



ANALYSES ET SYNTHÈSES


-  French banks' lending to the professional real estate sector in the second half of 2015

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Summary

- ❑ On 15th April 2015, the French *Haut conseil de stabilité financière* (HCSF – High Council for Financial Stability) published its analysis of the French commercial real estate market: several indicators suggest the presence of imbalances, in particular on the office segment in *Île de France* (Paris region), and the HCSF, while requesting the opinions of market professionals about its analysis, called for vigilance. Against this backdrop, the main French banks' exposures to real estate professionals are closely monitored.
- ❑ The second edition of the new survey of the General Secretariat of the *Autorité de contrôle prudentiel et de résolution* (ACPR) shows that, in a context where activity has been particularly strong both in France and in most European countries since 2010, new lending to the professional real estate sector rose by 33.3% in the second half of 2015 to stand at EUR 62.3 billion. Growth was robust across the board, rising by 29.1% in France, 38% in the rest of Europe and 42.3% in the rest of the world. This increase in new lending mainly benefited investors and property companies, which continued to account for the major share (with 60% in the second half of 2015) ahead of developers and property brokers (38.4%), and retail, which almost tripled. Lending to the office sector (19.1% of the total) grew by 22.8% in H2 2015, while new lending nevertheless remained almost stable between the first and second halves of 2015 in *Île de France*.
- ❑ Driven by new lending, banks' exposures rose by 8.6% in H2 to reach EUR 162.4 billion at end-2015, or 2.64% of their total balance sheet. As in the case of new lending, the increase in exposures was more rapid in the rest of Europe (15.7%) and in the rest of the world (18.1%) than in France (3.3%). The breakdown of exposures by type of recipient confirms the predominance of investors and property companies (47.9%), far ahead of developers and property brokers (24.6%). Lastly, residential real estate continued to account for the bulk of exposures (34.3%), ahead of offices (21.8%).
- ❑ The quality of exposures has been continually improving since 2010: the amount of gross non-performing loans fell by 5.8% in H2, with the gross non-performing loan ratio falling to 6.79%; due to a slightly faster decline in the amount of impairments, the coverage ratio for these loans decreased marginally but remained at a historically high level (38.6%). Finally, the few indicators providing usable information suggest that risk-taking by the banks in the sample was modest.

Key words: real estate professionals
JEL code: G21.

Study by Pierre Harguindeguy and Emmanuel Point

Preliminary comments

- ❑ This issue of “*Analyses et Synthèses*” is based on responses collected in the framework of the 2015 annual survey on lending to the real estate sector, conducted by the General Secretariat of the ACPR and covering BNP Paribas, *Société générale*, *Crédit agricole* group, BPCE group and *Crédit mutuel* group.
- ❑ The information collected for H2 is still incomplete but, since they had committed to do so, all institutions gave more comprehensive responses. Like for H1 2015, some risk indicators and their trends nevertheless still remain difficult to interpret, both for new lending and exposures: indeed we observe significant changes in scope between the two half years and, for most indicators, the information is only available for a small share of new lending or exposures. Lastly, given the fact that the new survey was implemented relatively recently, some banks are gradually improving the data accuracy, which may lead to sometimes significant variations that do not in the least reflect their risk profile.

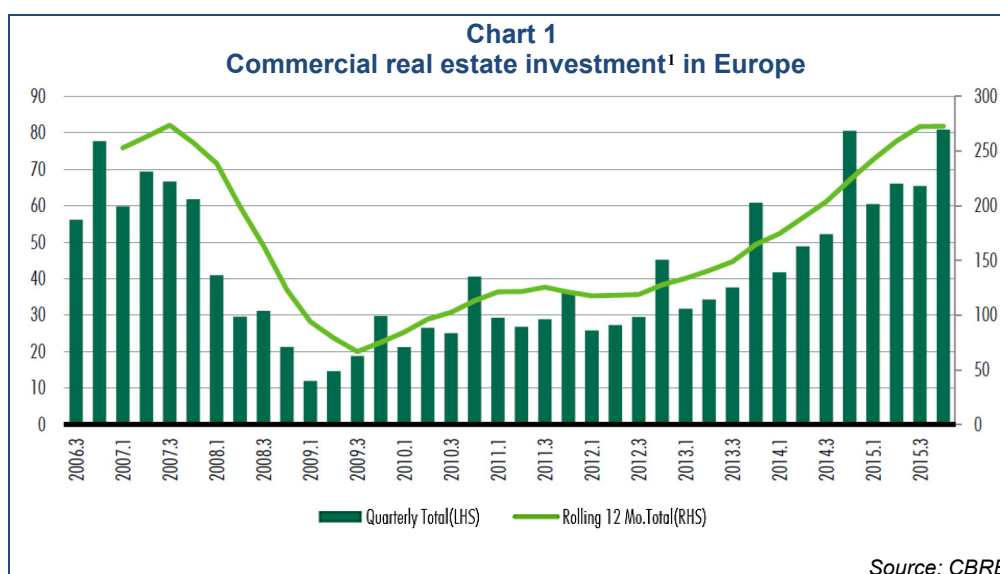
1. Commercial real estate markets in 2015

The commercial real estate market remained buoyant in 2015 in both Europe and France, particularly in H2.

1.1. The European commercial real estate market

1.1.1 Sustained activity followed by the start of a decline

In Europe, commercial real estate transactions continued to grow in 2015, reaching EUR 263 billion against EUR 223 billion in 2014 (up 18%). Activity was particularly robust in Q4 2015 even though year-on-year growth at the end of 2015 slows down in comparison with previous years (Chart 1). The countries with the highest investment in 2015 were Poland, Germany and Austria whereas the United Kingdom and Sweden saw a relative decline in the presence of foreign investors. Indeed, certain large investors, such as sovereign wealth funds, avoided the main European markets.

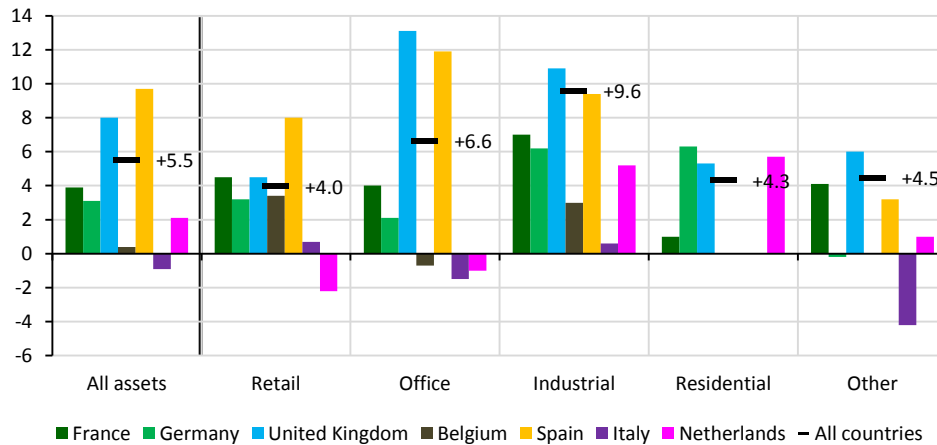


1.1.2 Prices continued to rise

Commercial real estate prices continued to increase in Europe, with a 5.5% rise for all types of assets across a sample of seven countries. This average nevertheless masks mixed developments both in terms of assets, where industrial premises and offices supported prices, and of the different countries, with the United Kingdom and Spain continuing to display strong growth (Chart 2). Overall, in France, prices rose at a below-average rate (3.9%) as well as for each asset type except for retail outlets (4.5%), for which growth was slightly above that of its European neighbours (4%).

