

CURRENT TRENDS IN FRANCE

Number of second hand sales ¹	↓
Number of new sales ¹	↑
Price of second hand housing ²	↑
Price of new housing ²	↑
Rents ²	↑
Construction ²	↓
Available supply of new housing ²	↓
Investment	↑

¹ Annual trends compared to 2008
² Annual trends compared to Q1 2009

ECONOMIC CONTEXT

The French economy is struggling to get back on its feet. For several months now, good news has been followed by bad, positive signs by negative signs. Across the board, things seem better, but the slight improvement is shrouded in uncertainty and the question of whether or not it will last.

From a business level, industrial production appears to have stabilised and generally speaking order books are healthier. In the service sector, the improvement is much sharper and business activity has increased. Yet despite all that, the job market is depressed and the unemployment rate does not look as if it will fall in the medium term. In all likelihood the seizure in business investment will not mend this year despite the fall in the euro and the resulting improvement in export competitiveness outside the euro zone.

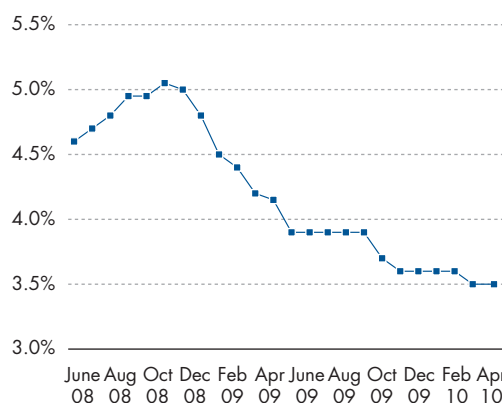
Against this backdrop, consumers' moral is low not least because of concerns about unemployment, the future of the country's pension schemes, and the problem of the public deficit. Consumer spending is posting mediocre results for 2010, exaggerated by rising inflation.

Finally, interest rates are extremely low, despite the slump in international finance markets at the start of May and fears as to the insolvency of some countries, in particular in Europe. At the same time, access to credit is still difficult.

The road to recovery will be long and bumpy in France with forecasts for growth hovering at 1.4% for 2010 and below 2% for 2011.

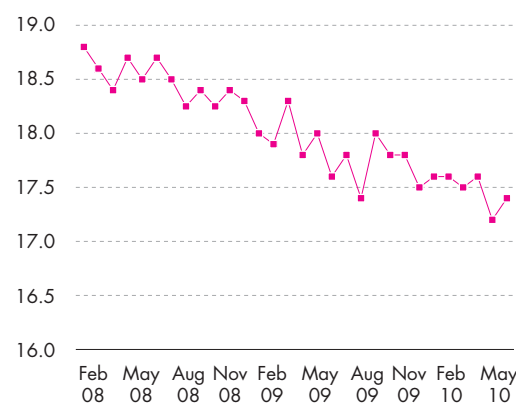
This environment explains the latest results of INSEE's quarterly survey of the state of the construction industry (approximately 1,000 companies questioned), even though there is a housing shortage in France. At the end of April 2010, demand from homebuyers for new housing slowed down considerably, in contrast to demand from tenants for new housing, which increased. Simultaneously, the developers interviewed claimed that both the deposit and financing capacity of potential homebuyers had fallen in recent months. It would appear that tax incentives and other measures had given the housing market a shot in the arm and that the time had finally come for the inevitable adjustments – profitable for some.

Changes in fixed-rate
 (15-year mortgage rates for A-rated application)



Source: Meilleurtaux.com

Average length of mortgages
 (in years)



Source: Observatoire du Financement des marchés Résidentiels

HOMEOWNER SALES

New housing

Housing construction falls further

The construction of new housing followed a downward trend in 2009 and the 1st quarter of 2010. The number of new construction starts **between March 2009 and March 2010 fell by 14.8% compared to those in the year to March 2009**. Building works started on some 312,465 normal homes (flats and houses) in twelve months, with a 12.5% fall in the construction of flats and a sharper 21.2% decline in the construction of houses. Government measures, principally the Scellier law, **tended to bolster demand for the construction of flats**, widening the gap between the two market segments.

