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FRANCE GRI 2024

Expert analysis of economic forces and exclusive insights into investor sentiments and strategies from the annual real estate gathering of French market leaders

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As the French real estate market continues to face challenges from wider macroeconomic impacts, this year's France GRI 2024 began with in-depth analysis of economic winds at play from one of the continent's economic experts.

Setting the stage for the discussions to follow, the projections shown for economic growth present both challenges and opportunities for the real estate market. Discussion participants insightfully addressed these throughout the conference, noting the French market's superior stability in comparison to its neighbours, however with a clear caution around "value traps" as transaction volumes expect to pick up towards the end of this year.

At a crucial point in the market cycle, this report provides invaluable insights into the forces at play, and the sentiments among the real estate market's most prominent figures.

Enjoy reading!

GUSTAVO FAVARON
CEO & Managing Partner, ***GRI Club***

INTRODUCTION

For more than 25 years, GRI Club's exclusive networking events have been providing unique opportunities for the industry's decision makers to exchange valuable insights and experiences, igniting deal flow and potentialising the real estate market.

GRI Club reports present the key takeaways from these events, including the most valuable insights, the most ardent discussions, and the most intriguing strategies.

This report was compiled following the annual **France GRI 2024**, gathering senior real estate leaders active in the French real estate market to address market opportunities and challenges, exchange invaluable insights and experiences, and participate in a senior, yet informal, networking environment.

CLICK HERE TO ACCESS ALL THE **FRANCE GRI 2024** PHOTOS

MACROECONOMIC WINDS

At the start of 2024, five key economic convictions shaped the outlook for the European economy in the coming year.

Inflation

Firstly, inflation was expected to continue moving towards central bank targets, paving the way for easier monetary policy over the next two to three years and enabling central banks to begin easing cycles.

Recent data reveals significant shifts in inflation rates, especially evident in Europe where countries like the Czech Republic experienced inflation rates nearing 20%. However, aggressive monetary tightening by central banks since March 2022 has brought inflation back on target. This has allowed some central banks to begin cutting rates.

A key observation is China's unique position, as it did not experience the inflation spikes seen globally. Instead, China faced deflationary pressures, causing reluctance in consumer spending and investment. This situation suggests that China will not drive global economic recovery as it did post-2009.

Monetary & Fiscal Policy

Monetary policy easing is critical, particularly as fiscal support fades. Last year, fiscal policies significantly bolstered growth in France and the US, with fiscal impulses contributing more than half of the GDP growth. This support is expected to wane, necessitating easier monetary policies to sustain economic momentum.

Germany, already grappling with recessionary pressures, lacked fiscal support last year and continues to face challenges. The hope is that economies will respond positively to monetary policy easing, offsetting the reduced fiscal support and stabilising growth trajectories.

Image: GRI Club / Midjourney

Economic Recovery

Despite recent sluggishness or recessionary trends, global economies - especially in Europe - were expected to recover.

Economic growth is projected to trend towards potential and even exceed it by 2026, while inflation is expected to remain higher than pre-pandemic levels. This scenario presents both challenges and opportunities, particularly for real estate investments, which can act as an inflation hedge.

Lower financing costs, driven by central bank rate cuts and easier credit standards, are expected to provide more planning security for investors in real assets, fostering a conducive environment for economic recovery and growth in the medium term.

China's Role

A particularity to the current economic cycle is the lack of substantial support from China, a critical factor in investment strategies across various asset classes. This is particularly significant for export-dependent economies like Germany and Switzerland, which rely on their manufacturing sectors' access to markets such as China.

Geopolitics

Finally, the impact of geopolitics was acknowledged. This year is marked by significant events, including the US election and other geopolitical issues, contributing to a new global disorder Geopolitical concerns continue to weigh heavily on the global economic outlook, influencing potential growth assumptions.

In 2024, more than 60 countries across the world will hold elections. Historically, political events such as these have impacted financial markets, as seen in the appreciation of the Swiss franc ahead of the 2017 French presidential election. The Swiss National Bank's recent rate cuts aimed to mitigate similar currency appreciation pressures, highlighting the interconnectedness of politics and economics.

