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French professional real estate financing market: current state of affairs

Summary of first market survey conducted in France

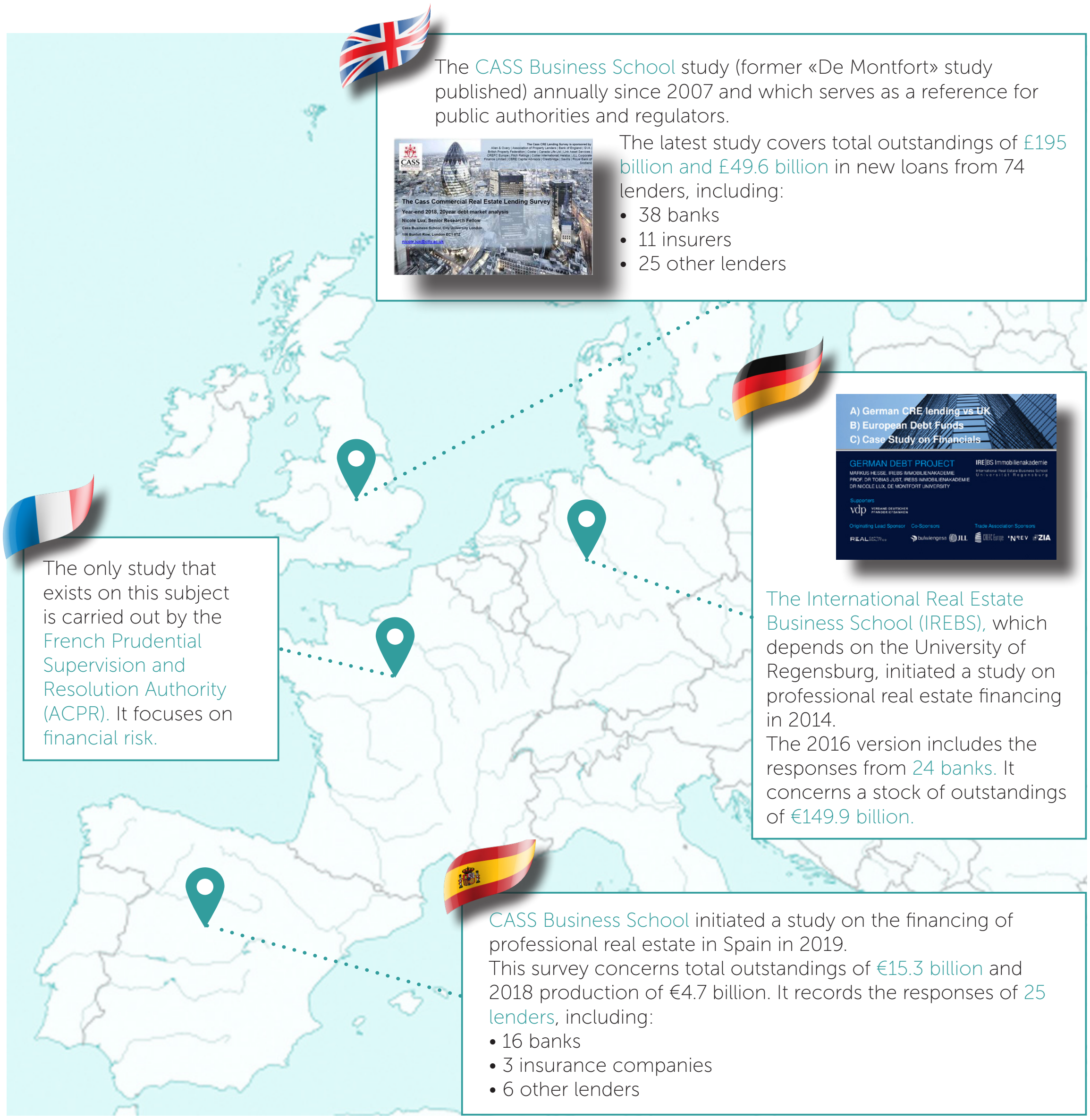
December 2019

CONTEXT AND SCOPE OF THE STUDY

Against a backdrop of particularly high real estate investment volumes by professional investors in France, the debt market is a key factor. It is therefore crucial to gain a better understanding of it, both in terms of the volume of its outstandings and the dynamics of its production.

