

FRANCE REAL ESTATE STRATEGIC OUTLOOK

First Quarter

IN A NUTSHELL

- _ Following a difficult year, the French real estate market is now well-positioned for recovery.
- _ We remain positive on logistics, particularly urban locations around Paris, and we feel there is a strong case for residential.
- _ The outlook for offices is less certain, although pricing for core product is holding up. The disruption to the retail sector continues, with the sector vulnerable to further price corrections.

Following a difficult year, the French real estate market is now well-positioned for recovery. Logistics remains the top-performing sector, particularly in urban locations around Paris. The outlook for offices is increasingly uncertain in view of weak demand from occupiers, although pricing for core product is holding up. The disruption to the retail sector continues and high streets are increasingly vulnerable to further price corrections. Residential has performed well throughout the Covid-19 pandemic and we believe that demand is likely to remain strong over the next five years.

Rise in infections causing further lockdowns

With an easing of restrictions, third quarter GDP rebounded more quickly than expected as a result of strong household spending.¹ However, the growing number of infections in the fourth quarter and at the start of 2021 has resulted in further restrictions and a contraction in economic growth. Overall, GDP is likely to have fallen by more than 8% in 2020.²

¹ Oxford Economics, December 2020

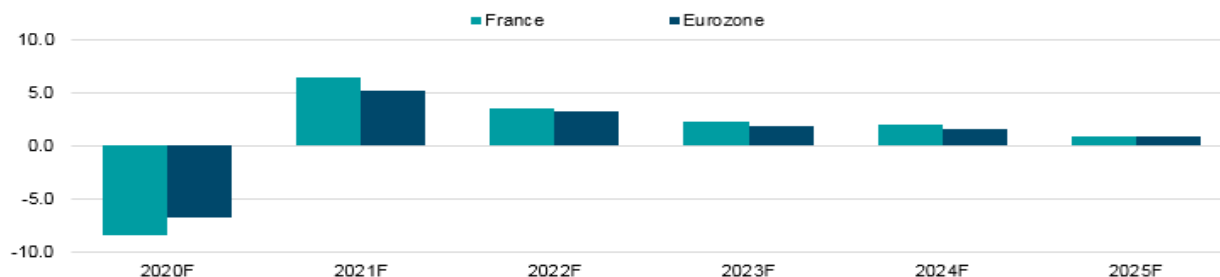
² DWS, December 2020

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GDP Growth (% P.A.)



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The rollout of vaccinations in France has been relatively slow, but is set to accelerate in early 2021. Assuming a successful rollout over the course of the year, an economic recovery should ensue. Over the next five years, we forecast economic growth in France to outperform the Eurozone average.

Weak office occupier market

While there are clear implications for the retail and logistics sectors as a result of Covid-19, it is still unclear how the office sector will be affected. In France, working from home was not the norm before last year, but this has quickly changed due to the pandemic. The fact that unions are negotiating with employers to ensure that working from home in the future will not be at the cost of employees' wellbeing and finances suggests that a change in the way of working is already foreseen.³

In view of this trend, the economic downturn in 2020, and ongoing restrictions to reduce infection rates, occupiers are exercising caution. Take-up in Lille, Lyon, and Paris for the first three quarters of 2020 was only around half that of the corresponding period in 2019.⁴

As a result, availability has increased. In Paris, the most marked rise in vacancy has been in La Défense, where the weakness in occupier demand has coincided with an influx of new completions. As supply and demand rebalance, we are expecting to see several years of rental decline in this submarket. The CBD market entered the crisis with historically low levels of vacancy and, despite an uptick in availability, we feel any rental correction in 2021 is likely to be short-lived.

Of the regional markets, we believe Marseille is likely to see the most limited rental correction as a result of Covid-19. This is partly because the market has not experienced significant rental growth in recent years, and rents are still relatively affordable. Constrained growth in supply over the next five years should also support rents.

The Lyon office market is boosted by a stronger regional economy than Lille and Marseille, but a high level of completions in 2020-21 is likely to dampen short-term rental growth.

High street values start to correct

The bounceback in retail spending when restrictions were eased in the third quarter of 2020 bodes well for a strong recovery in 2021. However, an increasing proportion of spend is likely to go through online channels, with the closure of physical stores in 2020 forcing an acceleration in sales diversion.

High street retail has been relatively resilient to the wider disruption within the sector until this year. In the second quarter of 2020, prime yields for high street assets in Paris moved out for the first time since 2011.⁵ This is partly due to the fall

³ Le Figaro, September 2020

⁴ CBRE, December 2020

⁵ CBRE, Q3 2020

in tourist numbers caused by Covid-19, but is also likely to be the start of a longer-term trend as in-store sales are eroded by the growth in online sales. Our forecast is therefore for retail to underperform over the next five years while values correct.

Logistics pricing reaches new highs

The logistics sector has benefitted from continued investor interest over the past year in anticipation of strong rental growth as a result of a structural shift towards online retail. Prime yields have now fallen below 4.00% – a historical low.⁶ The low interest rate environment may support some further yield compression over the next three years but we expect the rate of compression to slow.

Paris and Lyon are the top-performing markets in our forecasts due to the strength of demand for new space and relatively constrained supply. Rental growth in Lille is likely to be limited by the extent of new completions expected in the next two years.

Potential in residential

We see an increasing focus on the private rented residential sector. The sector is becoming increasingly investable in France, although compared to the United Kingdom and Germany, there is still relatively little institutionally owned stock and ownership is fragmented. New housing construction has slowed over 2020 and this could support stronger value growth in the coming years.

The most favourable dynamics are in Paris, where a higher concentration of young professionals creates a natural demand pool for rental stock, and supply is constrained. In 2020 apartment prices in the capital are expected to have grown by around 6%.⁷ We expect rental growth to have slowed in 2020, but would anticipate a swift recovery, with annual growth of over 3% from 2022 to 2025.⁸

In Lyon, we also expect strong rental growth of almost 3% per annum over the next 10 years due to a buoyant local economy and steady levels of new completions.

Prime Rent Growth by Sector (% P.A., 2021-25F)



Source: DWS, December 2020. F = Forecast. There is no guarantee the forecasts shown will materialise. Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect. Forecasts are not reliable indicators of future returns.

Overall, we see the most attractive opportunities in the logistics and residential sectors this year. With yields still at low levels and uncertainty remaining around demand, our approach to office acquisition is likely to be more selective.

⁶ CBRE, Q3 2020

⁷ Notaires de France, October 2020

⁸ DWS, December 2020

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