REPORT

FRENCH REAL ESTATE MARKET OUTLOOK

LATEST INSIGHTS: FINANCING, OFFICES, LOGISTICS, VALUE-ADD, & INNOVATION IN FRENCH RE

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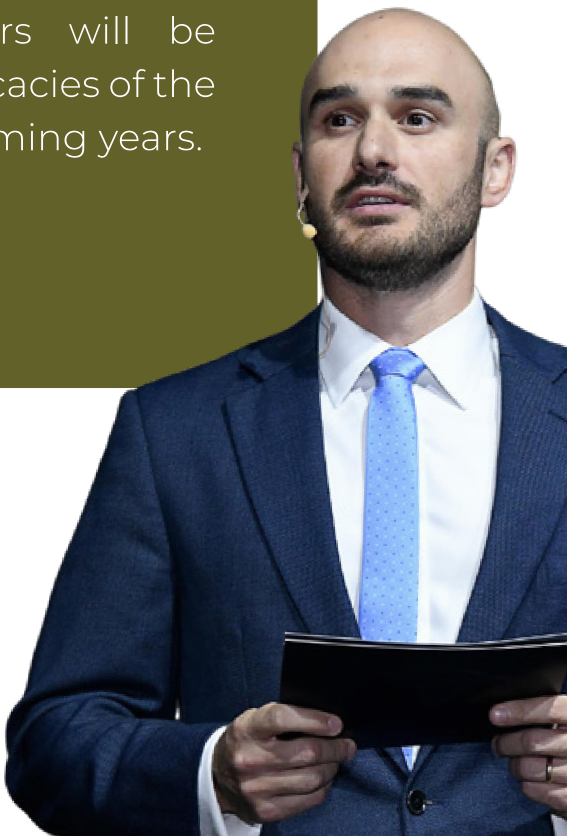
WELCOME TO EUROPE GRI

Amidst global uncertainties France's real estate sector continues to show robustness. Investors are navigating a complex interplay of factors, including supply constraints, lifestyle and culture shifts, a stringent regulatory landscape, and evolving demands for sustainability and innovation.

Considering this dynamic landscape, GRI Club events are increasingly serving as a forum for stakeholders to delve into emerging trends and discuss the potential risk mitigation strategies and diversified portfolios.

The consensus remains that adaptability, strategic foresight, and a keen understanding of evolving consumer behaviours will be instrumental in navigating the intricacies of the French real estate market in the coming years.

Enjoy reading!



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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 provide the key takeaways from these events, including the most **valuable insights**, the most **ardent discussions**, and the most **intriguing strategies**.

This report was compiled from conversations that took place during sessions on **French Real Estate** at **Europe GRI 2023** in Paris. The largest GRI Club event to date gathered more than 700 of the most senior leaders in the real estate market for 45+ investor-led roundtable discussions on a range of industry topics.

Photos: GRI Club

KEY TAKEAWAYS

» Access to financing remains scarce and fiercely competitive, particularly in the challenging terrain of office real estate.

» Banks exhibit a sensitivity tethered more closely to the client than the asset class, an observation that delineates the intricate interplay of relationships in the current financial landscape.

» The present scenario, distinct from 2008, demands a nuanced approach, considering higher LTVs, altered covenants, and the prominent role of ESG criteria in investment decisions.

» Successful navigation of these turbulent waters necessitates a return to fundamental principles — prioritising quality locations, tenants, and sponsors, even if it involves a measured sacrifice in returns.

» The power dynamics between sponsors and banks have become a critical determinant in financing and refinancing deals, adding another layer of complexity to an already intricate landscape.

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FINANCING

In the ever-evolving landscape of French real estate, industry players find themselves grappling with formidable challenges in the realm of financing and refinancing, all against the backdrop of an imminent 'wall of debt.'

The looming presence of Non-Performing Loans is apparent throughout Europe, with an estimated 300 billion euros scattered across the continent. France finds itself in the eye of the storm with a hefty 110 billion euros, closely trailed by Spain at 80 billion euros. These staggering figures, however, don't merely mirror a present wave but serve as a harbinger of an impending surge in the NPL domain.

Distinct from the financial turbulence witnessed in 2008, the current market dynamics pose unique hurdles, shaped by higher LTVs and altered covenants.

A focal point of discussion centred on recent financing and refinancing deals executed by investment funds, raising eyebrows at the staggering figures involved. This discourse unravelled a nuanced power struggle between sponsors and banks, underscoring the shifting dynamics of banks' attitudes contingent on the stature of the sponsor involved.

THE LENDING DILEMMA FOR OLD BUILDINGS

A captivating drama is unfolding as urban politics and architects align their focus on the revitalisation and repurposing of buildings. This collaborative effort seeks to breathe new life into the architectural tapestry of the nation, with a particular emphasis on renovation projects.

However, a significant hurdle emerges in the form of lenders, who, hesitant to embrace the risks associated with ageing structures, are reluctant to extend their financial support to such endeavours. Further deterring lenders are the rigid property legislations they face with older and often historic buildings.

