PROPERTY & OUTLOOK

QUARTERLY NEWSLETTER OF LA FRANÇAISE

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Real Estate Update and Outlook

In recent months, global growth and growth in the Eurozone has been on a positive trajectory and, although France may still be somewhat behind, the new government and its plans for structural reform have galvanised hope for the French economy. Emmanuel Macron's election as French president is widely accepted as a very positive outcome.

In the Eurozone, business climate indicators are at their highest levels since the end of the recession in 2010-2011 and this may indicate that the growth rate could, at least temporarily, tip over the 2% per year rate. Improvements are being seen across all sectors: industry, services and construction. Mario Draghi has confirmed that recovery in Europe is now sound. The ECB is holding its position and is not planning any rate increases before the end of its asset purchase programme, i.e. the end of 2018. Year on year, consumer prices rose from 1.5% in March to 1.9% in April. Inflation remains under control and, thanks to the ECB's programme, we should see a continuation of particularly favourable finance conditions. As for business performance, results were excellent over Q1 and should remain so as analysts are forecasting a 20% increase in profits for 2017.

This considerable improvement in the business climate has driven activity in rental markets across Europe. Transactions were therefore close to 3.2 million sq m across the main markets in Q1 2017, the highest level since Q1 2008. Vacancy rates fell across all markets, apart from London, while future deliveries remain limited. Market cycles appear to be gradually converging in a more positive direction, except for the United Kingdom which is suffering from the fallout of the vote in favour of Brexit and the resulting delays in corporate decision making. The average prime rent in Europe has increased, but only slightly as levels were slowed by the decreases seen in most British markets. Even so, levels are expected to increase over the next few quarters.

Investment also remained very strong at the beginning of the year with €56 billion in investments, making Q1 2017 one of the top three years for a first-quarter performance since 2006. It also slightly topped (by 1%) the volume recorded in Europe in 2016. The British market posted a considerable decrease in investments with a 19% fall (in euro terms) over the period. In the Eurozone alone, investment posted a more marked increase of 11%. German markets attracted almost €13 billion in investments over Q1 2017, representing a 49% increase compared with Q1 2016. The average prime yield posted a further nine-basis-point decrease since the beginning of the year; this is however lower than the 30-point year on year decrease recorded. The strongest yield compression was seen in German markets, particularly in Berlin and Frankfurt. The average prime yield should fall even further over the coming quarters.

People are croaking about it

One lily pad between two's not enough. *You're right.* *We need our own Grand Paris:* *our own 'Grand Pond', full of lily pads! Yes!*

DECODING THE COMMERCIAL REAL ESTATE ENVIRONMENT IN FRANCE

The French commercial real estate market: take-up in the rental market driven by an abundance of new supply

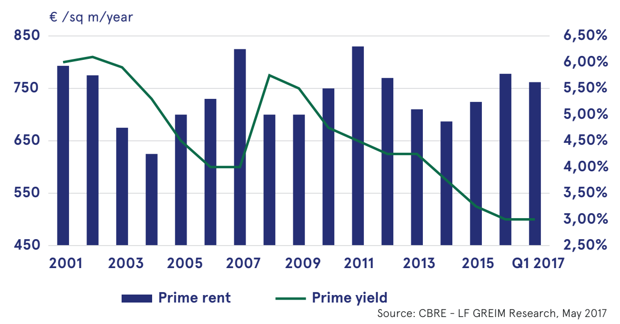
The French economy posted 0.3% growth over Q1 2017, representing a 0.1-point decrease on Q4 2016. Household expenditure also slowed (+0.1% following +0.6%). However, business investment posted a further increase (+1.3% following +0.6%). As a result, there has recently been a marked increase in the PMI index by Markit which measures private sector performance in France. In March, it reached its highest level for almost ten years. In addition, improvements in the business climate over Q1 (linked to hopes both in France and abroad for a win for Emmanuel Macron), should generate more sustained growth over the next few quarters. As a result, Rexecode is forecasting growth of 1.3% for 2017 and a 38-point decrease in unemployment compared with 2016; this will take the unemployment rate to 9.37%. These unemployment estimates were established in Q1 when there was a 0.1-point decrease in unemployment, whereas the number of jobseekers increased by 1.3%. Finally, INSEE is forecasting that inflation for 2017 will stand at 0.8%; at this level, there will only be a limited impact on householder purchasing power.

