Press release

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Approaching peak levels

Knight Frank reviews the French corporate real estate investment market at the end of the 1st half of 2018

Following a good 1st quarter, activity in the French corporate real estate market noticeably increased over the last three months. "*Following investment volumes of 4 billion euros in the 1st quarter, almost 6.7 billion euros was invested in France in the 2nd quarter 2018, equating to an increase of 66 %. Over the whole of the 1st half of the year,* ***investment volumes in France totalled 10.7 billion euros, an increase of 34% compared to the same period last year*** *and 54% compared to the 10-year average.* ***It is the 4th best 1st half-year ever recorded***" *says* Vincent Bollaert, Head of Investment at Knight Frank France.

The appeal of the French market remains sound, in spite of a start to the year that was marked by a fall in economic growth, an increase in political and economic risks at a global level, and the confirmation of the reduction in fund-raising by SCPIs. However, SCPI fundraising was at the same respectable level as that of 2016. Furthermore, the economic outlook remains strong, contributing notably to the good performance of the office rental markets. Finally, "**whilst certain large French investors have been less present in the market, other types of players have taken over.** As such, large deals undertaken by various foreign funds confirm the central position of the French market, which for several months now has been riding the coattails of the improvement in our country's image" continues Vincent Bollaert.

Large deals set the tone

The decrease in the total number of deals (- 15 % year-on-year) did not have an impact on the results of the 1st half of 2018, which was largely driven by the dynamism of large transactions. Amounting to 32 deals (compared to 21 as at 1st half 2017), **deals over 100 million euros totalled 6.9 billion euros, equating to 65 % of all investment volume in France, and an increase of 98% year-on-year**. The change is particularly significant for deals over 200 million euros: 12 deals were recorded for an investment volume of 4.1 billion euros, compared to 1.2 billion as at 1st half 2017.

The Greater Paris Region took the lion's share. 27 of the 32 deals over 100 million euros recorded in France since January were in the **Paris Region, where investment volumes – for all types of assets and investment volumes – amounted to 8.7 billion euros. The increase is 52% year-on-year.** Whilst the sale to HINES (on behalf of the German BVK fund) of the future Champs Elysées Apple Store is the largest deal of the first half of the year, it is in the office sector that the Greater Paris Region confirmed its predominance. As such, offices accounted for 25 of the 27 deals over 100 million euros undertaken in the Greater Paris Region, including the recent sale by OXFORD PROPERTIES of 50% of their Parisian portfolio for almost 400 million euros, the acquisition of "Metropolitan" (Paris' 17th district) by DEKA, and the sale to PGIM REAL ESTATE of "M Campus" in Meudon.

Offices: Paris dominates…a little less

8.1 billion euros have been invested in the French office market since the start of 2018, equating to 76% of all French investment volume. **The increase in investment volume is 38% year-on-year,**

driven by the growth in large deals (11 deals over 200 million euros compared to 4 at the same time last year) and the strength of the Greater Paris Region market.

Paris itself, where more than 500,000 sq m of offices have already been let or sold to occupiers since January, continues to act as a magnet for investors. **The city of Paris concentrated 56% of investment volumes in offices in the Greater Paris Region, fairly evenly spread between the CBD and other areas of the capital.** Among the most significant and most recent deals in the CBD we would highlight the two acquisitions by ARDIAN REAL ESTATE (former headquarters of Europe 1 on rue François 1er, 2 place Rio de Janeiro) and the sale to BNP PARIBAS REIM of the future BANK OF AMERICA offices at 49-51 rue La Boétie. In spite of a limited number of deals, volumes invested outside of the CBD are also significant, inflated by the sale to PRIMONIAL REIM of 50% of "Quadrans" (Paris 15th district) for over 500 million euros.