Unlike the United Kingdom and Germany, which have had market studies for a number of years, France did not have a comprehensive study on this topic. This study is an answer to a gap that enables France to fill. It should be noted that the Spanish market has also just been the subject of an initial study.

We are therefore very proud to present the first study on the French professional real estate financing market, conducted jointly by IEIF and PwC.



The CASS Business School study (former «De Montfort» study published) annually since 2007 and which serves as a reference for public authorities and regulators.

The latest study covers total outstandings of £195 billion and £49.6 billion in new loans from 74 lenders, including:

- 38 banks
- 11 insurers
- 25 other lenders

The only study that exists on this subject is carried out by the French Prudential Supervision and Resolution Authority (ACPR). It focuses on financial risk.

The International Real Estate Business School (IREBS), which depends on the University of Regensburg, initiated a study on professional real estate financing in 2014.
The 2016 version includes the responses from 24 banks. It concerns a stock of outstandings of €149.9 billion.

CASS Business School initiated a study on the financing of professional real estate in Spain in 2019.
This survey concerns total outstandings of €15.3 billion and 2018 production of €4.7 billion. It records the responses of 25 lenders, including:

- 16 banks
- 3 insurance companies
- 6 other lenders

Sources : IEIF, PwC Strategy&.

We would not have been able to complete the project without the 15 sponsors who decided to contribute to the launch of this study in France with the conviction of its importance and necessity, and we would like to thank them and mention them here.

The study has multiple objectives and meets at least three market expectations:

- Understanding professional real estate financing given its context and its outlook, while no study currently allows this in France
- Improving the transparency of this market in terms of performance indicators. This is something the different players have desired, both for themselves and for the prudential authorities;
- Providing a basis for comparison with studies carried out elsewhere in Europe, the aim being ultimately to carry out a pan-European study.

A rigorous methodology for collecting data from representative players in the sector.

This study was the result of discussions initiated with a limited number of market players, Allianz, BNP Paribas, Crédit Agricole CIB, Natixis and Société Générale, throughout 2018, as part of a feasibility study to define the purpose, scope and field of the study, as well as to reflect on data collection methods and legal and compliance issues.

This initial phase led to the development of two questionnaires, one for professionals in asset and corporate financing of the sector, the other more specifically focused on financing of «developers» and their operations in France.

These questionnaires cover the following fields:

- A «stock of outstandings» section details the portfolio's structure;
- A «production» section shows the main production data for the year, as well as information on the characteristics of the financing, the main indicators and debt covenants, interest margins, arrangement fees and consideration of environmental criteria;
- Lastly, a final section presents the forecasts for the next two years.

These questionnaires were sent to the identified contributors and were further processed by IEIF and PwC.

There are 15 contributors to the first study:

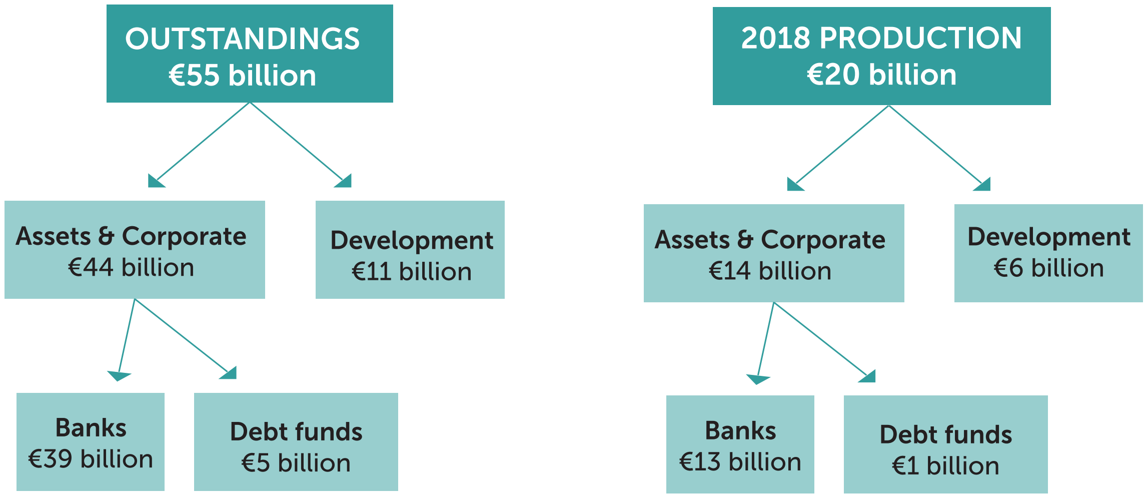
- 9 banks, including several investment banks and a few network banks;
- 6 debt funds and insurance companies.

