CBRE

The residential market is not immune to the slowdown caused by rising interest rates

▼ €1.2 bn
Residential investment – H1 2023

▲ 3.25%
Prime yield
Paris residential – August 2023

▶ 4.10%
Prime yield
Senior housing – August 2023

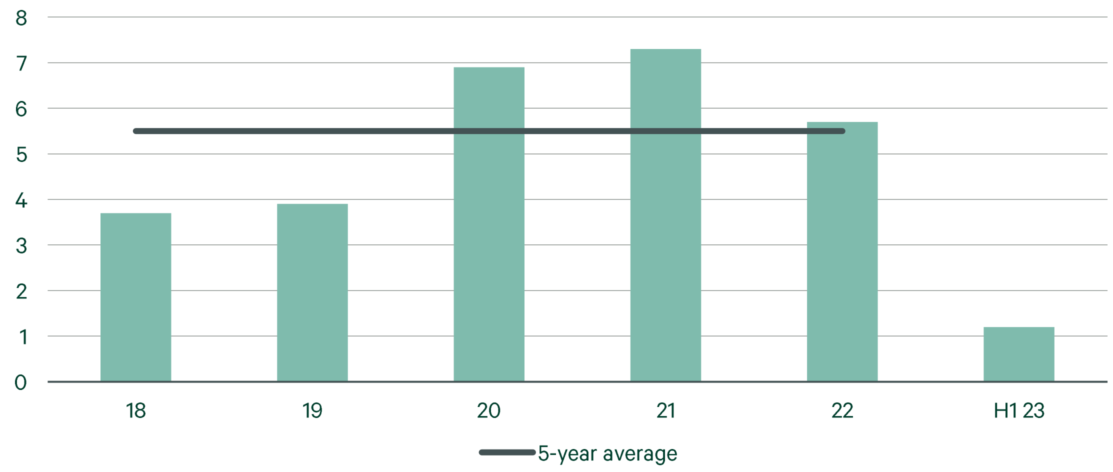
▲ + 2.7%
Existing home prices (houses and flats) – Q1 2023
Notaires de France

Note: The arrows indicate the annual changes

KEY POINTS

- With €660 million invested in Q2 2023, the residential investment market (excluding social housing) totalled €1.2 billion in the first half of the year.
- Volumes down sharply versus H1 2022 due to the lack of large portfolios during the period.
- A rise in residential yields against a backdrop of inflation and rising interest rates.
- Price drops in the major cities over the first half-year as lending conditions are weighing on households' real estate purchasing power.
- A strained rental market and continued increases in rents.
- Sluggish construction activity, with fewer housing starts over the past 12 months than during the pandemic.

FIGURE 1: Investment volumes in residential* in France (excluding social housing)



In billions of euros.
*Unrestricted, intermediate, and operated residential (coliving, student housing, senior housing, and intergenerational housing).
Source: CBRE/Immostat, Q2 2023

Common ground to be found between buyers and sellers

No large portfolios and few off-plan sales in the first half of the year

After a less spectacular Q1 in 2023 than in previous years due to the absence of large portfolios, Q2 confirmed the market's slowdown, with €660 million invested in residential (excluding social housing), bringing the volume for the entire first half of the year to just over €1.2 billion.

The sharp rise in interest rates over the last 12 months boosted investors' expectations in terms of yield on acquisition, whereas sellers preferred to pull their assets off the sales market rather than lower their prices. This conflict explains both the lack of large portfolio transactions in the first half of the year and the lower share of off-plan in total volumes invested (18% in H1 2023, compared with 47% in 2022). Developers, constrained by land prices and rising construction costs, are particularly reluctant to negotiate.