With 664,000 sq m of take-up over Q1 2017, activity in the rental market was very good, particularly in the Greater Paris Region. These results represent a 27% increase compared with Q1 2016 and the best first-quarter results since 2007. Increases in office take-up were seen across all space segments. Demand from both large and small companies benefited from the higher level of completions in Paris and the Inner Suburbs. Take-up was particularly boosted by the very large 89,000 sq m transaction carried out by Natixis in the Duo towers in Paris 13. Even so, several new deliveries of smaller buildings have driven activity as companies are prioritising good, well-located assets in the most central areas. The vacancy rate posted a slight increase, rising from 6.2% to 6.3% over Q1 2017. It remains low in Paris at 3.4%. Prime rents remained stable, but a slight rise was seen in the Central Business District where incentives fell once more.

Real estate investment in France reached €3.1 billion over Q1; this was stable compared with Q1 2016. Levels were sustained by several major transactions including nine deals for lot sizes over €100 million in Q1 2017. Q1 also saw German investors make a return to the Paris market. They are expecting the rents to recover over the medium term and accounted for a quarter of investments. The Greater Paris Region, and more specifically the Central Business District and La Défense, was the focus of the vast majority of transactions in the €100 to €200 million segment. Competition between investors remains rife as they are seeking the same products, very few of which are available for sale. The prime office yield remained stable over Q1 2017. Following a rise in interest rates, the risk premium fell further to 200 basis points, but remains highly favourable in historical terms.

Following Emmanuel Macron's election and the arrival of high levels of capital from the United Kingdom, activity should see a marked increase over the next few months; this will lead to an acceleration in the level of investments and yields will see some further slight compression. Rents for second-hand assets will tend to fall, although with high levels of incentives. Rental revenues should remain under pressure as the vacancy rate could see further moderate increases by the end of the year.

Prime rent and yield



Source: CBRE - LF GREIM Research, May 2017

DECODING THE COMMERCIAL
REAL ESTATE ENVIRONMENT IN THE UK

The British real estate market: prime market values and investments falling

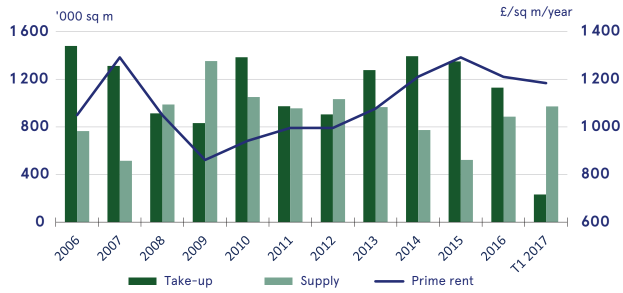
Growth in the UK economy stood at 0.3% over Q1 2017. There has been strong growth in the service sector over the last 12 months, whereas both construction and industry have struggled. Exceptionally low inflation, mainly linked to falling oil prices and strong competition between retailers, have benefited household finances. However, the marked depreciation of sterling means that imports will systematically become more expensive and the Bank of England is expecting inflation to rise. Unemployment continued to fall in the United Kingdom and the unemployment rate stood at 4.6% in Q1 2017.

Despite the continued strength of growth seen in recent months, the rental market continued to show signs of weakness at the beginning of the year. Transactions over the quarter posted a considerable decrease of 35% compared with the first three months of 2016. Levels were considerably lower than the quarterly average for the last ten years, particularly in the less central areas of Docklands and the South Bank. There has been a rapid increase in the vacancy rate which rose from 4.3% to 4.7% over Q1 2017. The latter was affected by a lack of major transactions, despite the 13,400 sq m lease by Freshfields in the City of London. Prime yields therefore continue to fall in both the West End and Midtown - areas which also posted the highest levels of take-up.

The investment volume for Q1 2017 stood at €16.3 billion, representing a 19% decrease compared with Q1 2016. Even so, the market remains attractive with a high level of foreign-investor activity which mainly focused on offices located in London. Asian investors alone accounted for 50% of the overall volume. The prime yield in London remained stable over Q4 at 3.75%. Market values remain high but are starting to fall, due to rent levels that are gradually decreasing across all market areas. The market is therefore still in a phase of adjustment.