We would like to thank them for their involvement.

A substantial study scope, which will gradually be extended in the coming years.

All of these contributions represent a significant volume, with total outstandings of €55 billion, broken down into €44 billion for «assets & corporate» and €11 billion for «development», and 2018 production of €20 billion, broken down into €14 billion for «assets & corporate» and €6 billion for «development» loans.

In a 2018 investment market of €32 billion and LTV criteria providing relatively secure financing (see below), the amount of new 2018 loans in our sample therefore appears significant (€14 billion).



Sources : IEIF, PwC Strategy&.

The objective is of course to extend this panel to new institutions during the next updates of this study.

MAIN FINDINGS

We have identified **five key findings** from this study, which reflect the financing strategies implemented by the institutions and financiers in our sample:

1. The professional real estate financing market is very active and functions smoothly.

2. It has all the characteristics of a very secure and homogeneous market, by type of product (senior debt), by location, by type of asset and also through its characteristics in terms of size, term and level of covenants.

3. Debt funds favour the most «core» financing in terms of location, type of assets and loan characteristics. As they are less constrained than banks over time, they invest in sometimes longer-term financing.

4. Compared with the British and German markets, the French market presents significant differences: very high proportion of the Greater Paris region, predominance of office real estate and low private institutional investment in housing, limited share devoted to alternative assets, very secure debt in terms of leverage and highly concentrated around senior debt.

5. A margin policy with little differentiation according to the different levels of covenants (LTV, ICR, DSCR) and a relatively standardised practice.

HIGHLIGHTS

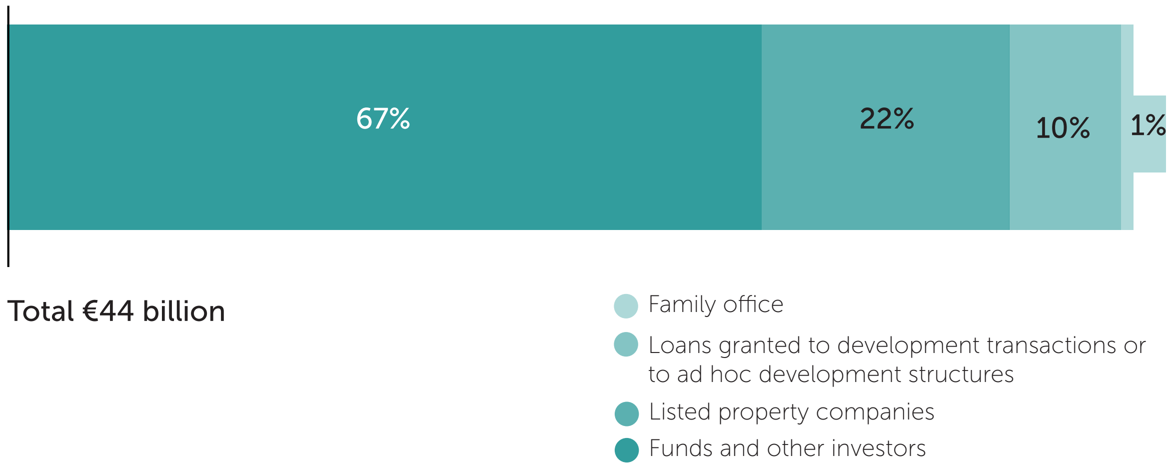
This study gathered a large amount of data on the French professional real estate financing market and analysed this market from several angles: customer segments, types and locations of assets financed, levels of covenants for financing granted and consideration of the environmental dimension.