"Whilst Paris still concentrates most activity, **the geographical readjustment in the investment market that we anticipated at the end of the 1st quarter did indeed take place.** The shift mainly benefitted the Western Crescent and the Northern Inner Suburbs which, over the 1st half of 2018, concentrated between them 38% of office investment volumes in the Greater Paris Region" states Vincent Bollaert. In the West of the Greater Paris Region, Neuilly-Levallois and the Southern Loop take the lead due to the completion of some major transactions, such as that to SOGECAP of "Kosmo" in Neuilly-sur-Seine, that of "M Campus" in Meudon to PGIM REAL ESTATE and the acquisition by PRIMONIAL REIM of the "Dueo", "Trieo" and "Galeo" buildings in Issy-les-Moulineaux. During the 2nd quarter, investment activity remained buoyant in areas close to La Défense (Courbevoie, Nanterre), which contrasted with the lack of significant deals within the business district itself. In the Northern Inner Suburbs, almost 800 million euros have been invested since January, of which 600 million were invested during the 2nd quarter. In this sector, which is benefitting from investors focusing on future Grand Paris Express hubs, large deals have recently been recorded, for example the "Balthazar" in Saint-Denis which was bought by LA FRANÇAISE on behalf of Korean investors.

The increase in amounts invested in the Greater Paris Region is also due to the growing interest for core+ and value-added assets, even if core assets account for the majority of investment volumes in the Paris Region office market due to the weight of a few very large deals. Whilst the historically low vacancy rate and the dynamism of the letting market make Paris an obvious target for the acquisition of assets that need refurbishing, investors' risk-taking is not limited to the capital. Reassured by the lack of new supply and the improvements promised by large urban projects, investors are also betting on other less established areas of the Greater Paris Region, as seen with the forward-funding sale recently undertaken in Saint-Denis ("#Curve", bought by GCI and BENSON ELLIOT) or Fontenay-sous-Bois (38 rue Roger Salengro, bought by STAM and TRISTAN CAPITAL PARTNERS).

With almost 800 million euros invested during the 1st half of 2018, investment volumes in offices in the French regions show a decrease of 27% year-on-year, in spite of a few good deals. This decrease needs to be put into perspective with the excellent result seen in the 1st half of 2017, which saw the completion of a large number of deals. That being said, investors are still showing interest in the regions. Large deals are expected during the 2nd half of 2018, for example the future sale by GECINA of two office portfolios for almost 800 million euros.

Retail: increased selectivity

1.6 billion euros were invested in the French retail property market during the 1st half of 2018, equating to 15% of corporate real estate investment volumes and an increase of 23% year-on-

year. *"This increase is misleading because it is due to the completion of one exceptional deal: the acquisition by Hines, on behalf of BVK, of the future Champs Elysées Apple Store for almost 600 million euros. Without this deal, investment volumes would have been 52% below the average of the last five years"* explains Antoine Grignon, Head of Retail at Knight Frank France. Recent trends thus perpetuate the analysis made at the start of the year: that of a distinct shrinking of the retail market, characterised by a limited number of deals. Contrasting with the success of other types of investments from players looking to diversify their property holdings (residential, logistics, etc), activity in retail remains restricted by **the mismatch between supply and demand from investors, whose selectivity has increased and become widespread across all asset classes.**

High streets account for a large majority of investment volumes. Inflated by the sale of the Champs Elysée Apple Store, investment volumes for this asset type total almost one billion euros, equating to 65 % of the French retail market. Other significant sales comprise mainly Parisian ground floor retail, whether that be on luxury streets (rue Saint-Honoré) or less upmarket streets (32 rue des Archives and 54 rue de Rennes, sold by THOR EQUITIES). Retail parks take second place due to several sales of individual assets for more than 20 million euros ("Les Grands Philambins" and "Saint-Priest", both bought by IMOCOMPARTNERS), but also due to the sale of retailer portfolios. Limited by the scarcity of available latest generation assets, investment volumes in out-of-town retail remain low, almost less than half of the half-year average recorded since 2015. Even if the shopping centre market does not suffer from a lack of supply, the market remained sluggish and only accounted for 14% of investment volumes in French retail since the start of 2018.

Industrial: increasing volumes and popularity

A little over 1 billion euros was invested in the French industrial real estate market during the 1st half of 2018, equating to an increase of 20 % year-on-year. This increase, indicative of **foreign investors' appetite for logistics,** is also due to the increase in sales of portfolios. Amongst these deals – which account for more than 60% of all investments volumes in the logistics sector – appear most notably the recent acquisition by GRAMERCY of a property comprising just under 300,000 sq m of warehouses for 175 million euros, and the sale by ARGAN to DWS of 6 logistics platforms for almost 100 million euros. Individual new, or recent, assets that are well located and secured on long term leases are also highly sought after, as illustrated by the acquisition by Argan of a logistics platform let to SAMADA in Wissous, and the sale to DWS of LAPEYRE's new logistics base in Mer, close to Orléans.