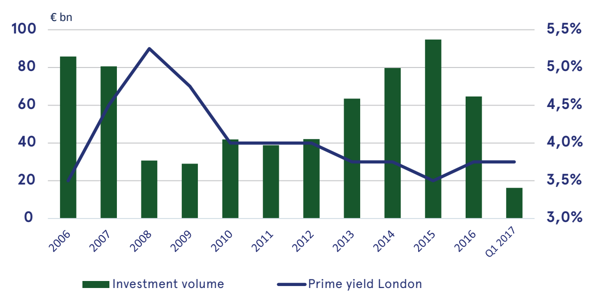
The British economy should continue to perform reasonably well until the negative effects of Brexit become apparent. As such, according to the Office for Budget Responsibility, growth could slow over 2017 and 2018, as businesses start to postpone investment decisions and householders start to feel the effects of rising inflation. Market values continue to fall, mainly due to decreases in rents which are coming under pressure due to the high level of deliveries in the pipeline. However, these decreases, combined with the depreciation of sterling, have afforded foreign investors a substantial increase in purchasing power for taking positions in Europe's deepest and most liquid market.

Central London take -up, supply and prime rent



Source: CBRE - LF GREIM Research, May 2017

Investment and prime yield



Source: CBRE - LF GREIM Research, May 2017

DECODING THE COMMERCIAL
REAL ESTATE ENVIRONMENT IN GERMANY

The German commercial real estate market: market values still rising

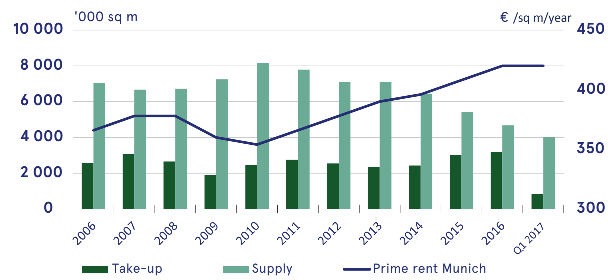
The German economy posted growth of 0.4% over Q1 2017, driven by a strong business climate. The IFO business climate index for April reached its highest point since 2011, even in though the market is facing considerable uncertainty given the current geopolitical climate. The unemployment rate remains particularly low compared with other countries in the Eurozone and stood at 5.7% at the end of April.

The rental market remained highly active over Q1 2017 with 848,000 sq m in office transactions across the five main markets; this represents a 6.5% increase compared with Q1 2016. Thanks to a several major transactions, cities such as Hamburg and Munich posted sharp increases in rental transactions. However, there was a 10% decrease in take-up in Frankfurt over Q1, although several searches for good-quality space in the city centre for banks and financial institutions based in London are currently underway. Activity should therefore see an increase over the next few quarters. New technology companies continued to expand and reached 19% of the overall take-up. There was a further substantial decrease in supply over Q1 2017. The vacancy rate fell considerably in Munich and Berlin where levels at the end of March 2017 stood at 3.7% and 4.2% respectively. There were more deliveries, although these were rapidly absorbed by occupiers seeking new space. Through to the end of 2019, less than half of the space yet to be developed remains available to rent. Rents continued to rise this quarter, particularly in Berlin.

The German investment market made a record-breaking start to the year. €12.6 billion was invested across all markets over Q1 2017, representing a 49% increase compared with Q1 2016. This volume was the highest ever recorded over a first-quarter period. However, no major transactions over €1 billion were recorded this quarter – the largest was a logistics portfolio that was sold for €975 million. The level of core acquisitions fell in favour of transactions with higher risk profiles and higher yields – a clear indication of investor confidence in German rental markets. However, these volumes remain heavily concentrated in the seven main cities. Office assets and the main markets therefore attracted 45% and 75% of the overall investment volume respectively. Berlin posted a very significant increase in investments. Investments stood at almost €960 million In Q1 2016 and this rose to €1.7 billion in Q1 2017. Yields saw further contraction, driven by strong demand from foreign investors whose activity has more than doubled this year.