The number of new construction starts varied from region to region in France. The only regions to see a rise were Bourgogne, Haute-Normandie and Picardie, where construction starts increased by respectively 10.8%, 8% and 7.6%. In all other regions they **fell - by as little as 1.3% in Ile-de-France and as much as 40.6% in Limousin**. The largest year-on-year falls were in Auvergne (down 30.8%), Lorraine (down 34.4%) and the Limousin (down 40.6%). The gentlest falls were in Ile-de-France, Pays de la Loire, Champagne-Ardenne, Corse, Languedoc-Roussillon and Centre, ranging from 1.3% to 10%.

But the market is still active

In **2009**, the number of new homes sold in France stood at 106,282 compared to 79,359 in 2008, which is an **annual increase of 34%**. By contrast, at 26,666 sales were **stable** in the **1st quarter 2010** compared to 1st and 4th quarters 2009.

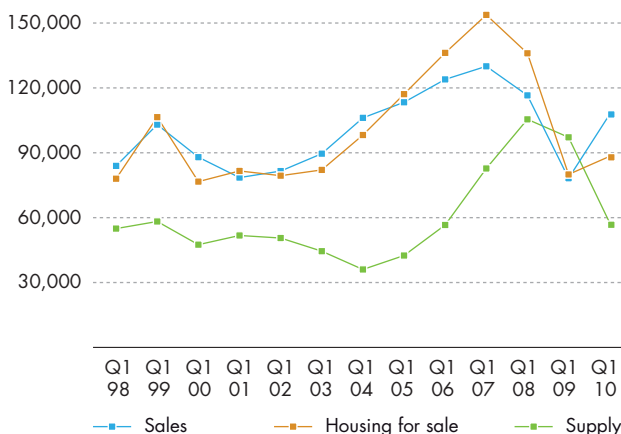
2010 may prove to be the year when the French start seeing the consequences of the slump in construction that was triggered by the credit crisis and resulted in a supply reduction even though sales continued as usual or even rose.

It is estimated that 67,475 new homes were available in France in the 1st quarter 2010 and that number is falling. Simultaneously the time it takes to sell a home is shortening each quarter and is now less than 8 months.

The regions of Ile-de-France, Rhône-Alpes and Provence-Alpes-Côte d'Azur were the most active with housing sales of respectively 18,727, 17,544 and 14,842 in 2009. **Once again, the most intense commercial activity took place in the Paris region and along the southern border and in the north west of France**. However in 2009, commercial activity rose by 50% compared to 2008 in the regions of Centre, Pays de la Loire, Nord-Pas de Calais, Franche-Comté and Bourgogne.

Sales, housing for sale and supply of new housing in France

(in number)



Source: MEEEDM/SESP : SOeS, ECLN

Climate for property development

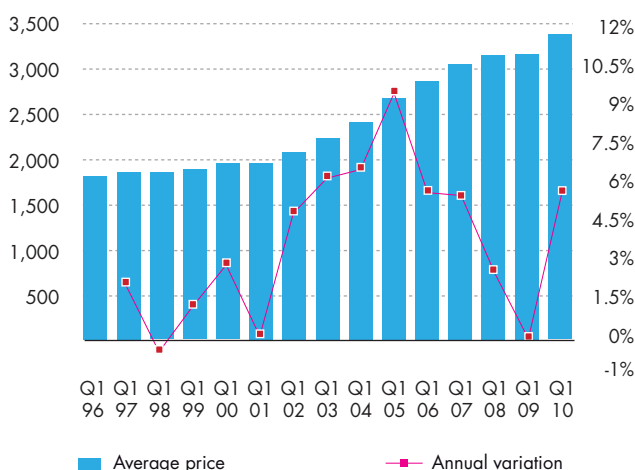
(balance of opinion in %, with seasonal adjustments)

	July 2009	October 2009	January 2010	April 2010
Demand from housebuyers	- 42	- 27	- 15	- 33
Demand for housing to rent	+ 8	+ 7	+ 4	+ 16
Supply/properties for sale	- 57	- 49	- 53	- 34
Average price of homes for sale	- 25	- 27	- 8	- 10
Downpayment capacity	- 35	- 23	- 13	- 24
Forecast changes in financing capacity	- 30	- 16	- 9	- 28