The highlights of these areas of analysis are presented below:

- In terms of customer segments, the vast majority of corporate real estate financing is for the benefit of funds, institutional investors and other private investors (67% of the value of the debt portfolio). The title «Funds and other investors» refers mainly to institutional investors (insurance companies and mutual funds, sovereign wealth funds, etc.), real estate investment trust (SCPI), real estate investment funds (OPCI), private equity funds, etc.

  A significant portion of professional financing is also geared towards the development/rehabilitation/renovation of buildings acquired or owned by major investors.

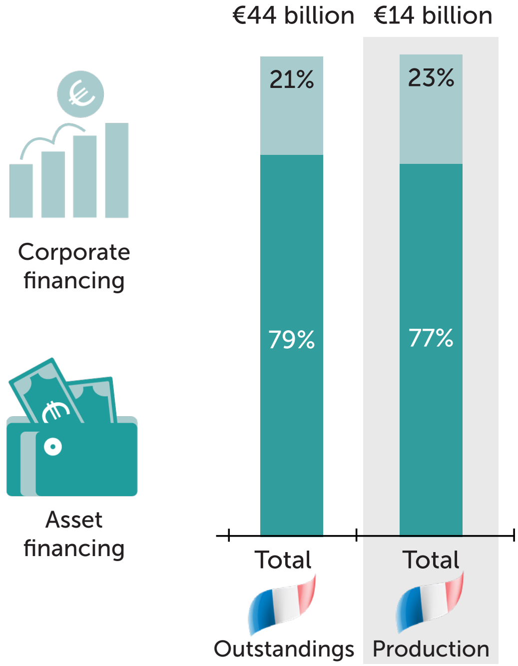
Amount of debt by type of financier and by beneficiary
(outstandings in 2018; %)



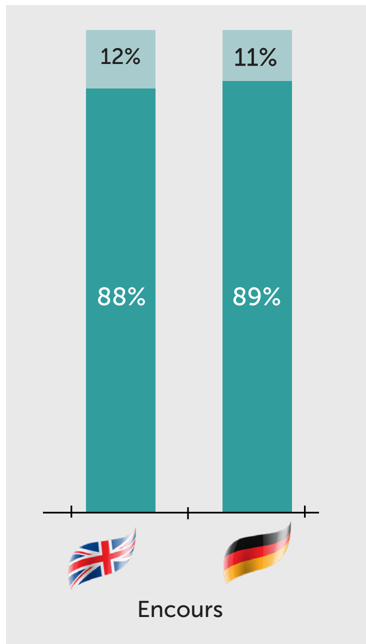
Sources : IEIF, PwC Strategy&.

- Based on our panel, in France, 80% of the market relates to asset financing and 20% to corporate financing. It is interesting to note that French banks value corporate counterparty risk more highly than banks in the United Kingdom and Germany. This counterparty dimension remains an important criterion for granting financing.

Amount of debt by type of financing in France (outstandings and new production 2018; %)



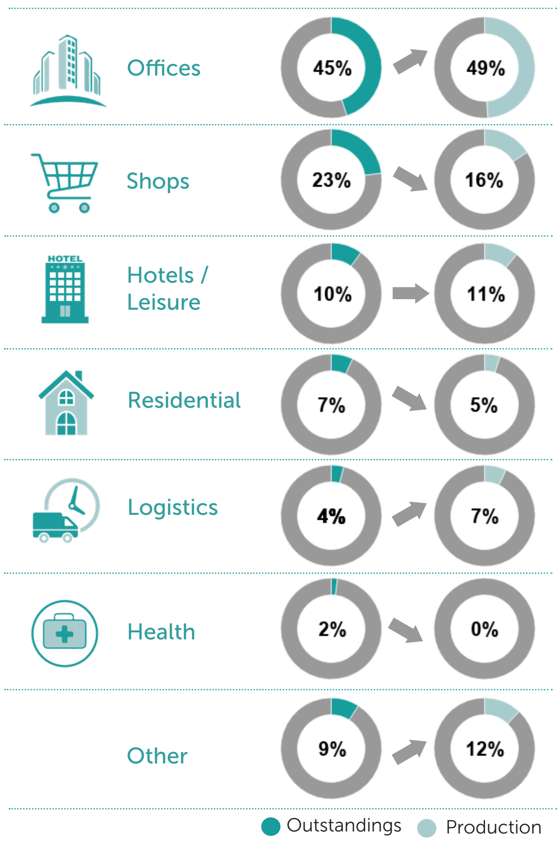
Amount of debt by type of financing in the United Kingdom and Germany (outstandings; %)