¹ Transactions over EUR 4 million related to business premises, warehouses, and retail outlets (residential real estate is excluded).

Chart 2
Commercial real estate prices in Europe (%) in 2015



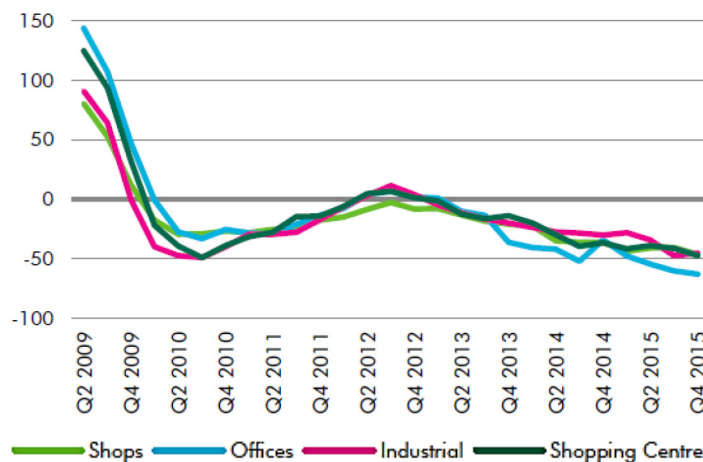
Source: MSCI; total = average rates weighted by the amount of assets of the countries considered; residential real estate data not available for several countries

This rise reflects investors' search for yield against the backdrop of very low financing costs.

1.1.3 A decline in returns

Returns continued to fall in most market segments, with offices registering the fastest decline since 2013 – over 50 basis points (bps) over 12 months (Chart 3).

Chart 3
Prime rental returns over 12 months² in Europe (bps)

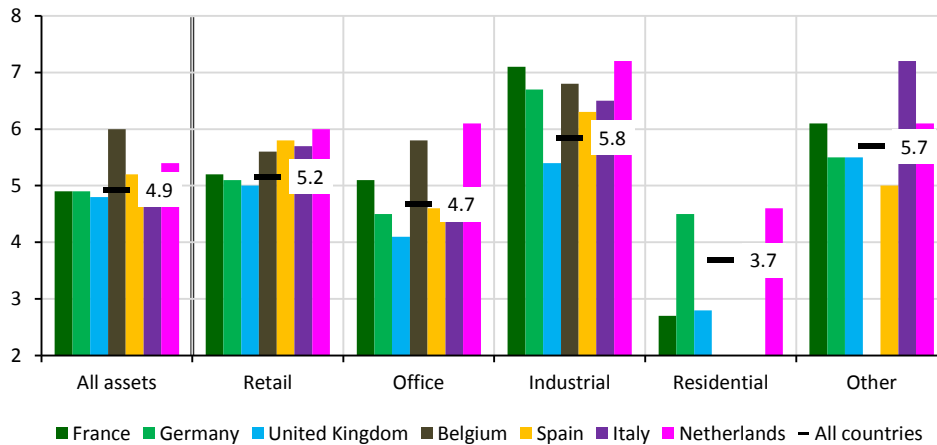


Source: CBRE

A country comparison shows a certain homogeneity in rental returns across assets, with France and Germany being around average, and only the United Kingdom below average (Chart 4). However, a breakdown by asset type shows a certain heterogeneity, with rental returns on residential real estate in France being relatively low, average on retail outlets and above average on all other market segments and, in particular, on offices.

² "Prime" assets are the most sought after, with a limited rental risk due to their location (e.g. central business district), their quality, etc.

Chart 4
Commercial real estate rental returns in Europe (%) in 2015



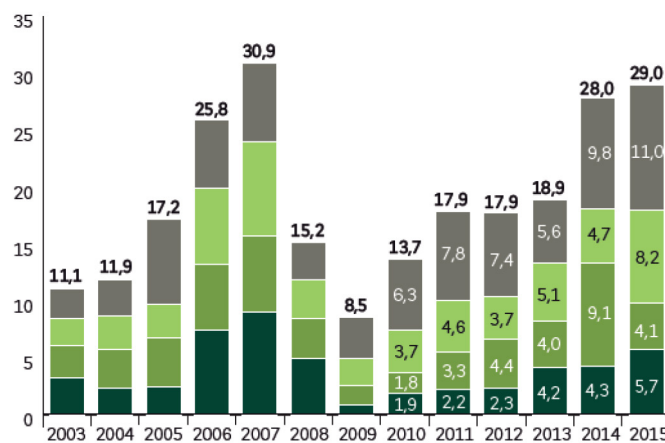
Source: MSCI; total = average rates weighted by the amount of assets of the countries considered; residential real estate data not available for several countries

1.2. The French commercial real estate market

1.2.1. A high volume of transactions

Thanks to strong activity in H2, the total amount of transactions reached EUR 29 billion in 2015, or a 3.6% rise compared with 2014 (Chart 5). In addition to the search for yield from which the European commercial real estate markets in particular benefited (see above), this sharp rebound in activity in H2 can be attributed to several major deals by large foreign investors on alternative assets such as hotels, theme parks, etc. The most significant investments were located in the Paris Central Business District (CBD) and the Western Crescent, while activity waned slightly in *La Défense* and the inner suburbs.

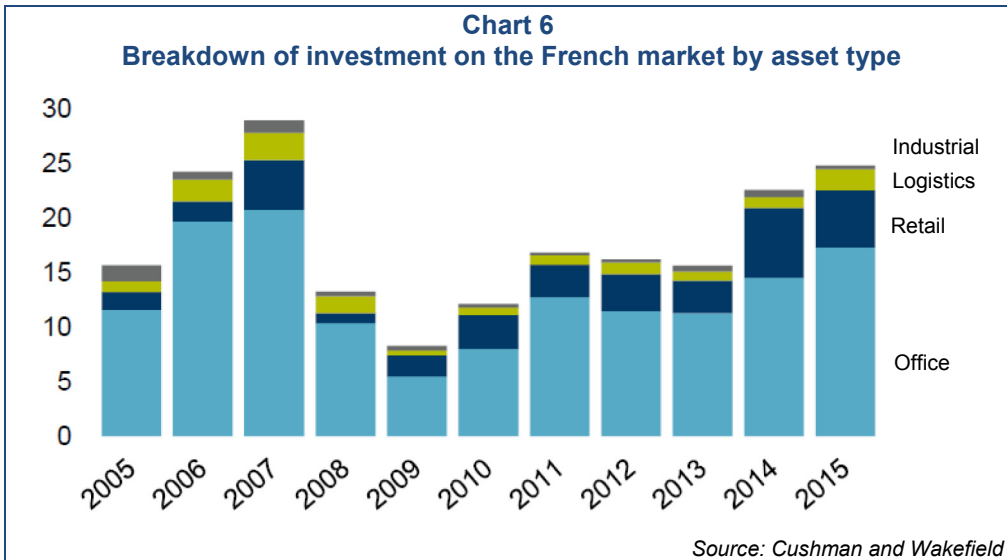
Chart 5
Commercial real estate investment in France (EUR billions)