Image: GRI Club / Midjourney

CROSS-BORDER INVESTMENTS IN FRANCE

» Investor Appetite

Discussions among market players suggested a cautious yet growing optimism about the future appeal of the French real estate market to investors. There is a dual perspective on real estate's attractiveness from both equity and debt sides.

Prior to the recent interest rate hikes, real estate debt was particularly attractive to domestic limited partners (LPs), especially those sensitive to Solvency II regulations. Following the challenges which faced all asset classes in 2022 - real estate included - a sense of cautious optimism remains.

At present, LPs with strong real estate knowledge and those who can identify market entry points find the sector appealing, and many investors are diversifying their real estate equity allocations into debt.

With the current repricing of real estate and its inflation-linked income, the sector is believed to remain attractive, providing room for growth in the next investment cycle.

Expanding on the macroeconomic view, real estate will always represent a significant portion of institutional investors' portfolios, however, the exceptional liquidity seen in the decade prior to the recent economic reset is unlikely to return, primarily due to central bank policies.

Meanwhile, fixed income has emerged as a strong competitor, offering similar returns with potentially lower risk. Additionally, regulatory incentives for insurance companies are driving capital towards private debt markets, further impacting real estate investments.

US vs Europe

There are competitive dynamics between European and US real estate markets. The US is perceived as having better growth prospects and more significant repricing, making it a more attractive destination for global capital in the short term.

France remains a key player in Europe, and has shown resilience compared to other European markets, particularly Germany. France's stability and relatively steady performance make it a focal point for investors looking for opportunities within Europe.

» Current Market Outlook

Current market conditions present a prime opportunity for acquiring high-quality assets, with the bottom of the market expected to be reached this year. The primary objective for many investors in the European real estate market is to capitalise on the current downturn by purchasing good assets at attractive valuations, including well-located offices, and reap the benefits as the market recovers.

However, raising capital remains a formidable challenge. Despite the optimism around acquisitions, securing funding for these investments is proving difficult. This sentiment was echoed by several market participants who are actively seeking to raise money for European investments.

The difficulty lies in convincing investors of the merits of investing in European real estate, especially given the attractive opportunities available in other regions, such as the US.

There is a considerable amount of distressed equity in the market, which has made investors cautious, preferring to wait for more favourable opportunities. As a result, there have been fewer acquisitions, and even those that were pursued often faced difficulties in closing due to discrepancies between buyer and seller expectations.

However, there is an expectation of a shift towards more viable opportunities in the coming months, and an anticipation that these opportunities will lead to successful closings, providing a more optimistic outlook for the market. This shift is partly driven by the narrowing gap between buyer and seller expectations, making it easier to finalise deals.

When it comes to specific asset classes, there is a notable preference for well-located offices, residential properties, and hospitality, which are currently considered the most viable sectors. Interestingly, retail is also being reconsidered, with a recognition that it still holds potential despite previous reservations.

Image: GRI Club / Midjourney

Office

A critical issue facing the office sector is the performance of assets outside central business districts. Since 2018, the strategy has shifted away from secondary locations due to declining demand and increasing supply. The COVID-19 pandemic and subsequent economic reset have only exacerbated these challenges.

Consequently, the focus has remained on central offices, where rental growth is more robust, and the market dynamics are more favourable. The long-term outlook for secondary office locations remains bleak, with significant value loss that is unlikely to be recovered in the near future.

Core to Value-Add

Over the past two and a half years, there has been a noticeable pullback from core investments due to liquidity constraints. The liquidity crunch has made it difficult to raise the necessary capital for these investments, leading to a shift towards more opportunistic and value-add strategies. This shift is expected to continue into the near future, with core investments remaining a lower priority.

Geopolitical Risks

Geopolitical risks posed by the actions of leaders like Putin and Xi Jinping remain a deterrent against investment in European real estate, adding another layer of complexity and caution. To mitigate these concerns, some firms are focusing on debt investments, which are perceived as offering a better risk-adjusted return compared to equity.