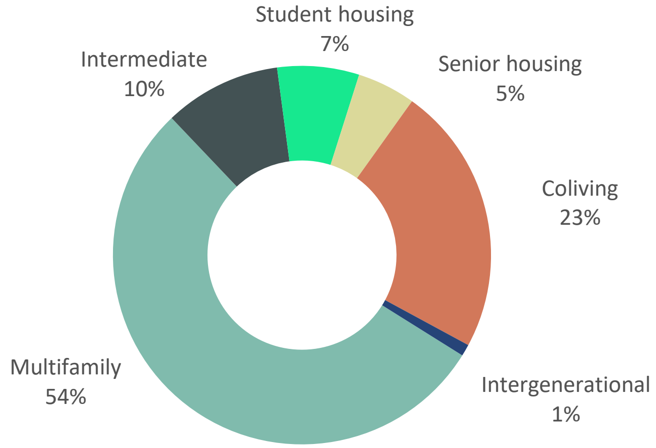
Operated residential, with higher yields for equally solid fundamentals, strengthened in this particular context, accounting for more than a third of the volumes invested in the first half, compared with less than a quarter last year. The coliving sector was particularly dynamic in the first six months of the year, with more than €280 million invested.

The second half of the year is expected to see the same trends, as market players have to adjust to the end of the low rates environment.

Prime yields continuing to go up

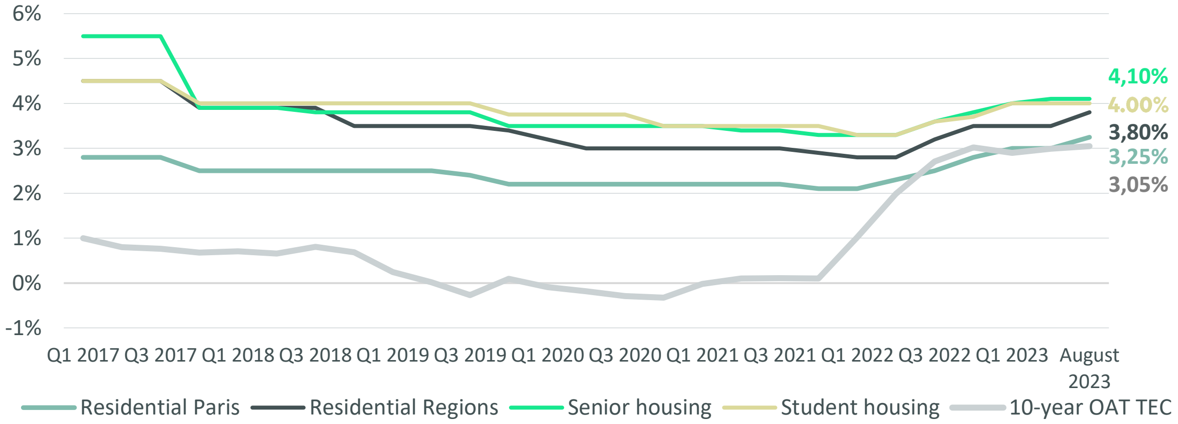
The rise in prime yields that began a year ago persists as central banks continue their policy of raising key rates in an attempt to curb inflation. The multifamily prime yield reached 3.25% in August 2023, an increase of 110 basis points over the last 12 months. Operated residence yields, where there was a greater spread with bond yields, rose less sharply: 70 basis points for student housing and 80 for senior housing to 4.00% and 4.10% respectively. Yields are expected to continue to widen in the coming months to rebuild the risk premium with bond yields.

FIGURE 2: Breakdown of volumes by type of residential asset in H1 2023



Source: CBRE/Immostat, Q2 2023

FIGURE 3: Prime yields by asset type



Source: CBRE August 2023, Banque de France (OAT TEC at 1 August 2023)

Prices are starting to fall in the major cities, while rising interest rates are weighing on household purchasing power

The rapid increase in interest rates is holding back the residential real estate market in France. The transaction volume fell every month over the past year, reaching 1,029,000 in May 2023 (latest available data). The decline in demand is beginning to be reflected in real estate prices in the major cities, which have become unaffordable even for relatively well-off households. For example, prices of flats in the Paris and Lyon markets fell 2% over the last 12 months.