Source: INSEE, Quarterly survey, Information Rapides April, 23th

Average prices of new apartments in France

(in €/sq. m)



Source: MEEEDM/SESP : SOeS, ECLN

Housing loans (in billion euros)

January 2010	February 2010	March 2010	Annual Variation February 2010	Annual Variation March 2010
737.9	739.5	745	+ 4.50%	+ 4.80%

Source: Banque de France

The zero rate loan halved to its original size in July 2010

The zero rate loan was introduced by decree of 29 September 1995 and modified by the finance act for 2005 (art. 93 of the Code général des impôts, art. 244). In 2009, as one of the measures taken to stimulate the economy, the amount people could borrow at 0% interest was doubled for the acquisition for new homes and increased for second hand homes. The measure was very popular with the French and it was a great success, playing its part in boosting real estate markets that had been virtually stagnant at end 2008.

The finance act for 2010 renewed the principle of the zero rate loan for three years, until the end of 2012. From 1st July 2010, however, the loan can no longer be doubled instead an increase in value of 50% is possible until 31 December 2010. For example a family of four buying a property in zone A can currently benefit from as much as €55,050. From 1st July, this amount will fall to €41,250.

In some instances, other increases can be cumulated and added to this basic ceiling limit. For example increases can be obtained in certain councils which get aid under the Engagement National pour le Logement (national commitment to housing), or in problem areas or free urban zones (known as ZUS and ZFU zones) and also for certain green buildings.

Sources: press release Cyber prêt, cbanque.com

Prices on the rise again!

Despite the crisis, **the average** price of new apartments in France **rose by 6.8% between 1st quarter 2009 and 1st quarter 2010**, compared to 0.27% from 1st quarter 2008 to 2009. This increase could be sustained or even be amplified in some sectors because of:

- the constant and growing pressure on the availability of development sites in markets like Paris and in the city centres of regional capitals;
- changes in legislation concerning Thermal Regulation (RT 2012);
- the indirect improvement in the buying capacity of some households due to tax incentives in the Scellier law (the number of loans granted for a real estate project in 1st quarter 2010 is close to that for 2004);
- low interest rates that are unlikely to rise for several months (3.5% for a 15-year mortgage);
- an imbalance between housing supply and demand in France.

Several factors contributed to keeping **the market for new housing healthy in France** in 2009 and 2010:

- the **Scellier provision** for landlords which gives tax relief under certain conditions while enabling the owner to build up an estate providing a modest but secure income now and for the owner's retirement, the latter being particularly appealing given the on-going reform of the pension system in France. The Scellier provision also helped the construction industry because it increased demand for new housing. It benefited the letting market as well by supplying the market with new homes to let with capped rents;
- **very low interest rates**, which continue to offset price rises;
- the on-going **need** for housing both in the letting and buying markets.

Rising prices have not yet blocked the market as there is a shortage of supply, interest rates are low and inflation is virtually zero. The return of inflation, leading to a rise in lending rates, may mark the start of a new cycle, characterised by a wait-and-see behaviour pattern due to falling household solvability. In this scenario, banks will play a decisive role in the market via the finance conditions they decide to offer or by proposing new services and other support for real estate projects.

Although the market for new housing has been artificially bolstered for several years by tax incentives and other measures and "Scellier" sales account for two thirds of total sales, bricks-and-mortar is still a safe investment product, close to the hearts of the French, who continue to place some of their capital in this type of investment product to guard against uncertainty in the economy.

Market fundamentals are expected to change in 2010 and may result in a less favourable situation for housing sales (higher lending rates, lower prices, an end to the doubling in value of the zero-rate loan, tougher conditions attached to the Scellier incentive from 2011 and so on). But several months will go by before any noticeable change will take place.

Second hand housing

The market is unblocked

Against all expectations, the number of second hand homes sold **remained at a decent level in 2009 with the conclusion of 575,000 transactions**, a reduction of 8.7% on 2008's results. On the heels of a difficult 1st half, when buyers were waiting to see what was happening in the market, transactional activity increased steadily at the end of 2009 and in the 1st quarter of 2010. Visibly the slight improvement in the economy and good financing conditions for real estate projects encouraged households to reassess their buying and selling intentions. Properties started trickling back on the market, making it slightly more fluid than a year or even six months previously.