Such geopolitical risks highlight the importance of a diversified investment strategy, including a geographically and sectorally diverse portfolio to protect against regional and sector-specific risks. This approach helps mitigate the impact of geopolitical uncertainties and economic fluctuations.

Image: GRI Club / Midjourney

DISTRESS IN FRENCH REAL ESTATE
A MIRAGE OR A DELAYED REALITY?

The French real estate market is experiencing a “perfect storm” moment, with multiple converging factors set to create significant distress. However, the anticipated wave of distressed asset sales has yet to fully materialise. This situation raises the question: are distressed asset sales a mirage or simply a delayed reality?

Several key elements contribute to the current precarious state of the French real estate market:

- **Elevated Interest Rates:** High interest rates are putting pressure on investment coverage ratios (ICRs) and loan-to-value ratios (LTVs), making refinancing more challenging.

- **Yield Increases:** Increased yields have a direct impact on property valuations and investor returns.

- **Maturing Investments:** Many deals completed during the record investment years of 2018-19 are reaching their maturity, requiring refinancing or renegotiation at a time when market conditions are less favourable.

- **Office Market Polarisation:** The office market is becoming increasingly polarised, with shrinking tenant demand and decreasing occupancy levels.

- **Regulatory Pressures:** Environmental regulations are accelerating the need for capital expenditures, adding further financial strain.

These factors together create a scenario ripe for distressed sales. Yet, the reality on the ground shows that distress is still relatively anecdotal.

Motivated Vendors and Withdrawn Transactions

Despite the conducive conditions for distressed sales, the market has not seen a significant number of such transactions. Vendors are motivated, but many transactions are being withdrawn from the market.

Last year, approximately €7 billion worth of transactions were not completed out of an estimated €10 billion investment volume. This indicates a substantial number of deals falling through. This is, in part, due to caution from investors around falling into value traps, where distressed assets may seem like bargains but carry hidden risks.

Perhaps more importantly, however, is the gap between bid and ask prices. There remains a significant gap, sometimes as high as 20-25%, between what sellers are asking for and what buyers are willing to pay.

This is exacerbated by the current scarcity of core capital in the market, in contrast to the prevalence of value-added capital. Value-added investors are looking for opportunities to buy assets at lower prices, undertake refurbishments, and repurpose buildings.

However, many vendors are reluctant to sell at the prices these investors are willing to pay, leading to a standoff in the market. Meanwhile, market volatility continues to deter risk-averse core investors who prioritise certainty and stability.

To Sell or Not to Sell

The situation is complicated further by the stance of banks. Currently, many asset sales are being pulled from the market, or extensions are being granted by banks. This temporary reprieve delays the inevitable pressure on owners to sell distressed assets.

Banks are generally willing to release loans, but the crux of the issue lies with sellers' ability to inject equity back into deals. Without this equity, refinancing becomes a significant hurdle, potentially leading to broader market disruptions.

The pressure of redemptions adds another layer of complexity. Investors, particularly from emerging markets, may need to sell assets rapidly to meet redemption obligations. This often leads to a significant volume of sales, sometimes at suboptimal prices. However, these investors might drop sales if the pricing isn't favourable, opting instead to delay or find alternative solutions.

Investors with the luxury of arbitrage can navigate these turbulent times more effectively. By selling assets in stronger European markets such as France, they can manage redemption pressures and potentially delay distress sales. The ability to perform such arbitrage allows investors to negotiate and avoid selling assets at distressed prices.

For some investors, the strategy involves selling certain assets to generate equity for reinvestment. If the future performance of specific assets is uncertain, selling them while still profitable can be a prudent move. However, if the market conditions aren't favourable, these investors might hold off on sales, contributing to the delay in distressed transactions.

The Sell-On Yield Problem

One of the core issues in the current market is the uncertainty around sell-on yields. While rental values in some areas, like prime locations in Paris, have been increasing, the variability in sell-on yields makes it challenging to forecast future returns.