The collective risks and challenges associated with these properties cast a shadow over the financial viability of renovation initiatives. This creates a noteworthy divergence between the ambitions of urban policymakers, architects, and the financial landscape required to fuel these ambitious construction projects.

INVESTMENT CYCLE

Against the backdrop of geopolitical shifts and deflationary risks, discussions around investments began with an in-depth examination of the state of the French market, where noteworthy transactions in France and Germany, especially in the dynamic retail property sector, were highlighted.

Forecasts for 2024 hinted at more substantial market volumes, underscoring the consistent performance of the European market, with Germany demonstrating resilience while the UK grappled with lagging fortunes.

Distinctions between buyers and sellers were highlighted, revealing variances in offerings. This led to an examination of the intricate relationships between investors and funds, considering factors such as the influence of the CPI on the market and considerations surrounding collection and recollection processes.

A recurring theme emerged: the anticipation of potential market developments, emphasising the imperative for agile responses to shifting conditions.

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OFFICES

Traditional office models are undergoing a seismic shift, prompting a crucial exploration of strategies to rejuvenate the sector. As the concepts of Flex Office, Coworking, and the Operated Office gain prominence, a critical question looms: how can the industry adapt to these transformative trends?

Participants scrutinised the rising trend of remote work, highlighting the working culture in larger enterprises such as multinational IT services and consulting company Capgemini, where employees can work remotely up to 40% of the time, including 30% from anywhere globally.

FLEX OFFICE DYNAMICS

The Flex Office debate revolves around optimising square footage, but success hinges on offering high-level services, encompassing amenities, technological advancements, and a shared environmental vision among employees and investors. This shift comes at a cost, with office spaces becoming more expensive due to the demand for quality services.

A transformative distribution of office space is evident, with 70% allocated to collaborative group work and 30% to individual tasks. The Flex Office concept was exemplified by participants who drew attention to the working culture at EDF (Électricité de France), where square metres are organised into “territories” for teams, fostering flexibility and movement between offices and meeting rooms. Achieving this requires a meticulous analysis of each team’s working dynamics.

There’s a palpable demand for “à la carte” teleworking, signalling a preference for total flexibility. However, meeting these evolving needs demands significant internal investments, both in terms of CapEx and operational priorities.

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DECENTRALISATION STRATEGIES

Investors grapple with uncertainties surrounding large, outdated 35,000 m² head offices constructed in the 2000s. With these structures lacking cash flow and facing falling prices, the real estate sector is in a waiting game. Investors contend with challenges such as centrality, the rise of teleworking, increasing interest rates, and the imperative to enhance the sustainability of these buildings.

New buildings constructed in recent years signal a departure from the conventional 70-80% occupancy rate to a focus on positions. For instance, the Orange head office boasts 2.2 positions per employee, expanding the possibilities for collaboration spaces in the post-COVID era.

A new trend emerges: geographical reflection. Rather than employees commuting to centralised locations, there's a growing debate about going to the employees. This shift is driven by the desire to stimulate activity and employment in regions, prompting a reconsideration of traditional workplace dynamics.

Discussions also broached the topic of artificial intelligence and its potential impact on jobs. While the impending rise of AI is acknowledged, the current focus remains on immediate workplace interactions, leaving the AI jobs debate on the periphery.

In conclusion, the French office sector grapples with dynamic shifts, prompting a reassessment of strategies to meet evolving demands. Flexibility, innovation, and a deep understanding of changing work dynamics are at the forefront of this transformative journey.

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LOGISTICS

The logistics sector has emerged as one of the most compelling markets within French real estate, drawing attention from experts and industry insiders eager to unravel its intricacies. France, with its sprawling landscape, boasts a diverse mix of small-scale operations and expansive industrial platforms.

Logistics discussions involved a keen focus on responsible and sustainable investments. A key strategy highlighted involved acquiring infrastructure, emphasising the importance of proximity to consumer centres to align with the growing trend of consumerism. The logic was clear – seek assets close to the end-user.

Strong demand for logistics services, especially in urban areas, underscored the need for proximity and expertise to effectively cater to these markets. The surge in e-commerce has played a pivotal role, prompting industry players to explore regions that mirrored the logical movement of the French population, shifting from cities to the countryside or mid-sized cities.

The market's dynamism also reflected a shift in the class of assets, with warehouses experiencing a 20% increase in height over the last two decades, providing more versatile spaces. Notably, participants discussed the potential for renovations or changes in destination, such as converting offices into warehouses.

While the logistics market may currently be perceived as less risky, participants acknowledged potential challenges arising from macro-trends in real estate, exemplifying the ongoing office sector crisis. Concerns lingered about whether logistics assets would find buyers in five years.

The regulatory landscape in France, marked by lengthy adherence processes and authorisation challenges, presents hurdles. Participants provided the example of the major player Amazon, who recently faced resistance from local authorities regarding acceptance of their logistics buildings.