But **uncertainty prevails, placing a question mark over the longevity of this improvement**. Unemployment is high and further deterioration in the international economy is still likely. On top of this are the ongoing problems of a supply shortage and the difficulty for consumers of managing bridging loans.

In regional France, the fledgling improvement in transactional activity is restricted to certain very popular districts of large cities, especially in city centres where supply and demand are in tune with each other.

Prices also rising

The short period of falling prices ended in 2009, giving way to a new episode of growth. Halfway through 2009 slight increases in prices in the best districts of Paris were recorded. **The average price for second hand housing in France as a whole also rose slightly, by 1.8%** (compared to 1% for flats) between 1st quarter 2009 and 1st quarter 2010.

The situation varies from one area to another, but generally speaking the trend is similar across France with prices showing a year-on-year increase in 1st quarter 2010 of 5.7% in Ile-de-France, 3.4% in western France and 2.4% in southwest France.

Mortgage conditions at the start of 2010 were particularly good because **prices were at the level seen end 2005** (the current moderate rise has not wiped out the effects of the falls since 2008) and the **recent fall in lending rates** boosted the borrowing capacity of households.

THE LETTING MARKET

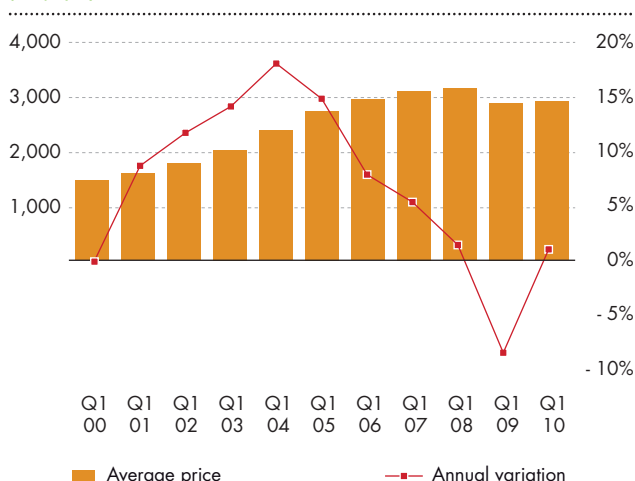
A slowdown in activity

In 2009, the mobility of the French was at its lowest level for 10 years, standing at 25.8%. It rose slightly at the start of 2010, by 0.6 point, but the number of transactions is on a downward trend. In 2009 there were **5.8% fewer leases signed than in 2008**. In the current climate of **uncertainty** and rising unemployment, the French prefer to stay put and are avoiding moving homes.

Generally speaking, the letting market has therefore been **affected by a drop in its fluidity**, but the situation can vary quite widely in some **micro-markets**. In some instances the supply of housing with capped rents has risen with the completion of new housing built under the Scellier investment scheme and this makes it easier for people to move.

Average prices of second hand apartments in France

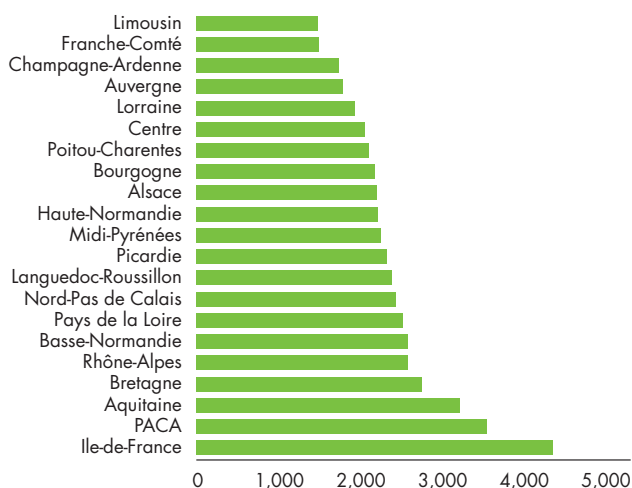
(in €/sq. m)