This uncertainty is compounded by the evolving nature of property use, with shifts from traditional office spaces to mixed-use developments incorporating offices, student housing, and hotels. The real estate market is undergoing significant changes, driven not only by financial factors but also by shifts in property use and demand.

The evolution from retail to logistics, and potentially from offices to data centres, underscores the need for adaptive strategies. Investors must consider these trends and the associated capital expenditures and sinking funds required to maintain and enhance property value.

Amid these uncertainties, the ability to accurately predict exit cap rates will be crucial in making informed decisions about refinancing, equity injections, and asset sales.

Historical Context

The current cautious approach is also influenced by past experiences. Major distress wasn't seen in the aftermath of the 2009-2011 financial crisis, and stakeholders are keen to avoid a repeat of the distress witnessed in the 1990s.

This historical context shapes the current market sentiment, where the preference is to avoid selling under distressed conditions whenever possible.

The Road Ahead

Looking forward, the market is expected to see an increase in distressed asset sales, particularly as substantial refinancing volumes come due in the next few years. Analysts predict around €80 billion in financing needs for 2023, 2024, and 2025. The real test will come when banks start enforcing more stringent terms and pressing for sales.

Until then, the distress in the French real estate market remains more of a looming threat than an immediate reality. The worst might still be ahead, as the market waits for a more significant alignment between bid and ask prices and a shift in bank policies.

Image: GRI Club / Midjourney

OFFICES

Consensus revealed that the office market, particularly in Paris's Central Business District (CBD), might have reached its lowest point in terms of value, and confidence is emerging among investors that prices have stabilised.

However, this optimism is tempered by the realisation that the broader office market outside the CBD presents a different scenario, with certain assets potentially facing significant devaluation or even obsolescence.

Paris's relatively shorter travel time - compared to London and New York, for example - have maintained a higher office occupancy rate. This dynamic has supported the demand for centrally located office spaces, as companies prioritise proximity to attract talent and enhance productivity.

Prime locations, such as La Défense and other high-demand areas, are seen as more resilient, with rents driven up by inflation-linked indexation and strong demand for quality assets. Conversely, secondary locations face declining rents and higher vacancy rates, necessitating a strategic pivot for investors.

Looking ahead, the French office market's trajectory will depend on several factors:

- **Regulatory Changes:** Upcoming regulatory requirements, particularly those affecting financial and environmental standards, will play a crucial role in shaping investment strategies.

- **The Bid-Ask Gap:** A persistent theme is the bid-ask gap which has stifled transaction volumes, despite the presence of capital. This misalignment between sellers and buyers is exacerbated by uncertainties around future yield expectations and exit strategies.

- **Innovation in Asset Use:** Creative approaches to asset repurposing and adaptive reuse will determine the long-term viability of many office properties. The focus on value-add investments remains strong, with investors exploring opportunities to reposition or repurpose office buildings.

  This strategy involves transforming underperforming assets into more viable uses, such as residential or mixed-use developments. The challenge lies in executing these transformations amidst regulatory hurdles and fluctuating market conditions.

INDUSTRIAL & LOGISTICS

Amid volatility in the French real estate market, the logistics sector stands out as a relatively stable and promising area.

One of the key reasons for the stability is its ability to reprice more quickly compared to other real estate sectors. This swift adjustment has made logistics assets more attractive for investors seeking stable and predictable returns.

The return of these corporate investors has consequently bolstered investment volumes, surpassing even those in the office sector early in the year, which, in turn, has boosted investor confidence and interest.

Underwriting and Cost of Capital

The ability to underwrite at today's core yields is another factor contributing to the stability of the logistics sector. With core yields for logistics around 5%, underwriting becomes more feasible, and investors can secure a lower cost of capital, suggesting the return of core investors is not so far away.

Competition remains strong, however, and to succeed, investors must focus on granular leads and specific opportunities that offer the best returns.

Image: GRI Club / Midjourney

DEBT AND REFINANCING

At the beginning of the year, the market for new acquisitions was notably calm. This slowdown has prompted a shift in focus towards refinancing and extending existing loans. Banks are now more focused on their portfolios, with a keen eye on managing their existing assets while being selective about new lending opportunities.