Source: BNP Paribas Real estate

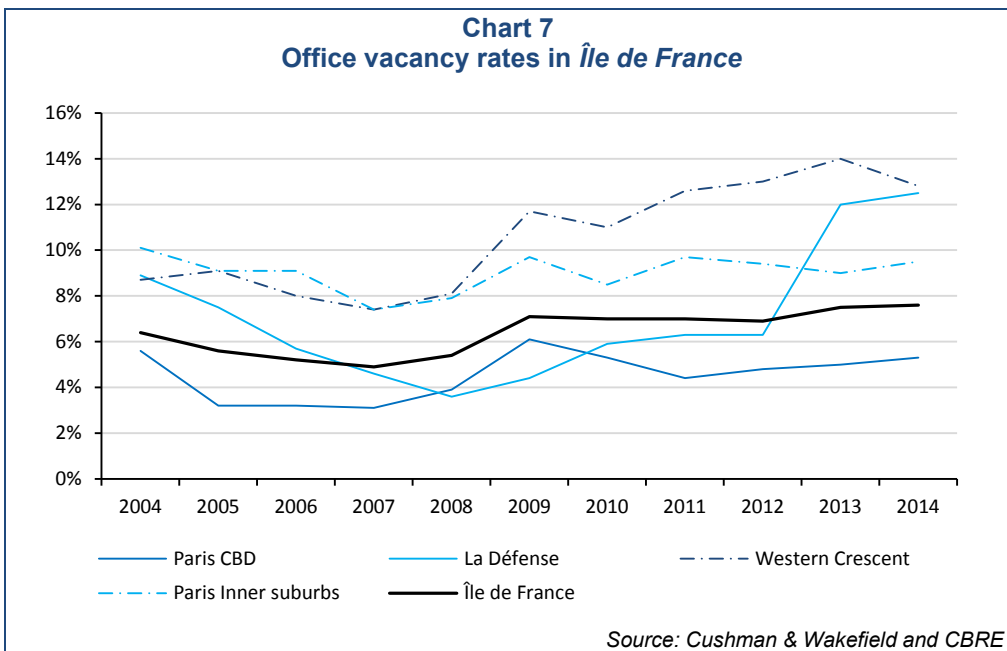
As regards the allocation of investments, offices saw an increase in their market share, which rose by 8 percentage points (pts) between 2014 and 2015, to 73%, while the share of retail fell by 9 pts to 18% (Chart 6). Beside the corporate real estate sector, the property development sector seems to have returned to growth thanks to tax incentives (*Pinel Law*³) which probably sustained the volume of transactions outside Paris.

³ Applicable to property purchases with an overall ceiling of EUR 300,000 and EUR 5,500 per square meter, in the form of an income tax reduction of 12% over 6 years, 18% over 9 years and 21% over 12 years.



1.2.2. Declining but still heterogeneous vacancy rates

At the end of 2015, the office vacancy rate in the Paris region stood at 7.3%, slightly down on that of end-2014 (7.6%). Some areas are characterised by a structurally higher vacancy rate (*La Défense* and the Western Crescent with rates of 11% and 12.5% respectively), even though it is lower than that of the previous year, whereas it fell to 4.6% in Paris CBD, which remains a very sought after area (Chart 7).

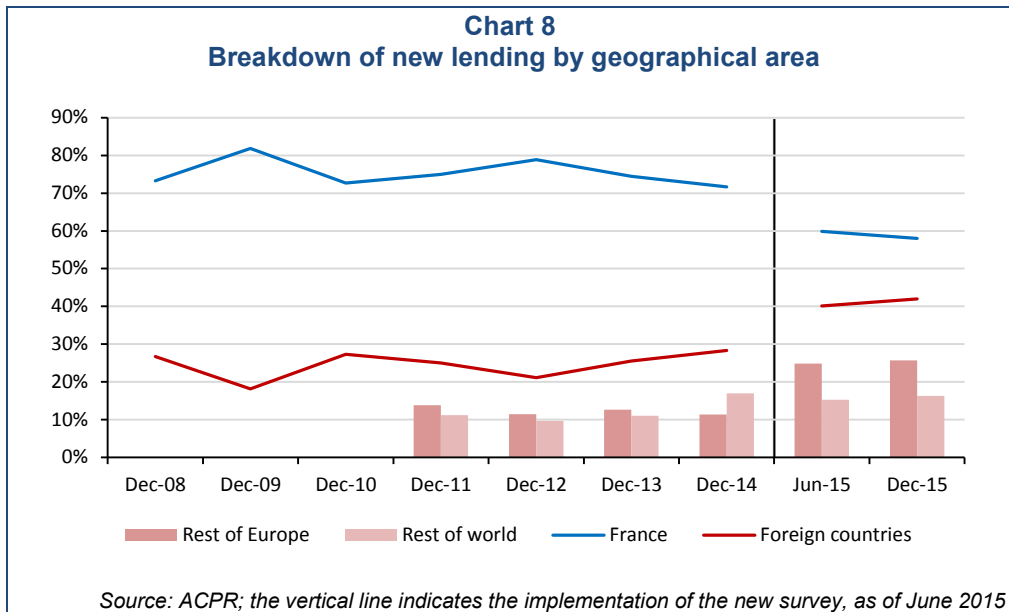


2. New lending to real estate professionals

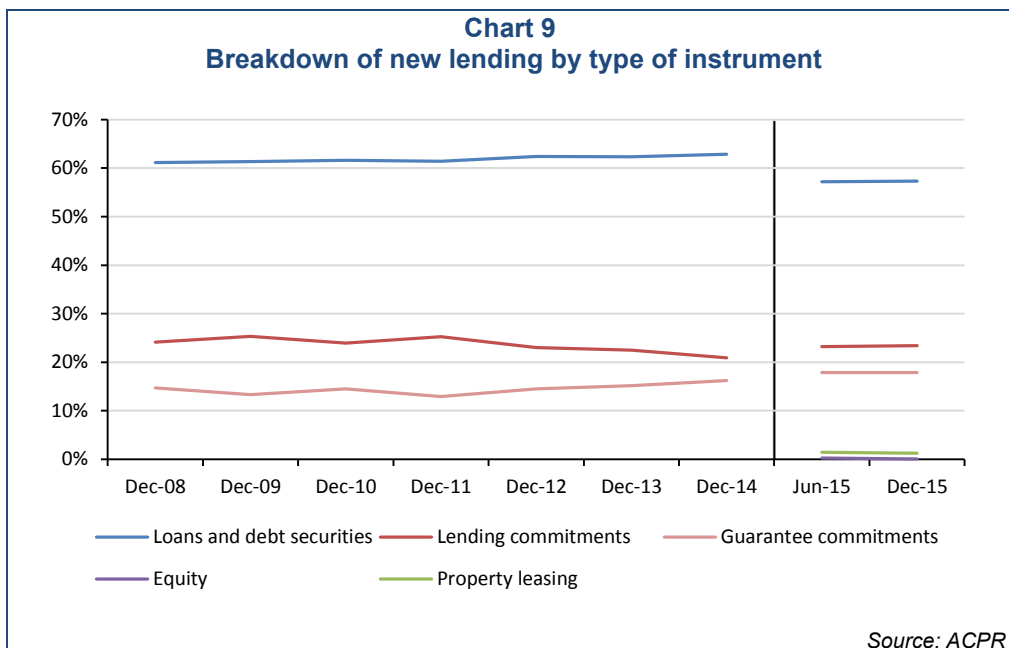
2.1. Robust growth in new lending

New lending in H2 2015 stood at EUR 62.3 billion, up 33.3% on the first six months of the year, due to strong growth in activity on the investment market in both France and Europe (see above). Growth was nevertheless relatively less sustained in France (29.1%), than in the rest of Europe (38%) or the rest of the world (42.3%).

In this context, the share of new lending abroad continued to increase in H2 2015, from 40.1% to 42%, to the detriment of France (Chart 8).