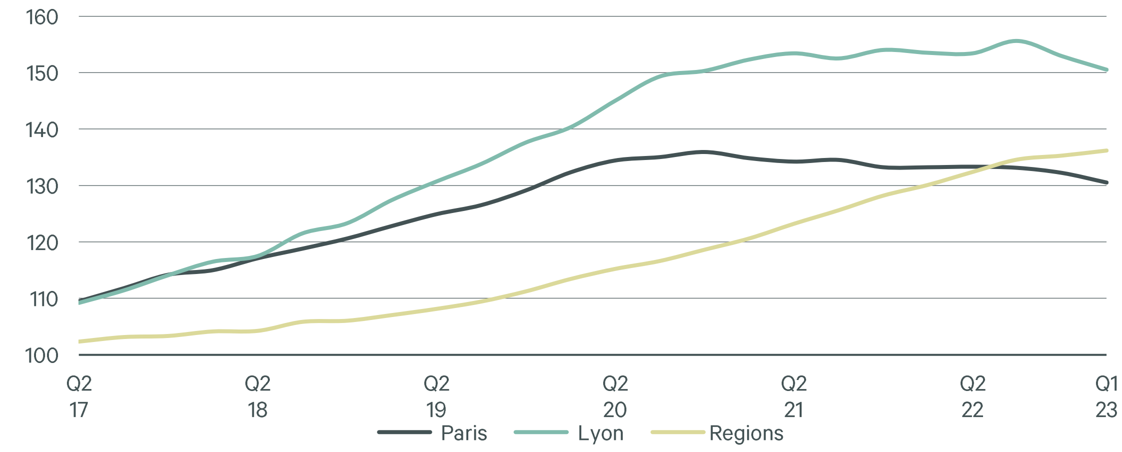
However, the decrease in prices is not a countrywide phenomenon. Market values have continued to rise in the Regions, up 4.7% over the last 12 months. This resilience can be explained by the better match between household purchasing power and prices in the Regions and by the second-home market, which has been rather dynamic since the pandemic.

A strained rental market

Already saturated due to a structural lack of supply, the rental market is seeing growing pressure on the demand side, as more and more households are no longer able to access home ownership or buy a property that meets their needs and are turning to renting. In Q1 2023, for example, the residential rent index for the unrestricted sector saw its strongest increase in the last 10 years at 1.5% (Figure 5). To curb this rise and in the face of the slow deceleration of inflation, the government extended the cap on the rent reference index (IRL) to 3.5% until Q2 2023.

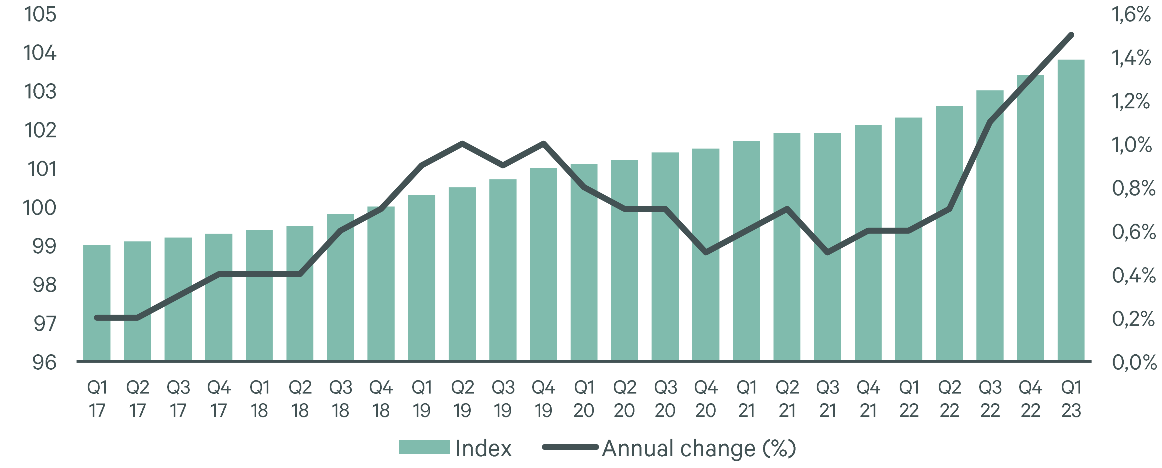
In the major cities, where rental pressures are the highest across the territory, rents are increasing at a more or less steady rate. In Paris, this increase was close to the national average of 1.4%. In Nice and Marseille, though, it was much higher over the last 12 months, with annual changes of 6% and 9% respectively. Paris remains by far the city with the highest average rent (€27.1/sq. m/month), followed by Nice at €15.5 and Lyon at €13.2.