The cost of refinancing has increased, due to regulatory changes and the rising costs of capital. This has led to a strategic shift towards amortising and de-risking deals rather than simply increasing margins. The approach must carefully balance increasing margins and maintaining manageable risk levels.

In the current market, equity plays a crucial role. There are pockets of pure equity taking advantage of opportunities, especially in prime locations in Paris. Leveraged buyouts, however, require higher equity contributions, reflecting the cautious stance of lenders. This is particularly evident in core assets, where the competition is fierce, and margins are tight.

Within the complexities of managing large-scale refinancing deals, significant assets needing refinancing have encouraged a shift towards club deals, involving multiple banks to spread the risk. This approach has become necessary as no single bank wants to bear the entire burden of large refinancing packages.

Valuation remains a critical component in the refinancing landscape. Financial institutions integrate economic analyses and historical data to determine LTV ratios and assess risk. This approach allows for more informed decision-making, enabling banks to offer competitive leverage while maintaining prudent risk management practices.

Regulatory Pressures

The transition to new regulatory frameworks, particularly the upcoming Basel regulations, was a significant point of discussion. Regulatory pressures are shaping the refinancing landscape. Increased capital requirements and stricter oversight are forcing banks to be more prudent in their lending practices.

“The regulator always arrives, a little late, but he arrives,” one participant observed, acknowledging the delayed yet impactful role of regulatory bodies in the market. In some cases regulatory pressures have already led to a notable increase in the cost of refinancing, particularly for banks with higher non-performing loan ratios.

Offices

Office space financing remains a significant focus, particularly in prime locations in Paris. The capital remains a focal point, with over €3 billion in deals reported since the beginning of the year, demonstrating the city's resilience and attractiveness despite the challenges.

The market for new office acquisitions has been slow, with much of the activity concentrated on refinancing existing projects. Despite the challenges, there is still activity in financing office developments and speculative renovations in high-demand areas. However, there is a notable gap between market realities and the values received, and significantly longer negotiation times involved.

Hospitality

The hotel industry, in particular, has seen increased competition, with local banks matching the aggressive pricing strategies of larger institutions. Refinancing of hotels has proven to be both challenging and rewarding. A cautious yet optimistic approach is being seen from financial institutions willing to engage in deals with well-structured financials and reasonable leverage.

Student Living

Student residences have emerged as a stable and particularly attractive sector in the current market, while other segments face greater uncertainty. The sector's resilience was emphasised, noting the strong demand and long-term lease commitments which provide a stable income stream.

Collaboration, Ethics & Proactiveness

A recurring theme among discussions was the importance of partnerships and collaboration. The relationship between banks, investors, and developers is crucial in navigating the challenges of debt and refinancing.

Transparency, trust, and proactive management are essential to maintaining these partnerships and finding mutually beneficial solutions. This transparency helps build trust, which in turn facilitates better negotiation outcomes and reduces the risk of defaults.

Another theme that arose was the importance of robust internal expertise and ethical practices. Participants emphasised the need for rigorous evaluations, and the ethical challenges that arise when internal valuations are based solely on acquisition prices.

There was a clear cautionary note about ensuring these valuations are realistic and reflective of current market conditions, rather than just historical purchase prices.

The panel concluded with a consensus on the need for proactive risk management. Waiting for problems to arise is not an option; instead, there is a need for continuous monitoring and early intervention to address potential issues. This proactive approach is essential for maintaining financial stability and ensuring the long-term health of the real estate market.

GRI CLUB MEMBERS WILL ALSO ATTEND
EUROPE GRI 2024

Founded in 1998 in London, GRI Club currently brings together more than 16,000 senior executives spread across 100 countries, operating in both real estate and infrastructure markets.

GRI Club's innovative discussion model allows free participation of all executives, encouraging the exchange of experiences and knowledge, networking and business generation.

GRI Club Members also have access to our exclusive online platform to learn more about other members and their companies, correspond and schedule meetings, and receive unrestricted access to all GRI Club content.

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