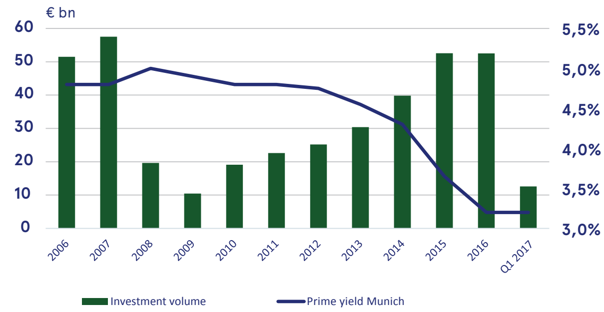
However, German growth should slow over the rest of the year while still achieving a satisfactory level of 1.5%. Increases in inflation could slow household consumption, even though the unemployment rate should remain under 6%. Prime rents could continue to rise over the next few quarters, particularly for new office space located in the various city centres of the main German markets. Yields should continue to fall over the next few months as there is an abundance of liquidity seeking positions in Germany.

Take - up, supply and prime rent



Source : CBRE - Pôle Etudes LF GREIM, Mai 2017

Investment and prime yield



Source: CBRE - LF GREIM Research, May 2017

DECODING THE RESIDENTIAL REAL ESTATE ENVIRONMENT IN FRANCE

The French residential real estate market: Good activity at the beginning of the year

As government bonds rose following Donald Trump's election and were further boosted by the optimism surrounding Macron's presidential win, credit rates for real estate have been rising since the end of 2016. At the end of April, the average levels for a 15-year term stood at 1.61% compared with 1.519% at the end of March 2017 and the low point of 1.34% which was recorded at the end of last year. These rates are however at historically low levels and should continue to rise over the coming months. Given this outlook, a high number of sales were completed at the beginning of the year.

The marked upturn in the new homes markets gained pace in 2016, both for new homes from developers and individual houses with no developer. As such 109,000 developer sales were recorded throughout the year representing a 6% increase compared with 2015. Since the beginning of 2017, real estate professionals specialising in new homes have strengthened their position. They have benefited from strong demand for their two main market segments - the rental investment market and first-time buyers - thanks to the Pinel incentive scheme and the new version of the zero-rate loan.

Construction starts for new home developments have continued to rise since 2016. Levels increased by 15.1% to 97,400 units between February and April 2017, compared with the same three-month period in 2016. There was a 13.7% increase in building permits (116,100 units) over the same period. Year on year, from May 2016 to April 2017, the share of detached houses under construction fell by 0.6% after having increased by 7.9%. Conversely, construction starts for collective housing (including residences) rose by 3.2% after having fallen by 5.6%.

There were widespread increases for new homes across France (+2,5%). These gained pace towards the end of the year and rose by 3.6% over Q4 alone.

The rental market made a timid start to 2017. Average rents stabilised in France after ending 2016 with a 1% increase. However, these changes vary depending on the type of asset. Over two months, two and three-roomed homes (60% of the market) posted 0.6% decrease, whereas there was a 1.1% increase for smaller spaces (22% of the market). Even so, most large French cities have seen falling rents, including Rennes, Le Havre and Nice where these decreases have been as much as 2.3%. In Paris, rents fell by 0.3% to €25.2 per sq m.

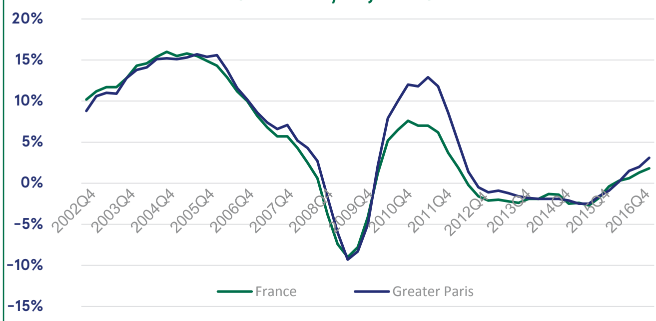
The decline in improvements and maintenance continued and the effort rate is now at a low point for the last 20 years. Only 14.1% of assets in the private rental stock were subject to renovation or maintenance work between two lettings, compared with an average of 22% over the last two decades.

The established homes market saw a continuation of the activity seen since the end of 2015 and has exceeded records. In fact, the number of transactions is now 5.5% higher than the very high level seen in 2006 with 881,000 transactions recorded over the 12 months to the end of March 2017. This sharp increase is due to low real estate credit rates as well as the expectation of increases over the course of this year. Any increases will automatically lead to higher loan repayments for householders.