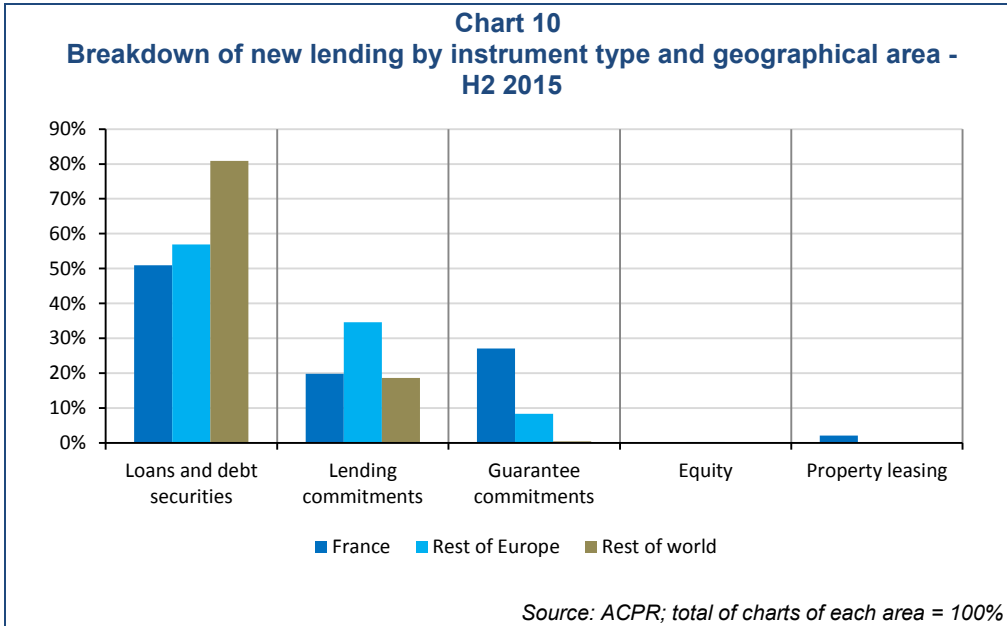


The breakdown of new lending by instrument type changed little, with loans and debt securities continuing to make up the bulk of new lending (with a share of 57.3% at end-2015), far ahead of funding or guarantee commitments, which stood at 23.4% and 17.9% respectively; Chart 9).



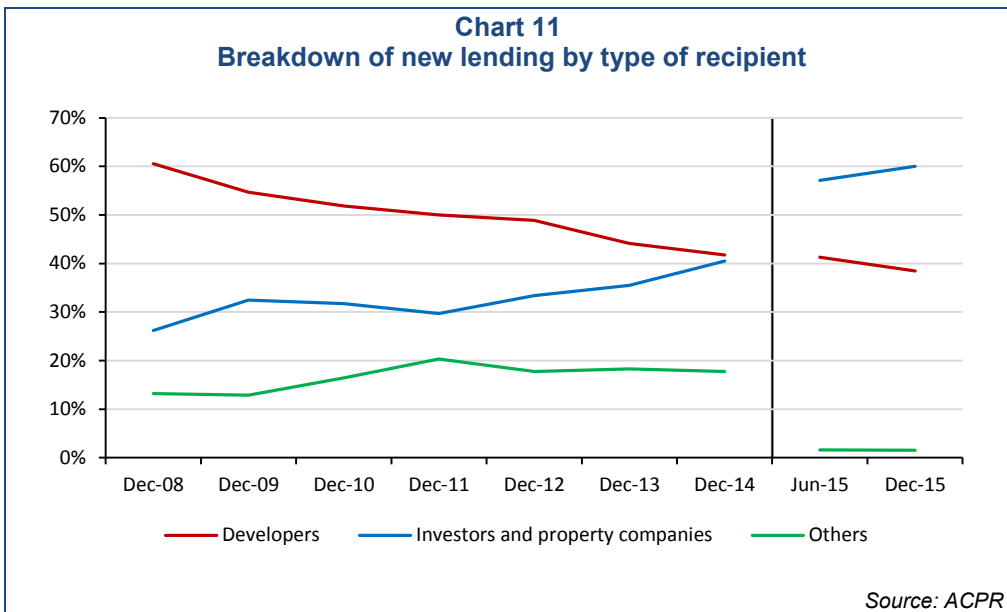
The French market differs somewhat from other geographical areas, even though the order of three main categories remained identical: loans and debt securities accounted for a relatively lower share than abroad (50.9% of new loans in

H2 2015), contrary to guarantee commitments (27.1%). Conversely, in the rest of the world, loans accounted for the bulk of new lending (80.9% in H2 2015; Chart 10).



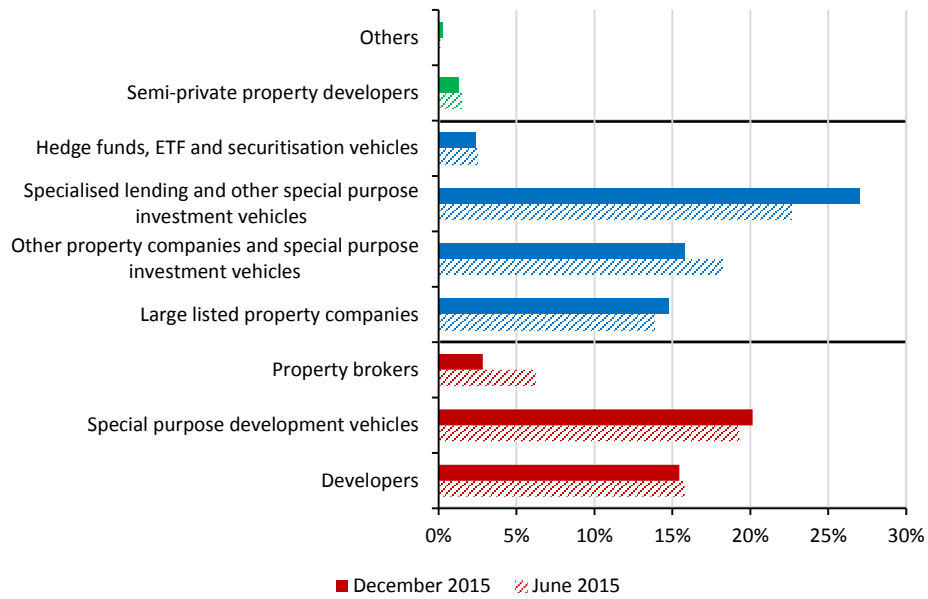
2.2 Investors consolidated their majority position

The share of investors in new lending increased in H2 2015, rising from 57.1% to 60%, to the detriment of developers and property brokers (-2.9 pts to 38.4%; Chart 11).



Among investors, new lending was mainly channelled into specialised finance or special purpose investment vehicles. Conversely, the share of hedge funds, Exchange Traded Funds (ETFs) and securitisation vehicles was much smaller (Chart 12). On the developer segment, special purpose development vehicles accounted for by far the largest share, while property brokers only represented a modest share. The changes observed between June and December should be interpreted with caution given that one bank had not reported this information for H1.