French / foreigners: a near perfect balance

Whilst the investment market remains primarily driven by French investors, they "only" accounted for 55 % of all investment volumes in France during the 1st half of 2018. **Their share continues to decrease and stood at 59% at the end of the 1st quarter 2018, compared to 69% for the whole of 2017.** "*Such a balanced distribution has not been seen for a long time, and can be explained by the lesser presence of certain French investors who largely drove the market last year, such as AMUNDI, but also by the growing strength of foreign funds"* explains Vincent Bollaert. **The Germans take first place with 13 % of French investment volumes at the end of the 1st half of 2018,** a share that was inflated by the acquisition for BVK of the future Apple Store on the Champs Elysées. They are also behind several large deals in other market sectors: Parisian offices, with the sale of the "Metropolitan" in the 17th district to DEKA and the acquisition by UNION INVESTMENT of "Euro Alsace" in the 10th district, and logistics with the acquisition by DWS of a portfolio of 110,000 sq m of warehouses from ARGAN. **North-Americans take second place (12 %)**. Finally, we would highlight the relatively large share of investment undertaken by Asians (6%), who have thus confirmed their interest for the French market and Greater Paris Region offices in particular with, for example, the sale to Korean investors of "Balthazar" in Saint-Denis.

The breakdown in investment volumes by type of player continues to see investment funds in the lead (39 % as at 1st half of 2018), ahead of OPCI/SCPIs (23 %) and insurers (21 %). The share taken by OPCI/SCPIs is clearly down compared to their share seen over the whole of 2017 (36 %), within a context of a decrease in fund-raising since the 2nd half of last year. Certain large savings collectors have, nevertheless, been behind some very large deals, such as Primonial Reim and BNP Paribas Reim, the new owner of 49-51 rue La Boétie.

Yields: an increase…in 2019?

Prime yields remain at their lower limit (between 3.00 and 3.25% in Paris), even if some recent deals have shown that new decreases are occasionally possible for new or recent office assets, secured on long term leases, in large regional cities and in the Greater Paris Region. **The emphasis placed on value creation transactions also contributed to the compression of yields for non-core assets,** provided that they are based on good fundamentals which reassure investors in their risk-taking strategy.

With the exception of the best ground floor retail unit locations (2.75%), **yields in the retail market have, conversely, seen renewed upward pressure**, illustrating investors' increased prudence with regard to off-prime and secondary locations, and even prime locations which do not offer all guarantees with regard to return. In the short term, this increase in yields does not seem to extend to other asset types. Logistics, where prime yields are currently comprised between 4.75 and 5.00 %, remain highly sought after by investors, whilst offices are benefitting from the dynamism of the rental market. However, upcoming sales of individual large office buildings show a slight upward pressure on yields, as we foresaw a few months ago.

A more general increase in yields does not seem to be looming before 2019. The expected increase in policy rates should furthermore remain limited and largely depreciable, whilst the buffer that comprises the spread between French 10-year government bond rates and the prime CBD yield remains significant (more than 230 basis points at the end of June 2018).

Conclusion

Given the amounts invested since January, and the volume represented by ongoing deals, 2018 should be the fourth in a row to reach 25 billion euros. "*A new France-Luxemburg tax treaty, strong fund-raising from life insurance companies, increased presence of foreign funds, the booming office rental market, opportunities related to the developments of the Grand Paris project, etc.* ***The reasons to bank on a new year approaching peak investment levels are not lacking***" predicts Vincent Bollaert. Several of these factors will continue to maintain activity beyond 2018. Changes in real estate will also play their role. "*Developers and occupiers continue to innovate in the design of their premises, adapted to new working and consumption methods. These structural changes admittedly raise a certain number of questions with regard to the future of a significant share of existing stock or certain market sectors; but* ***they equally constitute an excellent source of opportunities,*** *which will need a good deal of expertise, asset management work…and imagination*" concludes Vincent Bollaert.