Price increases for established homes gained pace over Q1 2017 after having fallen consistently between 2012 and 2015. Over this period, prices for established homes posted a 3% increase in France and 3.8% in the Greater Paris Region. Apart from improvements to real estate purchasing power (due to consistently low rates) there is also a good level of product on the market.

Real estate support measures for both new and established homes should continue throughout 2017. In fact, the continuation of zero-rate loans and the Pinel scheme as well as the 'refuge value' effect due to the tangible nature of the investment, mean that real estate should remain an active sector. Real estate credit rates should remain low in terms of the historic average, but levels have started to rise and could continue to do so. This outlook has contributed to sustaining high levels of activity since the beginning of the year. Transactions should only see a slight increase in 2017, compared with the strong activity recorded in 2016, although levels should remain very high leading to further price increases for both new and established homes. Finally, Macron's electoral victory is unlikely to change this outlook as investors will continue to pursue their strategies and interest rates are only likely to see limited change.

Annual growth rate of housing prices in France
(seasonally adjusted)



Source: INSEE - LF GREIM Research, May 2017

FOCUS ON

Grand Paris and housing

Housing has always occupied a special place in France. Apart from the values it conveys, real estate in its broadest sense and housing in particular embodies many attributes.

The residential market is sustainably supported by several structural factors: an active demographic compared with other Western European countries, a rising trend for household division, retirement preparations and, more broadly, a desire for homeownership. In economic terms, for the last few quarters acquisitions have been driven by the low level of credit rates, despite an increase seen at the end of last year. These very low credit rates have also been helping to rebuild householder solvency.

Furthermore, in the context of continued high volatility in the financial markets, the real estate asset class continues to represent a refuge value. These many supporting factors have ensured consistent activity in the house acquisition market and their combination has encouraged a considerable upturn in prices, particularly in the Greater Paris Region.

This high demand from French house buyers is increasingly concentrated in cities, as are populations, which are attracting the lion's share of activity. Over the years, regional imbalances therefore become exacerbated, leading to diverging trends in terms of residential pricing: large cities have seen strong growth in house prices, whereas demand for more secondary areas has slowed considerably leading to a decrease in values.

The most striking example is undoubtedly the Greater Paris Region. Despite a series of crises since 2008, there has only been a slight decrease in prices and only for a very short time. Levels have generally since risen again and estimates forecast new record prices in Paris at €8,800 per sq m for July 2017. Price increases in Paris have also had a ricochet effect on the suburbs.

The stakes are enormously high. Over the last few decades, the share of expenditure on housing has risen considerably and this has had a substantial impact on householder budgets allocated to other areas. For example, this has driven a downturn in consumption which has slowed the French economy and all its constituent parts. Analysts therefore point to the strength of the German economy which is particularly attributable to a better distribution of activity and residential areas across the country (despite having a considerably higher density than France), as this increases the competitiveness of companies and boosts household consumption by maintaining rents in the various cities at reasonable levels.

The Grand Paris project has been developed to confront these challenges. The construction of 200km of automated metro lines along with 68 new stations around Paris will greatly improve accessibility to certain areas that currently receive little interest from householders. This will contribute to broadening the sites available for construction and increase the housing stock. 70,000 new homes should therefore be developed every year for the next 25 years to meet the needs of the rising population in the Greater Paris Region (population of 13 million expected by 2030, compared with 12 million recorded in 2014) and create better fluidity in the residential market by reducing inequality.

From the institutional investor's point of view, the substantial decrease in yields for offices and retail have made the returns from residential assets increasingly attractive as they have become close to those offered by commercial real estate investments. In addition, the low rates of return offered by government bonds have automatically made the risk premium far more attractive.

Line 15 of the Grand Paris, the only metro line that will not run through any station in the capital itself, reflects the drive to look beyond the ring road and to incorporate the inner suburbs.

La Française is keen to be actively involved in the development of Grand Paris. We are therefore considering innovative means of offering householders easy access (due to the low cost) to new housing, including homes in the Paris region. The Grand Paris project offers a unique opportunity to break down the barriers between territories, make them more accessible, increase the overall supply of housing and improve living conditions for many more people.

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