Source: FNAIM

Average price of second hand apartments at Q1 10

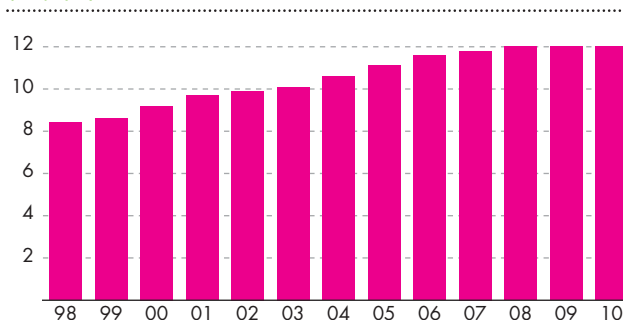
(in €/sq. m)



Source: FNAIM

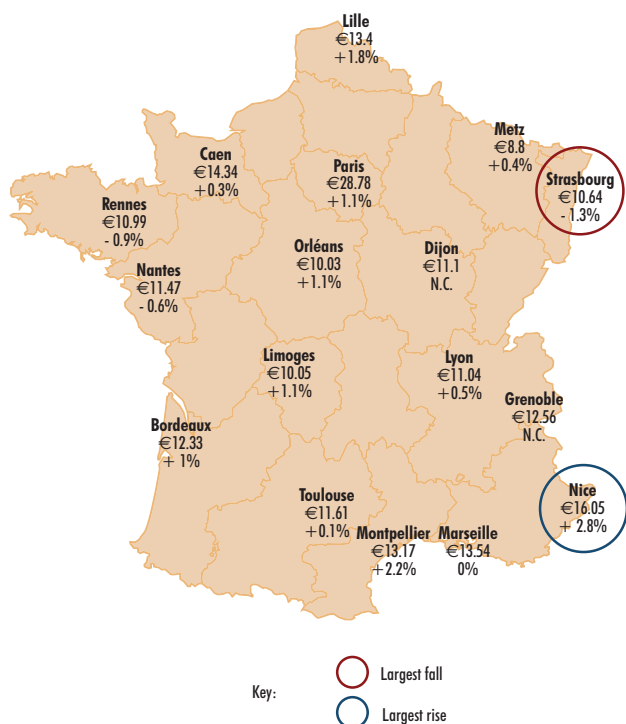
Average prices of second hand apartments in France

(in €/sq. m)



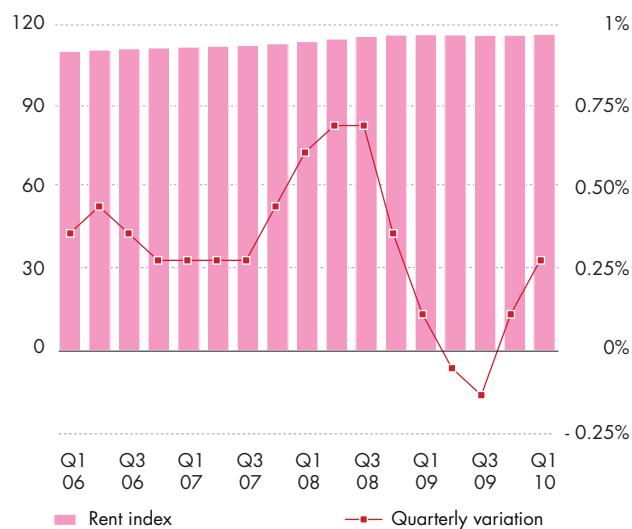
Source: Fnaim

Average rents for new leases on second hand apartments in France in May 2009
(in € net/sq. m, year-on-year variation)



N.C.: Not communicated
Source: Seloger.com

Changes in the rent index
(base 100 at Q4 1998)



Source: INSEE

Rents still rise slightly

The evolution of average rents in France, contained in 2009, will probably remain moderate in 2010. Low mobility is a contributing factor to such meagre developments.

Variations in asking rents range from a drop of 1.3% in Strasbourg and a rise of 2.8% in Nice. While Paris, Nice and Caen are amongst the most expensive cities with rents ranging from €28.78/sq. m to €14.34/sq. m, while the cities of Limoges, Orléans and Metz are the least expensive with average rents ranging from €10.05/sq. m to €8.8/sq. m (see map).

