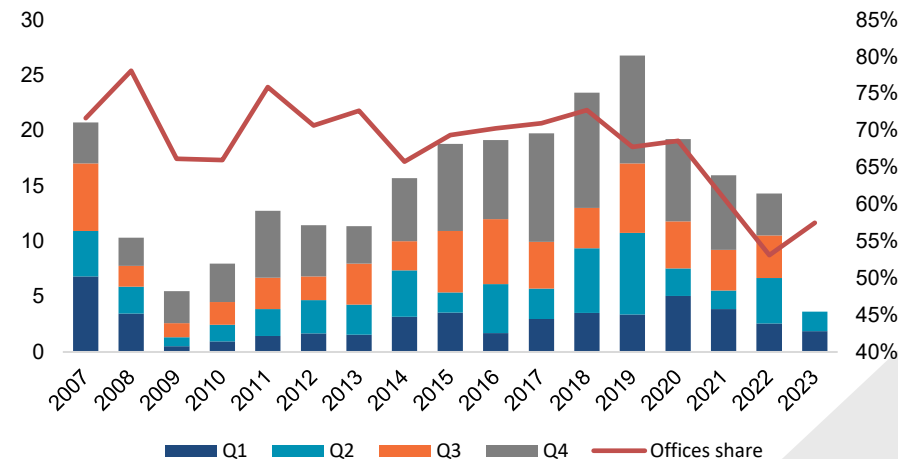
With the exception of the Sequana tower in Q2, no deals for lot sizes >€200 M€ were recorded. The few remaining pockets of liquidity were limited to the €20-100m segment, in Paris for small, high-quality Core assets by long-term full-equity or value-added investors. Regional markets are still sought after for new buildings which are lacking in many regional rental markets. Because of their liquid size, these opportunities are being targeted by SCPIs which, until the start of the year, were still seeing very good levels of inflows.

Against this backdrop, prime yields continued to rise - albeit gradually but increasingly selectively. The prime yield in the CBD now stands at 3.75%, with rises tempered by the persistence of very long-term players confident in the potential for rental growth brought about by the effect of structural scarcity in highly central markets. Conversely, the hierarchy of yields has been restored to better reflect the strength of the underlying rental fundamentals:

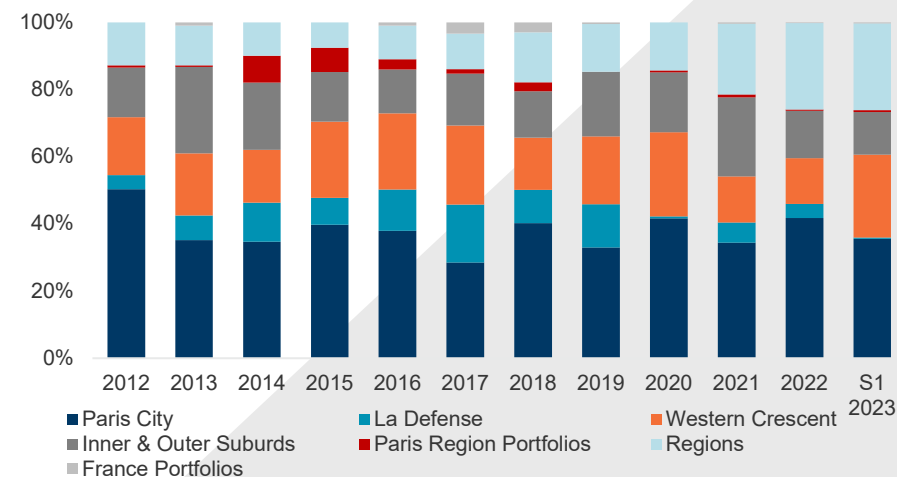
- within the Paris market, between the CBD and surrounding markets, particularly in the Centre-Est, where the surge in prime rents is beginning to slow;
- between Paris and its suburbs, to take account of the reality of the risk arising from some worrying vacancy rates.

This hierarchy needs to be restored so that the large amounts of capital raised on an international scale can eventually be invested in risk strategies in order to meet the growing challenge of repositioning assets that are becoming obsolete.