Sources : CASS CRE, IREBS, IEIF, PwC Strategy&.

- In terms of types of assets financed, the debt is mainly concentrated in offices, an asset class widely favoured by investors in France. However, it should be noted that all asset classes are represented and follow the major market trends, with shops experiencing a certain decline in financing granted in 2018 and logistics increasing in the portfolios. Residential real estate was still underrepresented in institutional investors' portfolios in the Greater Paris region in 2018. Future studies could confirm renewed interest in this asset class.

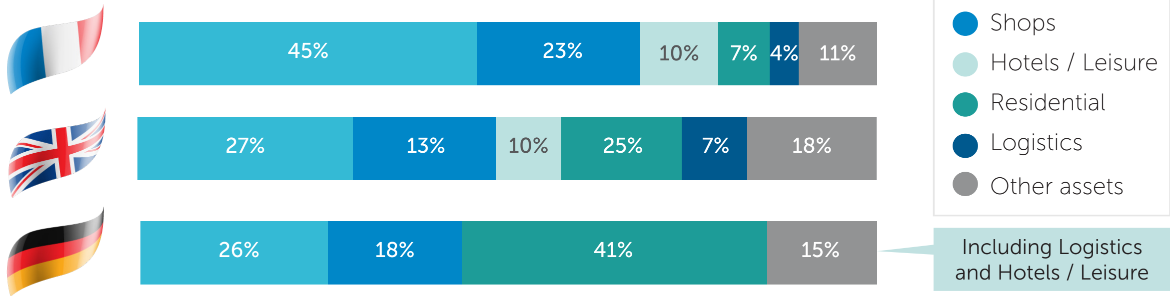
Breakdown of corporate real estate debt by asset type in France (outstandings and new 2018 production; %)



Sources : IEIF, PwC Strategy&.

- When we compare data from the major European markets, we see that the housing sector accounts for only 7% of assets financed in France versus 25% in the United Kingdom and, above all, 42% in Germany. This is explained by investors' longstanding disaffection with this asset class, which seems to have been reversed lately. Conversely, with 45% of outstandings in France versus 27% in the United Kingdom and 26% in Germany, offices remains the key asset for financing professionals in France. This information covers the investment market but not the property development market, a large part of which is focused on residential and home ownership.

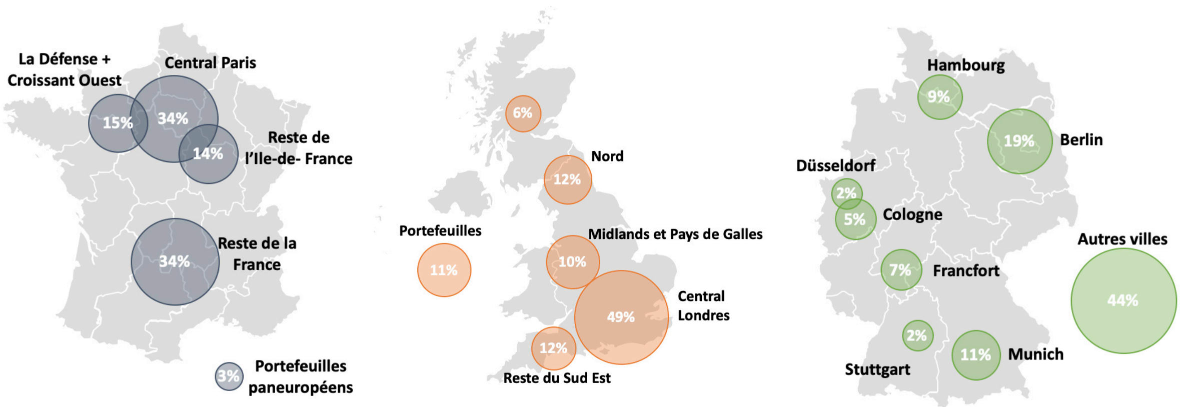
Amount of debt by asset type (2018 outstandings; %)



Sources : CASS CRE, IREBS, IEIF, PwC Strategy&.