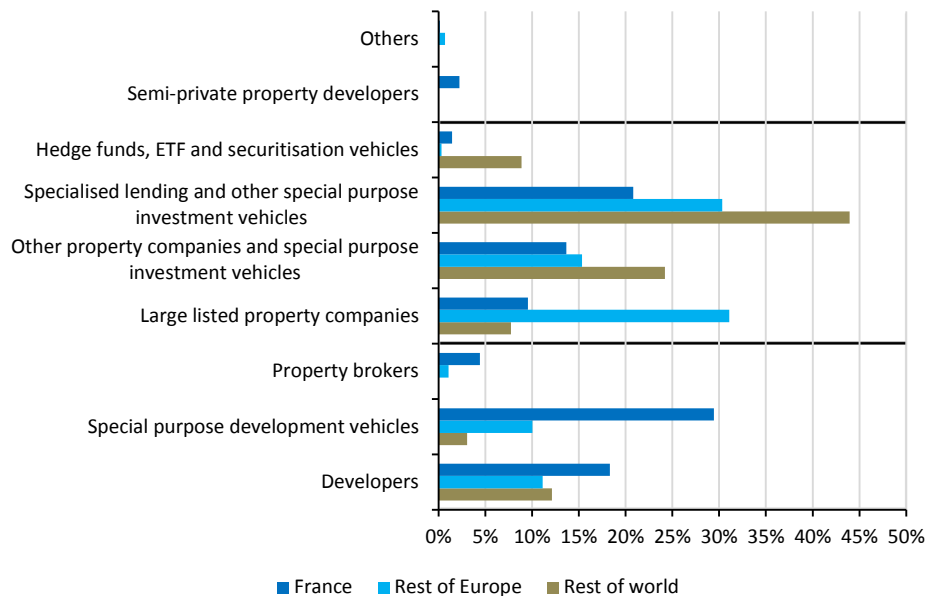
Chart 12
Detailed breakdown of new lending by type of recipient



Source: ACPR

On the French market, the breakdown of new lending is significantly different from that of other geographical areas, with developers and property brokers accounting for the bulk of new lending (52.2% in 2015) ahead of investors and property companies (45.5%; [Chart 13](#)). Conversely, abroad, investors account for by far the largest share, with 77.1% of new loans granted in H2 2015 in the rest of Europe and 84.8% of those granted in the rest of the world.

Chart 13
Breakdown of new lending by type of recipient and geographical area - H2 2015



Source: ACPR

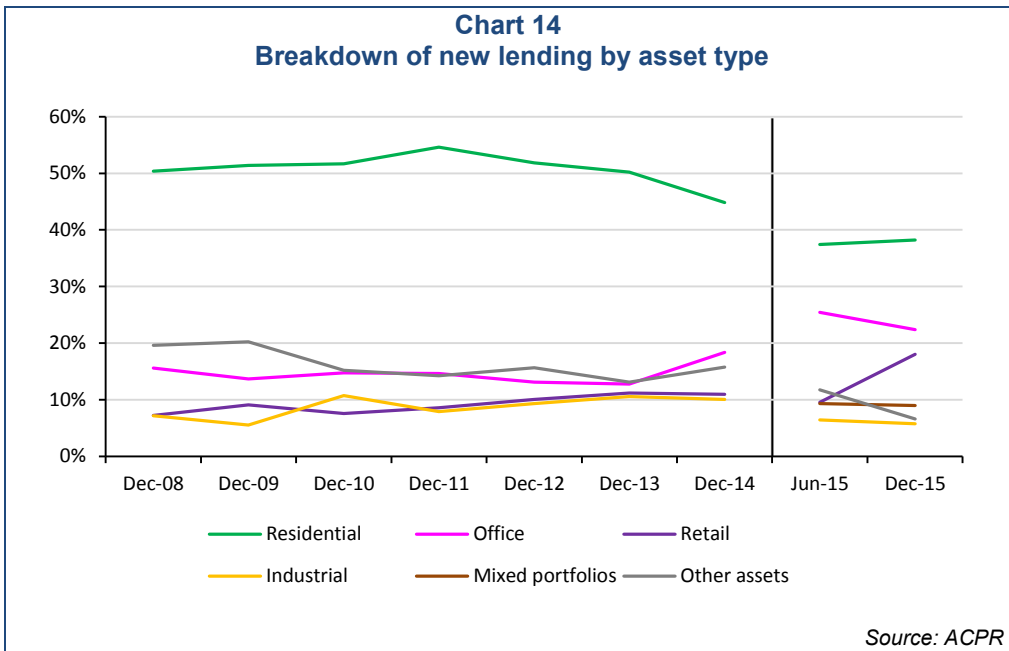
2.3 A sharp rise in lending to retail outlets

H2 2015 was marked by a sharp rise in lending to retail outlets, almost tripling compared with H1 due to a few very large deals. This rise was very significant in France, where new lending increased 2.5-fold and in the rest of Europe, where it doubled, but above all in the rest of the world where it quadrupled.

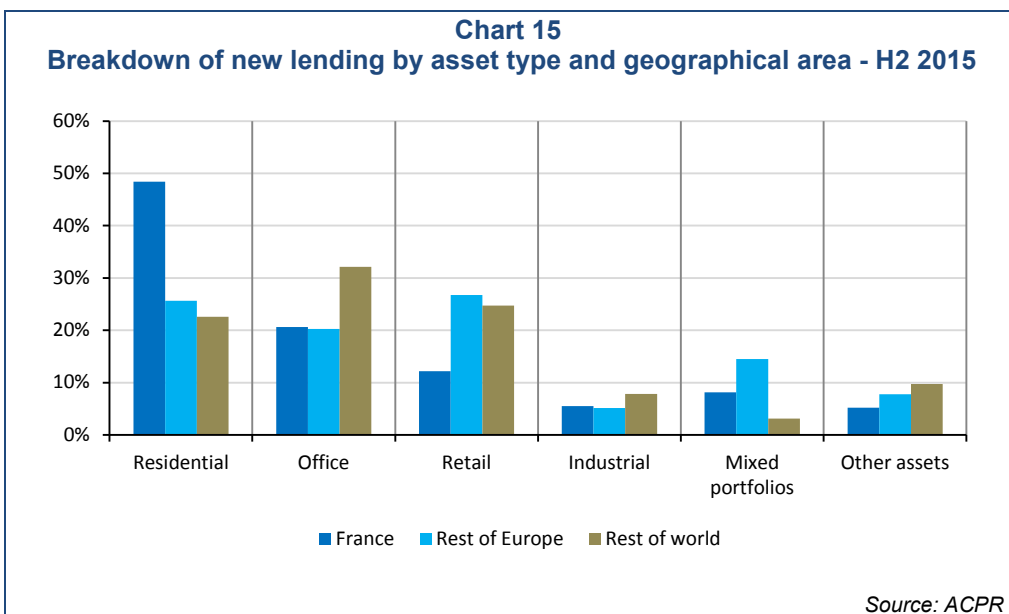
With a 22.8% increase in H2, new lending to offices saw a sharp rise outside Paris (96.1%), in the rest of Europe (46.1%) and in the rest of the world (69.7%); new lending nevertheless fell by 6% in *Île de France* in H2 2015.

Lastly, new lending to the residential sector grew by 49.4% in H2 2015, and was more buoyant in the rest of Europe (where it increased 8-fold) and the rest of the world (63.9%) than in France (34.5%).

In this context, residential real estate is still the main recipient with 38.2% of new lending in H2 2015; offices, which still ranked second, nonetheless saw a 3 pts fall to 19.1% while the share of retail increased sharply by 8.4 pts to 18%; [Chart 14](#)).