Some markets may have loosened up slightly, particularly due to the completion of "Scellier" buildings and a **cooling down in the rate of rent increases**. But the letting market in France is **still in crisis** and is generally marked by a shortage of supply and lack of fluidity.

In parallel, in 1st quarter 2010, the IRL index stood at 117.81, confirming the trend already noted towards stabilisation with a quarterly rise of only 0.3% since 4th quarter 2009 and a year-on-year rise of 0.09% since 1st quarter 2009.

SUMMARY AND OUTLOOK

The residential market is in a very different situation now than it was at the start of 2009. Some fears appear to have gradually been allayed, in particular that of a collapse in prices, so that market activity was able to pick up again. Reverse trends can be seen in some growth indicators, suggesting that France is on the road to recovery. These positive signs have enabled the population to turn to the future and consider new projects.

The market for new housing has been very active, enjoying specific financing possibilities and tax incentives during the construction, transaction and letting stages. This market is heading for change with the introduction, from January 2011, of the RT 2012 regulations and modifications to the Scellier law in summer.

While trends in the **second hand market** do not point to a turnaround, they are at least encouraging and have involved price increases, in some cases very large ones. These may hinder activity.

The **letting market** has benefited from the stock of new space created by the profusion of sales to investors.

Nevertheless, the price reductions needed for a real upturn in activity have not taken place. Such reductions would have been very healthy, cleaning up a market that has seen ten years of rising prices and has been heavily dependant on government aids.

BLOCK SALES

At the start of 2008, until the end of the 1st half 2009, the real estate market went through a vacuum. Buyers withdrew, bringing about a slump in transactional activity and a reduction in prices.

The collapse in stock markets led to renewed interest in residential assets, which, since mid 2009, has **stimulated market activity**. At present there is high demand and automatically a reassessment of prices, which are sometimes as much as 10% higher than at the start of 2009 for prime properties. We have been witnessing a **two-speed market**: prime properties in Paris are sought after and secure and their prices have tended to rise strongly, while markets in the rest of France have been spared such pressure, in particular pressure on prices, even though regional markets have been more active than in 2008.

The substantial growth in the number of people investing in real estate is due to **the low cost of money, credit availability and waning enthusiasm for stock market investments** prompting consumers and professionals **to look for other products**.

The **main players on the market are**:

- **institutional investors**: still selling some of their assets but now wanting to invest more;
- **estate agents and asset managers**: very active in the market, which they esteem is profitable. Both these types of investors enjoy good financing capacities, either via banks or because they work for private investors. Their strategies have started converging because the practice of selling off block acquisitions flat-by-flat has been slowed down. First because of the Aurillac law, which introduced a requirement for a higher degree of financial backing by agents; second because investment vehicles are more widely used and the rental income generated makes operations self-financing enabling them to be held on to longer;
- **privates or family offices**: since the subprime disaster, an increasing number of family offices are active in the real estate market for prime properties due to uncertainty and higher risk on stock markets. They tend to focus on traditional buildings in Paris;
- **social investors**: were active in the market even during the crisis. Their relative share has fallen again with the return of other categories of investors since mid 2009;
- a few **foreign investors**: particularly from the Middle East and Asia, for whom the French capital offers unparalleled advantages compared to neighbouring cities in Europe, many of which were hit harder by the crisis;
- **developers**: supplying the market with new properties, generally sold as individual apartments. However some sections of large-scale developments are sold as blocks, even though their share of the market has been contracting since the start of 2010.