- In terms of geographical breakdown, the French market is highly concentrated, much more so than in the UK and Germany, with 63% of debt issued to finance assets concentrated in the Greater Paris region, compared with 49% in Central London and, above all, only 19% in Berlin. In Germany, the market is highly fragmented, with the seven largest German cities accounting for only 56% of the debt issued. An analysis of the economic weight of capital cities also illustrates the high concentration of the market in France, with the Greater Paris region accounting for 31% of national GDP, London 23% of UK GDP and Berlin only 3.7%. This clearly leads to an over-representation of the Greater Paris region in the investment market and, as a result, in financing. The regions nevertheless benefit from a positive momentum and in terms of production accounted for 34% of the debt issued in 2018 (compared to 29% of the stock of outstandings).

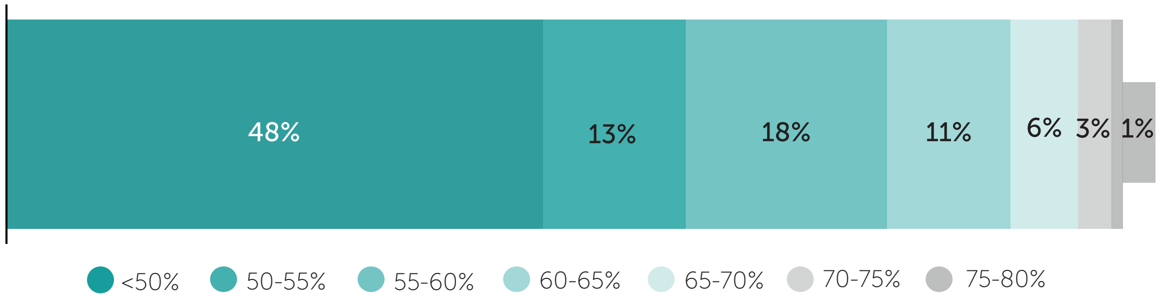
Geographical breakdown of debt issued (2018 production; %)



Sources : CASS CRE, IREBS, IEIF, PwC Strategy&.

- An analysis of the LTV, the main covenant in real estate financing, shows that the French financing market remains very secure. Thus, 48% of the financing issued is at LTV levels <50% and 80% at LTV levels <60%, probably far from the levels reached in the years prior to 2007.