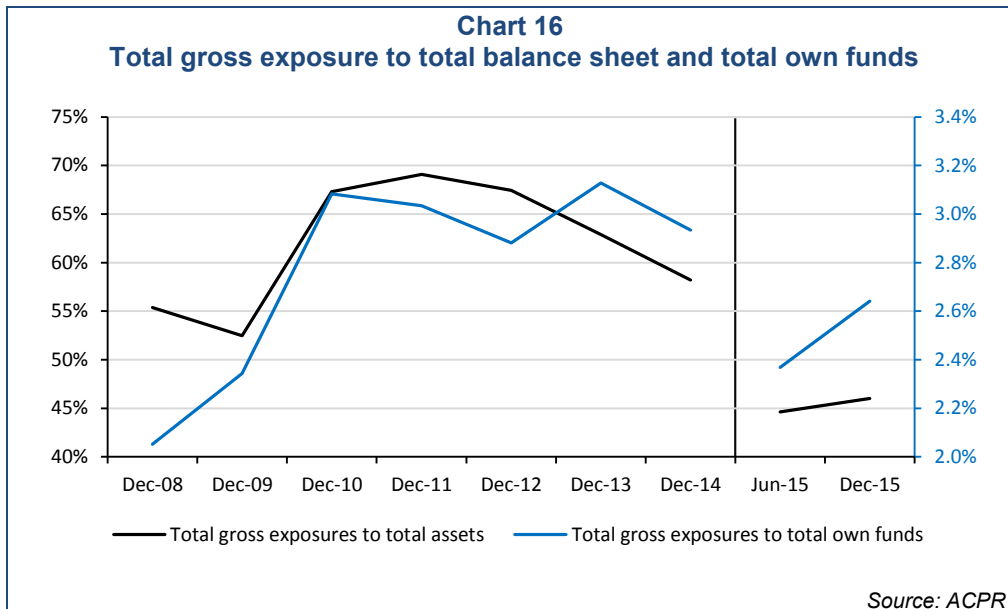
The breakdown of new lending by asset type nevertheless varies across geographical areas: while, in France, residential real estate is the main recipient of new loans (with 48.4% in H2 2015), offices account for a greater share in the rest of the world (with 32.1%), and retail outlets in the rest of Europe (with 26.8%) and the rest of the world (with 24.7%; [Chart 15](#)).



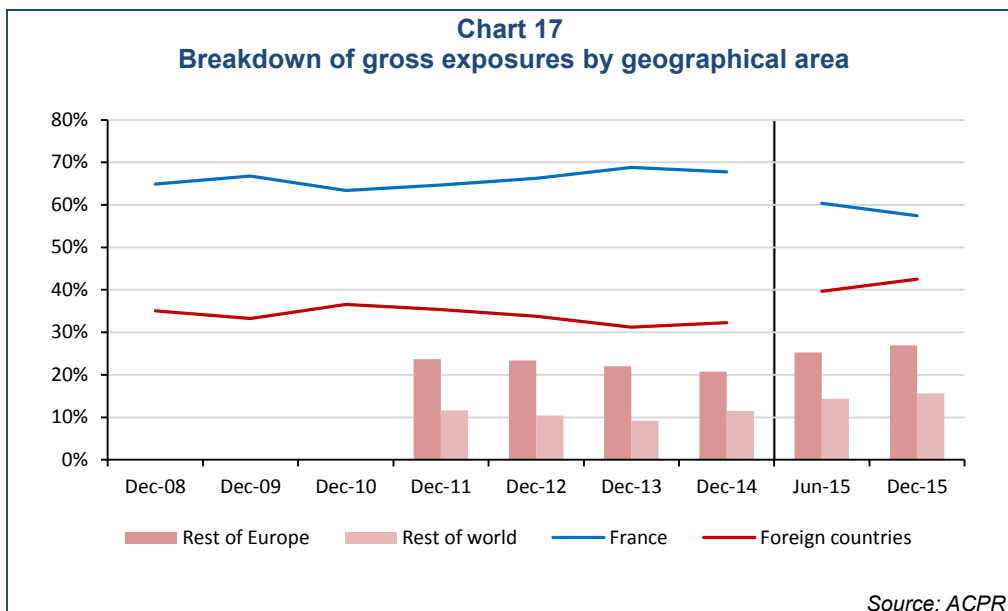
3. French banks' exposures to real estate professionals

3.1 A significant increase in exposures in H2

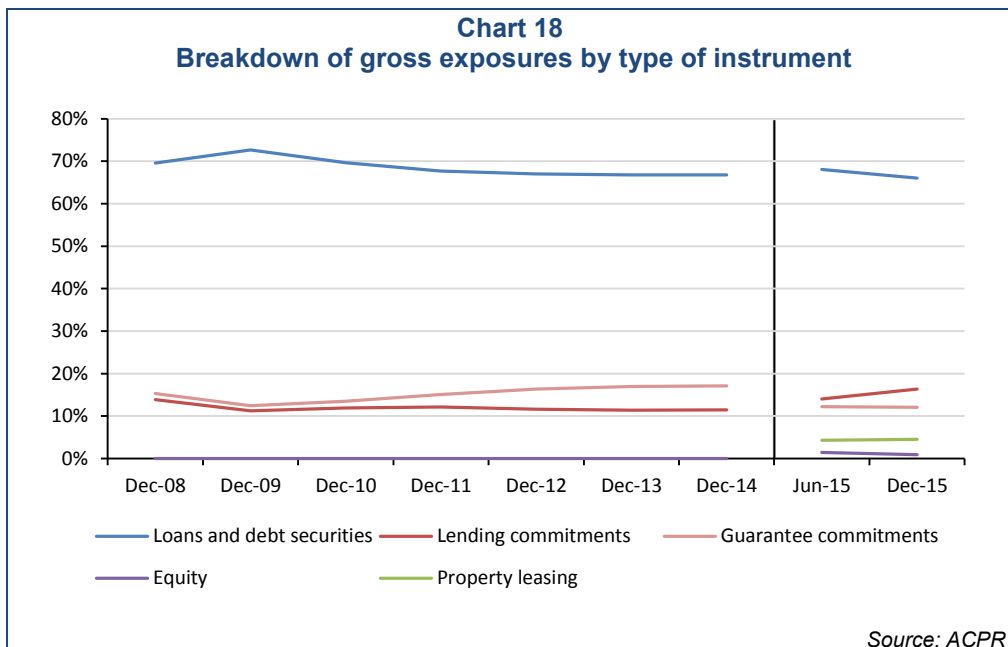
Gross exposures stood at EUR 162.4 billion at 31 December 2015, up by 8.6% on 30 June. Consequently, the exposure-to-total own funds ratio rose by 1.4 pt, to 46%, and by 27 bps as a proportion of total balance sheet, to 2.6% (Chart 16).