FIGURE 4: Flat price index (base 100 = 2015 average)



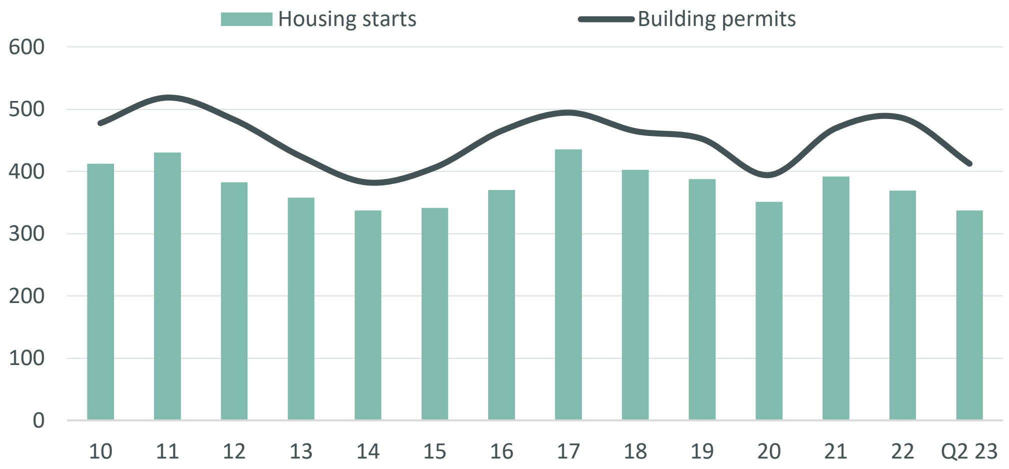
Source: INSEE, CVS data, Q1 2023

FIGURE 5: Residential rent index (unrestricted sector)



Source: INSEE, Q1 2023.

FIGURE 6: Change in housing starts and building permits



In thousands of dwellings, over a rolling 12-month period

Source: CGEDD SOeS/Sit@del, July 2023

Construction activity at its lowest level since 2014

A continuing decline in building permits and housing starts

The slowdown in construction activity was confirmed at the start of 2023, with a decrease in both building permits issued and housing starts. At the end of June, over a rolling 12-month period, a total of 337,100 homes had been started, a figure equivalent to the record low in 2014. This downward trend is set to continue, with the number of building permits issued also trending downwards. In addition to the many difficulties faced by the new housing construction sector over the last few years (proliferation of standards and administrative complexity, higher land prices, and greater costs of raw materials and labour), interest rates have also risen. This rise has hampered the financing capacity of developers and especially households, no longer able to borrow. At the end of June 2023, nearly 130,000 new homes on the market had no takers, a figure up 18% over the last 12 months. On the other hand, for professional investors, price adjustments are expected in order to obtain a sufficiently attractive risk premium, challenging the financial balance of projects anticipated by developers several months beforehand at the time of structuring.

This slowdown in construction is creating an even greater imbalance between an already insufficient supply and the demand for housing that continues to grow, particularly in the major cities, driven by socio-demographic trends (increased population and number of households) and new uses (second homes, growth in seasonal rentals, etc.).

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