OFFICE INVESTMENT VOLUMES BY QUARTER, € billions



OFFICE INVESTMENT VOLUMES BY LOCATION



Sources: Immostat, Cushman & Wakefield

RETAIL

Disappointing Q2 following an exceptional start to the year

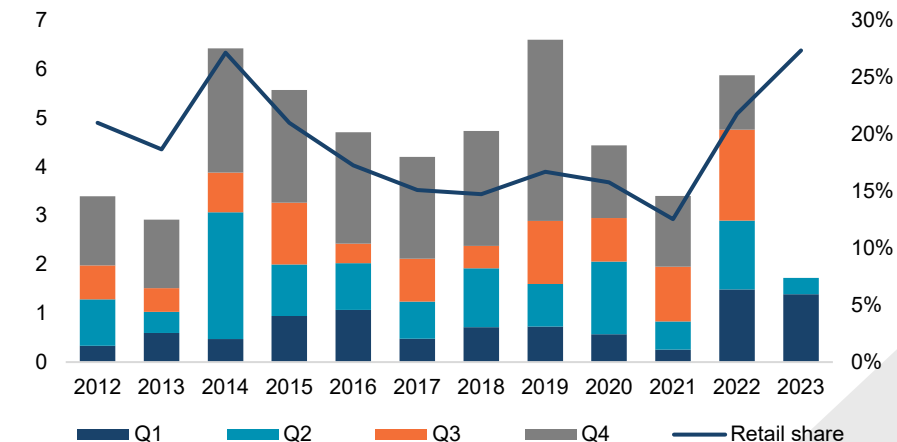
With just over €330 million over Q2, the investment market has set new records with the lowest amount invested for the H1 period and the lowest quarterly volume since 2012. Thanks to the investments seen over Q1, H1 performed well with a total of over €1.7 billion. This performance is slightly below the 5- year average (-7%) but well below that seen in 2022 (-40%), which was an exceptional year with €2.9 billion invested in retail by the end of June. Against a backdrop of a general slowdown, and despite the contraction in volumes seen in Q2, the retail segment is holding its own with a solid market share of 27%; this is significantly higher than both the 5- and 10-year averages (16% and 18% respectively).

Only one transaction was recorded in the large transactions segment (> €100m) this quarter: AEW's acquisition of Passy Plaza shopping centre in Paris from GENERALI. This transaction accounted for over a third of the Q2 investment volume and took the overall number of transactions in this segment to 4 over the H1 period (10 over H1 2022), a performance fully in line with the 10-year average. The remainder of the transactions recorded over Q2 were for lot sizes <€20m, which are more liquid and easier to finance at a time when credit is becoming more scarce.

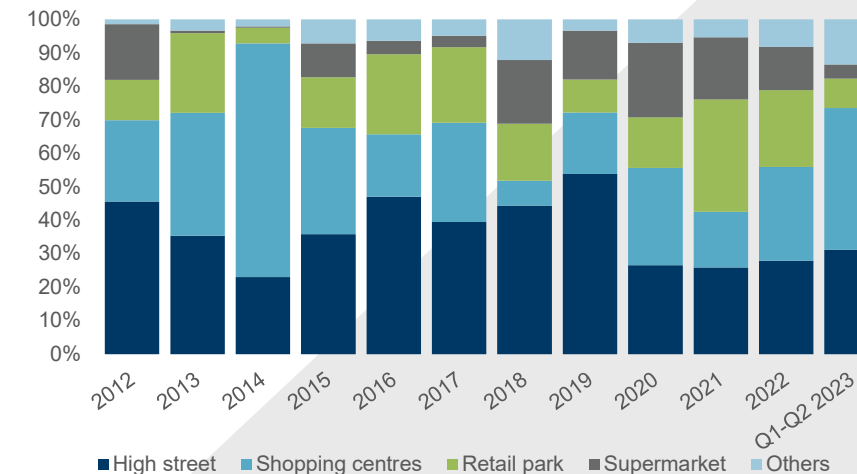
Accounting for almost ¾ of the total H1 investment volume, shopping centres and high streets clearly dominated the market; this was largely due to 2 major acquisitions over Q1 (the "Italie 2" shopping centre and the VALENTINO boutique at 35 Avenue Montaigne). In light of the transactions currently underway, 2023 could end on the same note with retail in a strong position in a very slow market for commercial real estate investment.

The reduction in transactional activity seen in recent months draws a line under the post-Covid boost seen in the market until Q1 2023. This change in pace is a delayed sign of market paralysis associated with the impact of soaring inflation and tighter financing conditions from spring 2022. As for prime yields, levels remained stable over Q2 at 3.75% for high streets, 4.75% for shopping centres and 5% for retail parks. With no easing in financial tensions expected over the short term, yields should resume their gradual rise between now and the end of the year, returning to the levels seen before the sub-prime crisis in the late 2000s.