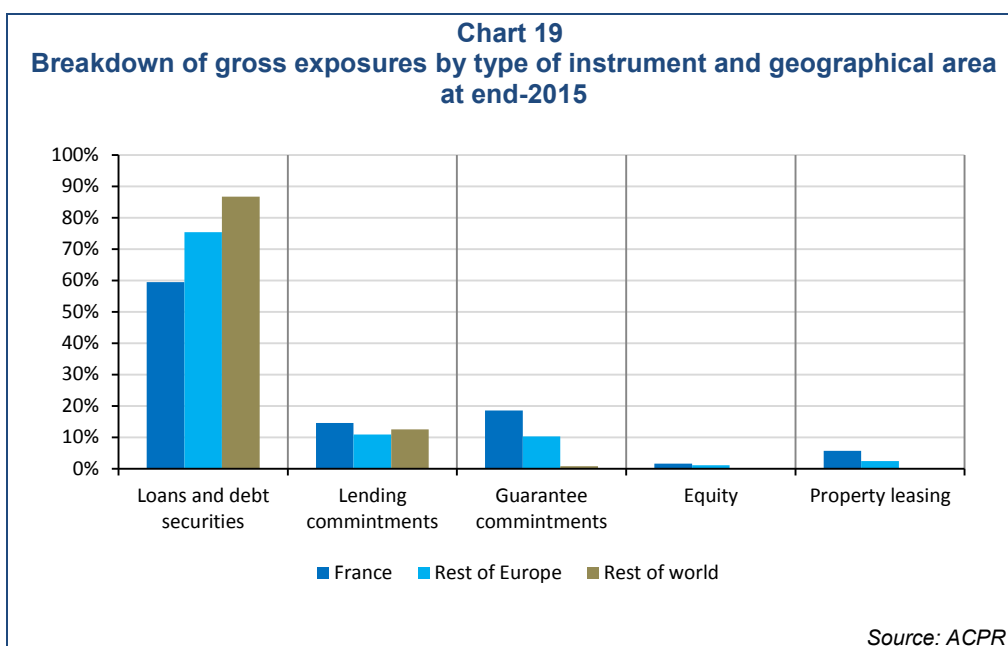
Exposures grew faster in H2 in the rest of the world (18.1%) and in the rest of Europe (15.7%) than in France (3.3%). As a result, the share of France in gross exposures continued to decrease in H2, at 57.5% against 60.4% in H1; conversely, the rest of Europe (27%) and the rest of the world (15.6%) saw their shares increase by 1.7 and 1.3 pt respectively (Chart 17).



Moreover, the rise in gross exposures stems in almost equal parts from loans and debt securities (EUR 5.5 billion) and lending commitments (EUR 5.6 billion); however, in relative value, the increase was much stronger for the latter (26.8%) than the former (5.4%), which resulted in a slight distortion in the breakdown of gross exposures, with loans and debt securities falling to their lowest level since 2008 (Chart 18).

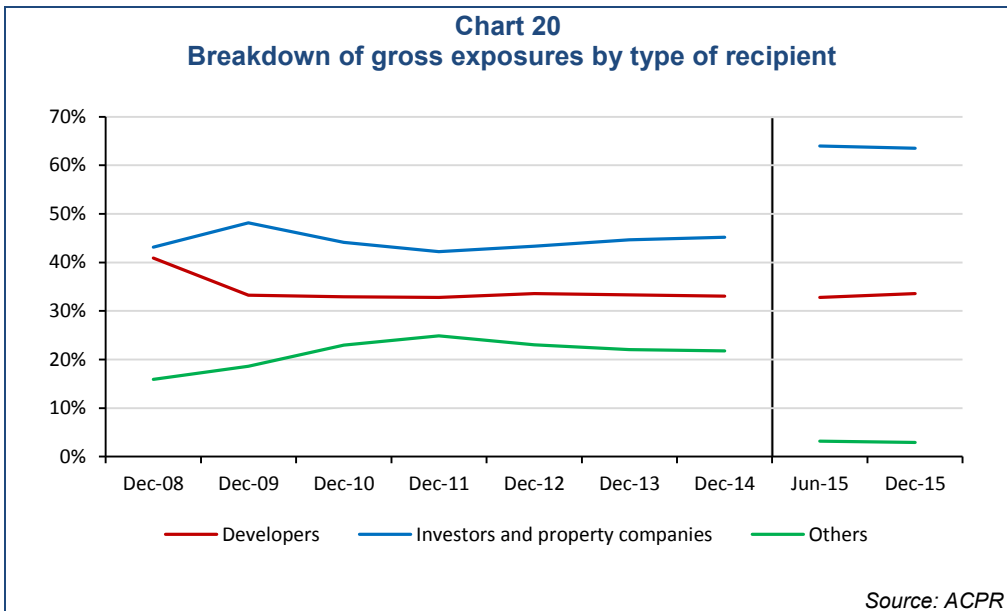


Lastly, in France, the breakdown of gross exposures is slightly different, in particular loans and debt securities are less represented, whereas guarantee commitments account for a slightly larger share (Chart 19). In the rest of the world, exposures nevertheless were almost exclusively made up of loans and debt securities.

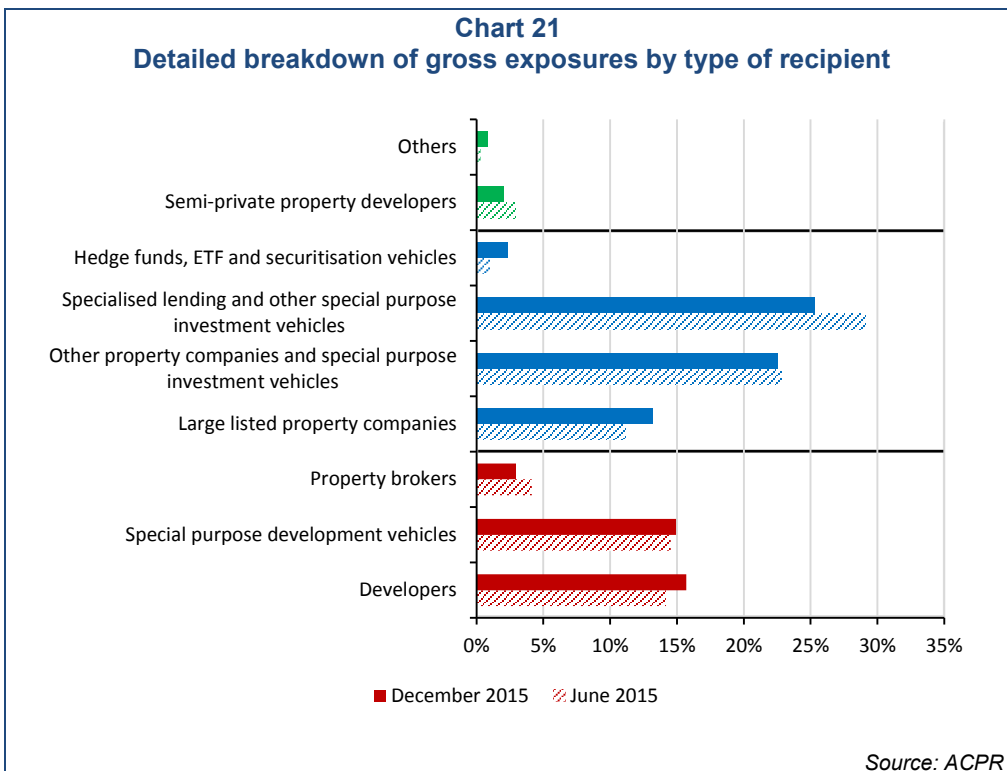


3.2 Investors continued to account for the major share

The breakdown of exposures by type of recipient changed little since end-June 2015. The share of investors remained high (63.5%), even though it fell very slightly, whereas the share of developers and property brokers rose by 0.8 pt to 33.6% (Chart 20); irrespective of the changes to the new survey, the share of the latter in gross exposures has nevertheless remained stable since 2009, hovering around 33%.