It was noted that despite a significant rise in rents over the past five years, the trend has remained manageable, contrasting with the challenges faced in England. The discussion emphasised ongoing transactions and the enduring value of logistics assets, with obsolescence being a minor concern compared to office assets.

In summary, the discussion emphasised the importance of responsible investments, technological advancements, and the sector's adaptability in the face of evolving economic landscapes, with a commitment to sustainability and strategies poised to meet the ever-changing needs of modern consumers.

OPPORTUNISTIC & VALUE-ADD

The spotlight turned to the nuanced shifts in asset values within the French real estate market, setting the stage for insightful discussions on opportunistic and value-add investments. The scarcity of diverse property types, aside from offices, underscored the need for strategic transformations while upholding stringent ESG standards.

The transformation of office spaces into residential havens emerged as a promising opportunity for those eyeing value-add ventures. However, a stark contrast in approach between American and French players became apparent, with the former quick to embrace losses and adapt to new opportunities - a characteristic necessary for such ventures.

The complexities inherent in executing value-add projects in the heart of Paris took centre stage, especially considering the labyrinth of rules and laws which present formidable obstacles, also extending to other areas of the Île de France region.

STRATEGY AND RISK MITIGATION

The discussion delved into strategic considerations against the backdrop of a market decline, poised to usher in transformative shifts within price zones.

Advocates for value-add strategies, especially those with longer time frames, contended that these approaches could serve as a risk-mitigating mechanism. Participants foresaw the potential for market cycles to evolve over the next 4-5 years, offering favourable exit points for carefully crafted value-add initiatives.

Recognising the maze of administrative risks tied to building ownership, participants stressed the importance of addressing such challenges. A key strategy highlighted involved securing necessary permits before acquisition, a move seen as pivotal in curtailing risk exposure, particularly in assets laden with significant administrative complexities.

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SUSTAINABILITY & INNOVATION IN FRENCH RE

French real estate is experiencing an evolving focus on innovation and sustainability while ensuring heritage preservation.

INNOVATION

Île-de-France presents both opportunities and challenges, with perpetual population growth and climate urgency driving regional innovation. Spatial planning aims for a polycentric region with 27 hubs, fostering economic activities and balanced growth. Energy renovation in buildings and addressing climate change are paramount, with an emphasis on achieving net-zero emissions.

The adoption of innovation is apparent with the Grand Paris Express and eco-district development, while also showcasing a commitment to sustainability.

The Mayor of Paris envisions the PLUb to address climate crises and ensure functional diversity in the city. Adaptation to climate change is marked by projects like expanding bike lanes and implementing green roofs.

Experimental projects, like Olympic Games arrangements that can be repurposed post-Games, showcase the potential for comprehensive building evolution. The creation of the Olympic Village not only revitalises neighbourhoods but also demonstrates technical achievements.

DATA

One notable observation during discussions was the imbalance of data, with a surplus of information on flows and transactions overshadowing insights into inventory. This discrepancy stems from real estate agents predominantly reporting transactions.

An initiative, in collaboration with AFTI and Link City, has been launched to comprehensively describe existing office inventory, aiming to bridge this informational gap. The challenge lies in identifying vacant properties and cities ready for the transformation of office spaces into housing units. A meticulous mapping of the market in segmented categories is underway, focusing on both transactional and non-transactional inventories.

ESG

A profound transformation is underway in real estate financing due to the growing importance of sustainability, marking a pivotal moment for the real estate sector in France. The complexity of ESG regulations adds an intricate layer to real estate investment, with the social and governance dimensions proving less developed than the environmental.

Sustainability is not just about compliance but also about resilience and adaptability in the face of evolving challenges. Investors and developers are urged to ensure the long-term performance of green buildings, renewable energy systems, and other sustainability initiatives.

Not only environmental aspects, but also social and governance aspects of ESG, are gaining recognition for their immense significance in value creation. Enhancing physical and mental health in workplaces, for instance, contributes to sustainability by bolstering employee well-being.

The shift in mindset towards considering sustainability as a core criterion for investments is evident. Finance is now actively steering funds toward environmentally and socially responsible projects. Although potentially more expensive, these sustainable investments are seen as critical for resilience and long-term value.

However, the panel highlighted a contrasting statistic – 40% of building projects in France still concern brown buildings, underscoring the urgent need for innovative and sustainable solutions in real estate financing.

Putting the ESG criteria into the market value poses a considerable challenge. While the rules are clear, the techniques to adhere to them remain in the evolutionary stage, especially when it comes to meeting political demands like the Stratégie Nationale Bas-Carbone (SNBC).

Furthermore, measuring ESG remains a challenge due to the lack of standardised tools, but the industry is gearing up for the task in the coming months, aiming to simplify and harmonise these metrics.

Sustainable finance emerges as a collective effort involving financial institutions, businesses, regulators, and civil society, requiring a coordinated approach to achieve sustainability goals.

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Photos: GRI Club

GRI CLUB MEMBERS WILL ALSO ATTEND

FRANCE GRI 2024

Founded in 1998 in London, GRI Club currently brings together more than 10,000 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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