RETAIL INVESTMENT VOLUME, € billions



INVESTMENT VOLUME BY ASSET TYPE, €bn



LOGISTIC

A sharp drop, despite faster price reductions than for other asset classes

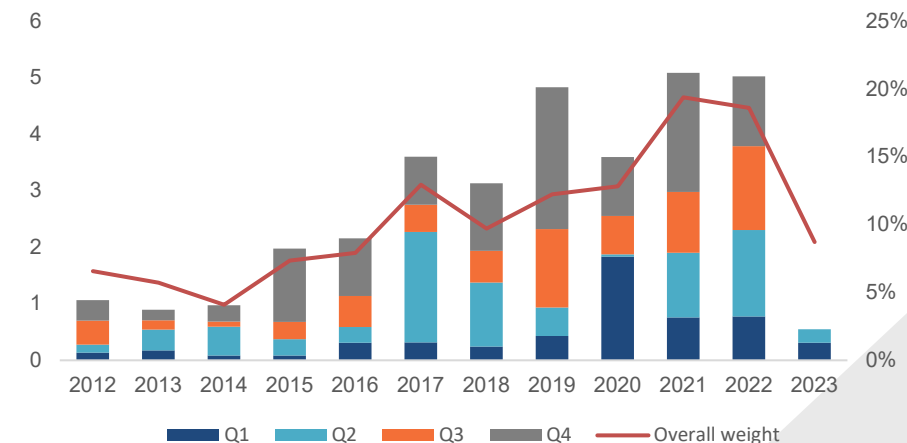
On the investment front, activity is slowing again: with €550,000 in investments recorded (according to provisional figures), H1 2023 was down -76% compared with the same period in 2022, with a reduction of more than -84% year on year.

As a result, the proportion of logistics in overall investments fell back below 10%; this is surprising given the drive by investors to diversify their portfolios as well as the price correction seen that has been faster than for other asset classes. Since the upturn that began last spring, the prime yield for logistics has jumped 150 bps to 4.50%, recreating a de facto spread with the office and retail sectors.

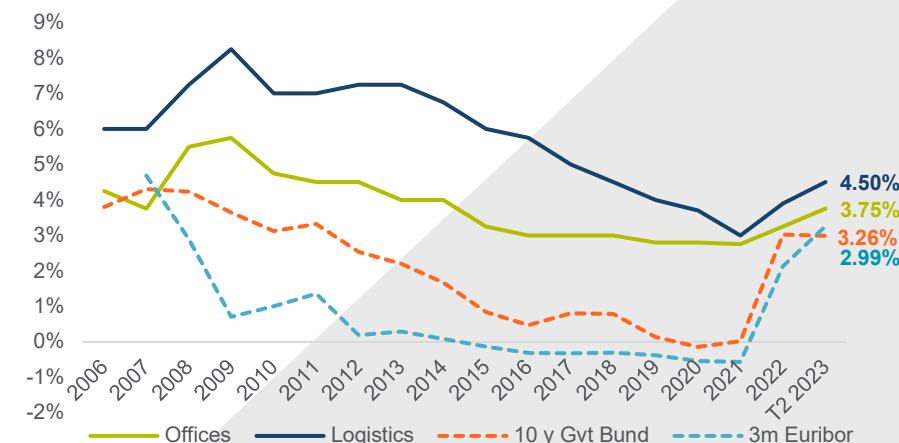
Investors are currently facing a dual problem: the low competitiveness of real estate yields compared with the levels of return now achieved by financial assets and above all the uncertainty surrounding the extent of the correction and the timing of market normalisation. The debate within the ECB on the timeframe for the end of the upward cycle in key rates continues: will it come quickly to limit the recessionary impact of the current monetary tightening, or not before a firm and definitive fall in inflation to the 2% target, a level which is increasingly questionable given the friction effects of the many changes underway in our economic model?

Against this already difficult backdrop, the logistics sector in particular appears to be suffering due to its high exposure to international investors, who have withdrawn massively in a traditional back-to-home move and from the increased difficulty of financing portfolios, due to the sums involved. Furthermore, it remains a relatively new asset class for non-specialist players, who may, in times of uncertainty, be even more cautious about a product that has long been regarded as a simple piece of cladding in the middle of a field... This runs the risk of ignoring the reality of the potential for rental growth due to the structural nature of the factors supporting it (increasing scarcity of land and the growing complexity of products, the strategic dimension of supply chain adaptation needs and the still limited weight of real estate costs in the value creation chain of market players, etc.).