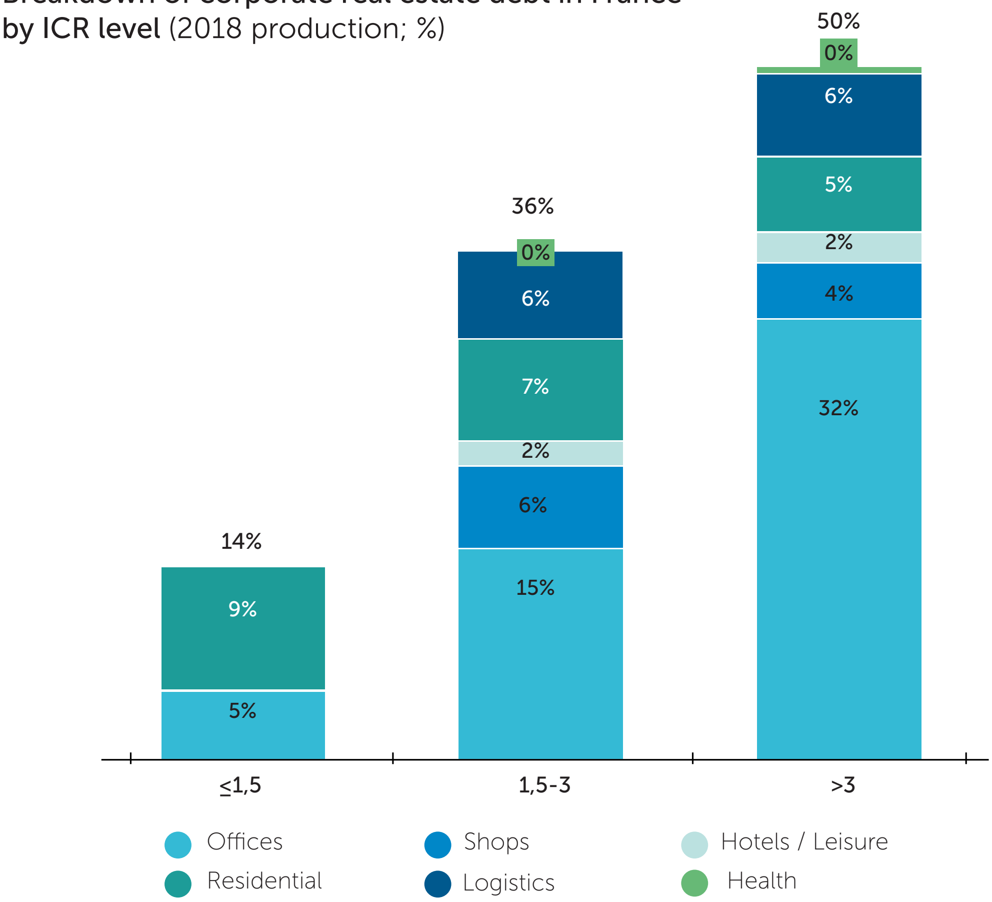
Breakdown of corporate real estate debt in France by LTV level
(2018 production; % of total production)



Sources : IEIF, PwC Strategy&.

- The debt is also secured by cash flow assets, as the ICR covenant > 3 for 50% of the assets financed and > 1.5 for 86% of the same assets. Banks have an even more secure profile as 56% of their debt is at ICR levels > 3.

Breakdown of corporate real estate debt in France by ICR level (2018 production; %)



Sources : IEIF, PwC Strategy&.

- In terms of the quality of the assets financed, 56% of respondents say they take into account SRI and ESG criteria in the terms of their loans and it is easy to imagine that this figure will increase very rapidly in the coming years.

56%

Of responding companies state that they take SRI/ESG criteria into account in their lending conditions.

48%

Of the real estate assets financed are covered by SRI/ESG environmental criteria.

Sources : IEIF, PwC Strategy&.

AREAS FOR CONSIDERATION

As a conclusion, thanks to this first study of the professional real estate financing market we can identify two areas for consideration to contribute to the deepening of this market.

1. **Moving towards more diversification:**
   - Geographical location: increasing the share of regions;
   - Asset types: increasing the proportion of residential and alternative assets;
   - Product types: broadening the range and making better use of the risk/return ratio;
   - SRI/CSR: developing this dimension in the portfolios.

2. **Improving market transparency:**
   - Developing tools that provide qualified information;
   - Refining data quality (final sponsors of financing, regional locations, identification of mixed projects, etc.);
   - Enriching the study panel by including more network banks, developing pan-European comparisons and producing long-term series of figures.

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ABOUT IEIF

Created in 1986, IEIF is an independent study, research and forecasting centre specialising in real estate. Its objective is to support real estate and investment players in their business and strategic thinking, by offering them studies, analysis notes, summaries and think tanks.

IEIF's approach factors in real estate both in the economy and in asset allocation. It is cross-cutting, with the IEIF following both real estate markets, real estate funds and financing.

IEIF currently has more than 125 member companies (two-thirds investors, one-third other players).

ABOUT PwC STRATEGY&

Strategy& is a global team of experts in the field of strategy consulting. We help our customers reach their potential and solve their most complex problems by helping them develop and achieve their vision. We combine a century of strategy consulting experience with the functional and sector expertise of the PwC network.

Strategy& is a member of the PwC network, present in 157 countries and comprising more than 276,000 people committed to providing quality service to their clients and partners in the areas of advisory, transactions, legal & tax, audit and accounting.

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