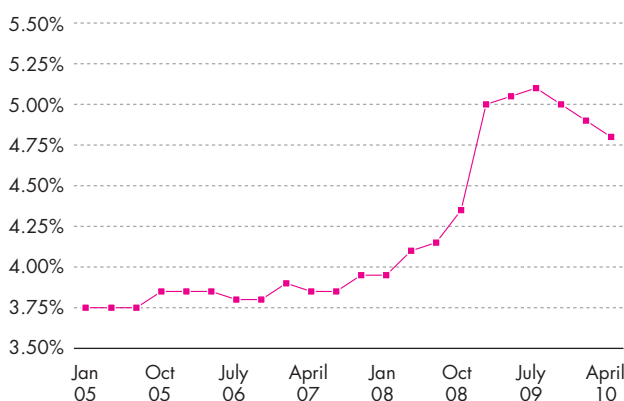
Prime* yields by product

	April 10	April 09
Offices Paris CBD	5.25% - 6.00%	6.25% - 6.50%
Offices La Défense	6.00% - 7.00%	6.50% - 7.00%
Offices in regional France	6.35% - 8.50%	7.00% - 8.50%
Class A logistics space	7.75% - 8.75%	8.25% - 9.00%
Industrial premises	9.25% - 12.00%	9.25% - 12.00%
Shopping centres	5.00% - 7.15%	5.50% - 7.25%
Prime retail pitches (n°1)	5.00% - 7.50%	5.75% - 7.50%
Residential	4.8%	5.5%

*Well located assets, let at market conditions
Some figures are valuers' opinions.

Source: CB Richard Ellis

Net immediate residential prime yields



*Well located assets, let at market conditions
Some figures are valuers' opinions

Source: CB Richard Ellis

Carbon footprints, standards and conversions

Virtually every business is now in the process of assessing its carbon footprint. Improving the energy efficiency of old offices can be very expensive. Consequently some residential investors are examining the possibility of converting high-energy old offices into housing, particularly ones that are judged too far from public transport to make a green conversion worthwhile. While such a conversion is not yet on the cards, it is something being considered and could be a source of new development capacity in markets where there is a scarcity of housing.

This kind of conversion could prove to be an efficient solution to prevent the type of urban wastelands developing that have recently been the subject of documentaries and magazine features.

For such a solution to be workable, more flexibility will be need to be introduced into regulations about the authorised use of land that is strictly controlled in local urban planning documents (PLUs).

wReform of the Real Estate VAT regime

A new VAT regime applicable to real estate operations, a parliamentary initiative text, came into force 11 March 2010, one day after it was published in the Journal Officiel. The purpose of this rather rushed text was to make the VAT applicable to real estate transactions comply with the VAT directive (2006/112/CE) and to simplify the regime.

The provisions in the text include:

- the suppression of special real estate VAT regimes and the suppression of special brokers' regimes with the extension of the common law regime;
- a new objective definition of a development site;
- making the seller systematically the one that pays the VAT;
- making VAT on off-plan sales payable as and when instalments are paid or upon completion;
- making the application of VAT optional outside the construction cycle.

The speed at which these provisions were introduced means that all the modalities for applying the regime are not yet clear. Future tax instructions will help us understand the ins and outs of the new regime and some of its consequences.

Sources: FNAIM, revuefiduciaire.groupef.com, village-justice.com

High-grade buildings in Paris not affected by the crisis

The market segment the least affected by the crisis is high-grade buildings in Paris selling at more than €12,000/sq. m.

The on-going price increases are due to the national and international appeal of such buildings to wealthy clients. It is an emblematic city but still cheaper and more stable than many of its European counterparts.

Prime yields rose 95 base points from mid 2008 (4.15%) to mid-2009 (5.10%), but have started to fall again due to increased competitive pressure, to 4.8% in April 2010.

The market for block sales has evolved since mid 2009. In some areas it has stabilised; in others, picked up slightly. This market is fraught with many questions because of the persistent supply scarcity, especially for prime buildings. In addition, the strength of the market depends greatly on the cost of money and availability of capital.

UNIT SALES

The market for unit sales has **followed the same general trends**, i.e. a rise in sales, mainly concentrated in Paris and Ile-de-France and a rapid rise in prime values.

This market is now suffering from **an on-going scarcity of second hand properties**, especially in Paris where there is a great deal of pressure from demand, reinforced by low interest rates. **Institutional investors and social housing operators**, which have adopted a strategy of selling off sections of their portfolios for several years now, still feed the market with units.

Regional cities have been following a **different cycle**, with a slowdown in sales still being seen and more modest price variations. In contrast to Paris, some building owners are putting their properties back on the letting market.

All types of buyers of housing units benefit from favourable conditions at the start of 2010:

- **tenants**, who enjoy low interest rates and the discount they benefit from when they decide to buy the home they occupy;
- **buyers** of a main unoccupied residence looking for average-sized units in Ile-de-France;
- **investors** of occupied properties who give priority to building up an estate (for children or the family) rather than looking at returns on investment. The notion of refuge value is very important at the moment.