INVESTMENT VOLUMES BY QUARTER,
€ billions



PRIME YIELD



MAP AND DEFINITIONS

Core: Asset benefiting from a prime geographic location and ensuring safe rental yields due to the quality of the tenants, the duration of the leases, the low vacancy rate and low rental rotation rate.

Core +: Assets for which an investor can accept a less secured income compensated by a further increase in value. Well located and of good quality, these assets may require renovation or active asset management to upgrade their occupancy rate.

EONIA (Euro Over Night Index Average) rate: Overnight interbank reference rate for the Euro.

EURIBOR: Euro Interbank Offered Rate: This is the rate at which Euro interbank term deposits are offered by one prime bank to another prime bank within the EMU zone. It corresponds to the daily valuation provided by a sample of 57 European banking institutions.

LTV (Loan-to-Value): Debt ratio (amount of funding over the total value of the asset).

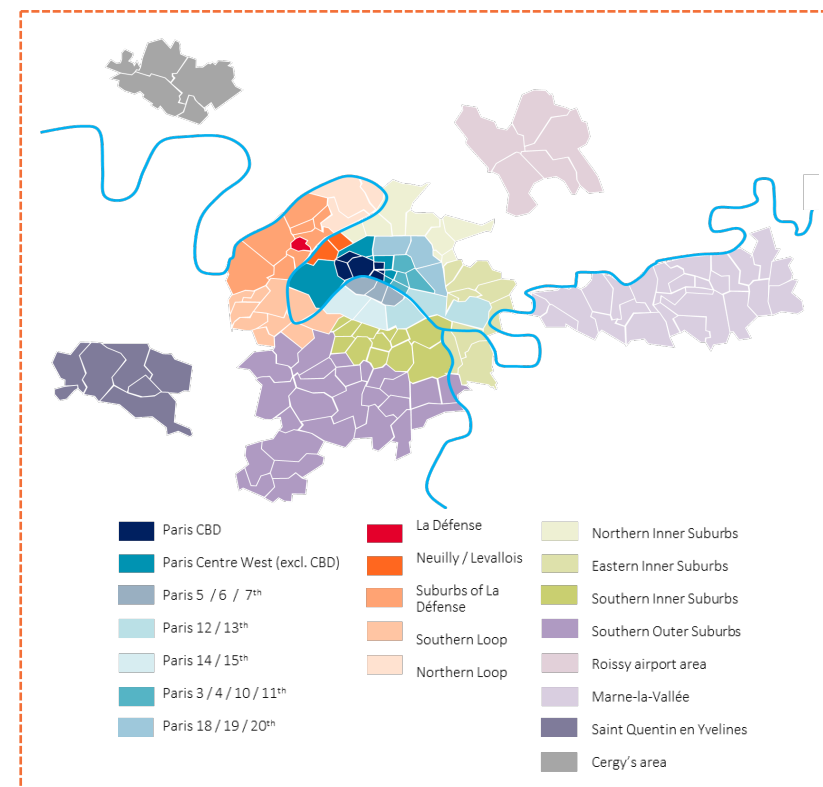
10-year Government Bond Yield: Treasury bonds backing long-term government debt, with maturities of 10 years.

Opportunistic investment: Investment strategy aiming to identify and capitalise on emerging investment opportunities and trends before they are fully recognized by the investors community.

Prime yield: Ratio of rents (less expenses) over the acquisition price (deed in hand) of the asset. The lowest profitability recorded during a given period, after outlying values have been eliminated (less than two occurrences).

Value-added: Assets acquired for the purpose of creating or recreating value through dynamic management.

Investment volume: Acquisition of commercial real estate assets – Office, Retail, Warehouses and light industrial – by "CRE" investors i.e. investors whose only purpose is to get rental income or capital gains when selling on.



Geographic sectors from Immostat

ABOUT CUSHMAN & WAKEFIELD

Cushman & Wakefield (NYSE: CWK) is a leading global commercial real estate services firm for property owners and occupiers with approximately 52,000 employees in approximately 400 offices and 60 countries. In 2022, the firm reported revenue of \$10.1 billion across its core services of property, facilities and project management, leasing, capital markets, and valuation and other services. It also receives numerous industry and business accolades for its award-winning culture and commitment to Diversity, Equity and Inclusion (DEI), Environmental, Social and Governance (ESG) and more.

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AROUND THE WORLD

400 offices

60 countries

52 000 collaborators

\$10,1bn USD turnover 2022

FRANCE

16 offices

+ 500 collaborators