This **phase of rising prime values may run out of steam** if interest rates rise as predicted, in the current context of economic instability and a weak euro. In addition, we may be heading for a period when government policies are not quite so accommodating, which will likely shake up market fundamentals.

FOCUS...

The Scellier law and recent changes

The government is planning to introduce changes to the Scellier law, first introduced in 2008 for investment in new or redeveloped housing carried out between 1st January 2009 and 31 December 2012. This law currently allows for a tax deduction over 9 years of 25% (37% in the case of social housing) of the price of the purchased property as long as the property is rented out at a capped rent. Two changes are planned for 2010: environmental provisions that enable the owner to benefit from better tax advantages and a rise in the ceiling limit put on rents in certain geographical areas.

Two different environmental standards: "éco-conditionnalité" and "Scellier BBC"

The principle of "éco-conditionnalité" adopted at the end of 2009 (cf BOI 5B-17-09) is the requirement to comply with the standards in force when planning permission is filed in accordance with certain modalities defined in the decree introduced after the Grenelle II environment talks. Without this compliance investors will not benefit from the Scellier tax reduction.

In addition, and in an attempt to encourage the construction of housing with low energy needs, and play a part in the reduction of greenhouse gas emissions, the government wants to make the Scellier law even greener. Investors can benefit from better tax reductions from 2011 by choosing to make an additional effort on energy savings. In 2011 and 2012 a 10 point difference is planned between low energy housing and housing that does not meet this standard. Specifically, the tax reduction will be 25% in 2011 and 20% in 2012 for low-energy buildings, and 15% in 2011 and 10% in 2012 for other housing.

Minister demands modification for summer 2010

To protect landlords and avoid a repetition with the Scellier law of the adverse side-effects experienced with the Robien law, the junior minister for Housing announced that he would make a certain number of proposals to the government before the end of the summer, in particular the revision of rent ceiling limits and the exclusion of some towns from the Scellier law.

In some instances, rents presented to future investors were too high compared to the reality of the local market, which seriously reduced, or even eradicated, the returns for some real estate investors.

In addition, the proposal is to exclude from the Scellier law some towns where there is very little demand for properties to let so as to prevent investors finding themselves in difficulty with their mortgage repayments: in some instances the lack of tenants meant investors found themselves with no income from the property and they could no longer claim the tax credit. In total, 170 towns may be excluded from the Scellier law including Alès, Béziers, Clermont-Ferrand, Dijon, Le Mans, Montauban, Mulhouse, and Valence.

Yet other towns currently in zone C and also in need of new homes on the letting market may become eligible. Each town will be considered on a case-by-case basis before coming under the Scellier law.

Rent ceiling limits

	Standard Scellier	Social Scellier
Zone A (Paris and several suburbs in Ile-de-France)	€21.72/sq. m	€17.38/sq. m
Zone B1 (Cities > 250,000 inhabitants and some communes considered expensive)	€15.10/sq. m	€12.08/sq. m
Zone B2 (Cities > 50,000 inhabitants, coastal and border areas)	€12.35/sq. m	€9.88/sq. m

Sources: guide-loi-scellier.fr, partenaire-europeen.fr, immobilier-neuf-investir.fr

Information herein has been obtained from sources believed reliable. While we do not doubt its accuracy, we make no guarantee, warranty of representation about it. It is your responsibility to independently confirm its accuracy and completeness. Any projections, opinions, assumptions or estimates used are for example only and do not represent the future performance of the market. The reproduction of the whole or any part of this report is only authorised if its source is credited.

CB Richard Ellis Ressources - Economic analysis support
Headquarters: 145-151, rue de Courcelles 75017 PARIS - Siren: 412 352 817 - RCS Paris

© 2010 CB Richard Ellis, Inc.

CONTACTS

Research

Aurélien LEMOINE

Head of Research

Tel.: 33 (0) 1 53 64 36 35

Fax: 33 (0) 1 53 64 40 00

aurelie.lemoine@cbre.fr

Marie-Josée LOPES

Residential research analyst

Tel.: 33 (0) 1 53 64 30 78

Fax: 33 (0) 1 53 64 40 00

mj.lopes@cbre.fr