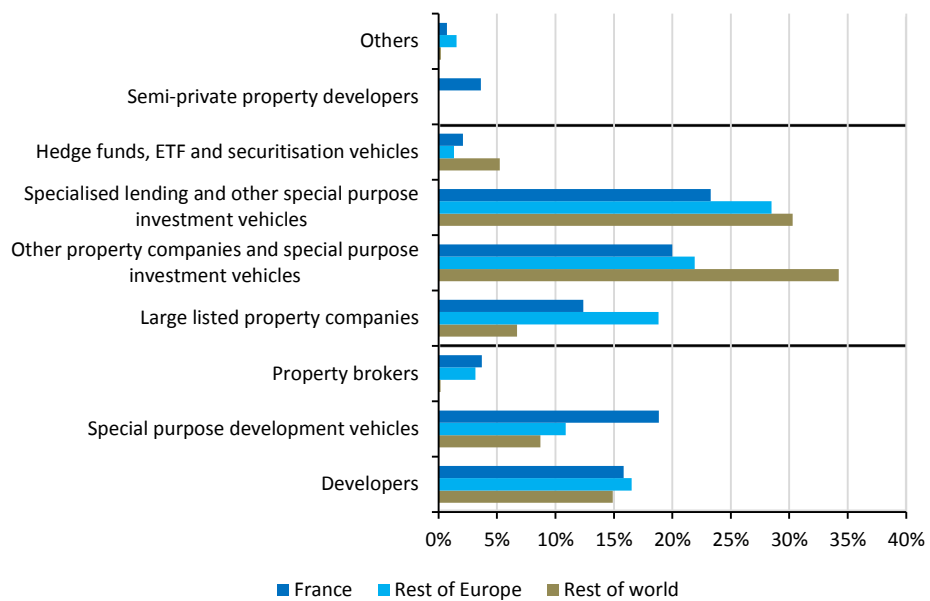


A more detailed breakdown shows that property brokers still account for a small share of property development sector, as is the case for hedge funds, ETF and securitisation vehicles among investors (Chart 21).



Lastly, the breakdown of exposures varies significantly across geographical areas: while, in each area, investors accounted for a large share of French banks' gross exposures at end-2015, developers and property brokers represented a bigger share in France than in the rest of the world or in the rest of Europe (Chart 22).

Chart 22
Breakdown of gross exposures by type of recipient and geographical area at end-2015

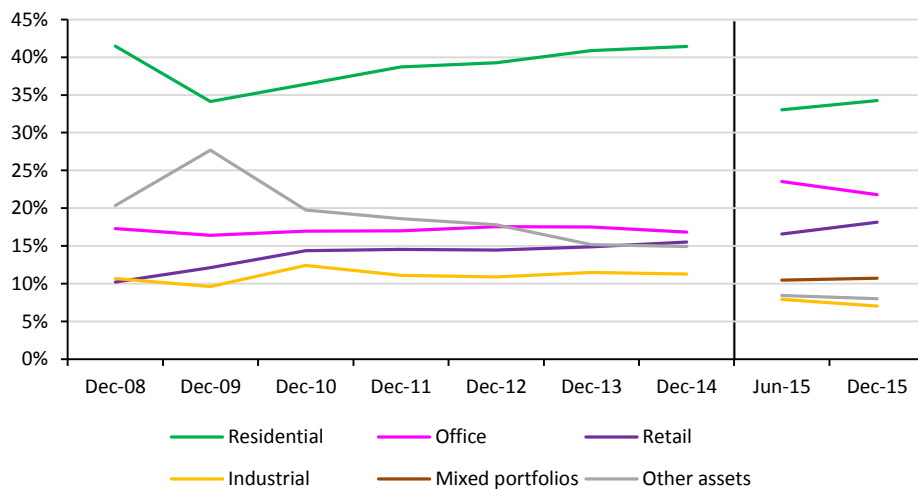


Source: ACPR

3.3 Residential real estate remains the largest sector of exposure

H2 2015 confirms the trends for residential real estate and retail observed before the survey change. The share of these two segments grew to reach 34.2% and 18.2% respectively of gross exposures. The office segment however confirmed the slowdown that is underway since 2012 and accounted for 21.8% of banks' exposures to real estate professionals (Chart 23).

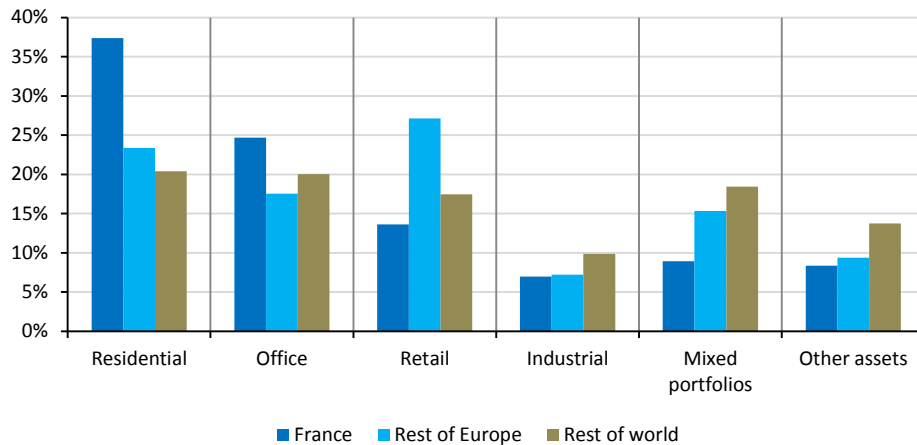
Chart 23
Breakdown of gross exposures by asset type



Source: ACPR

Like in the other areas of the analysis, France differs in that the share of residential real estate is much higher, whereas retail outlets account for a higher share in the rest of Europe, and offices account for a slightly higher relative share in the rest of the world (Chart 24).

Chart 24
Breakdown of gross exposures by asset type and geographical area at end-2015



Source: ACPR

3.4 Risks were contained in 2015

3.4.1 Risk-taking appears to remain moderate

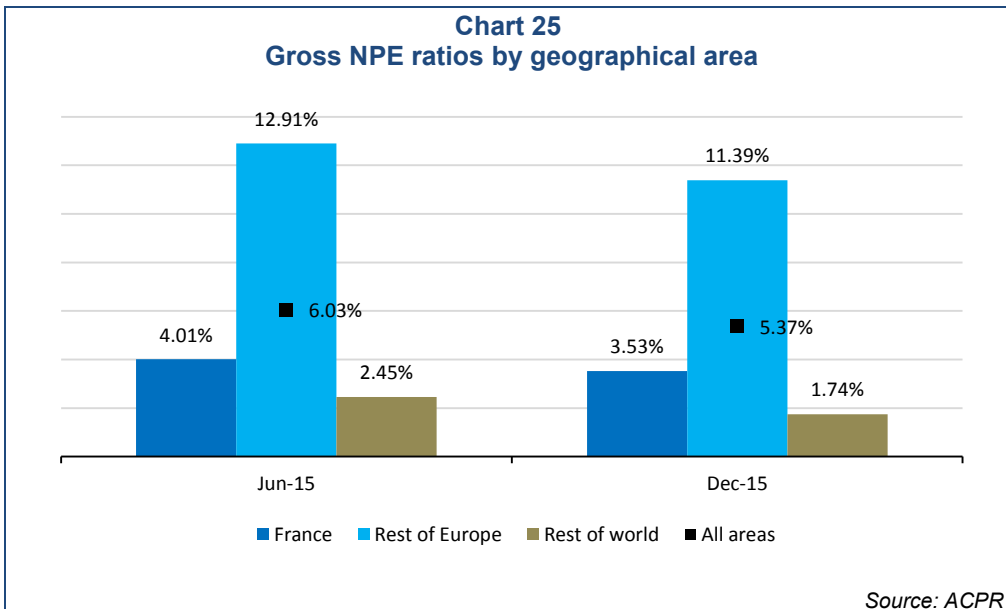
From the small amount of available data we can draw on, it appears that, like in H1, the risk-taking of French banks remained moderate:

- No unsecured financing was granted (i.e. with a pre-letting/pre-sales rate of zero) in H2 2015; moreover, 92% of financing in H2 2015 for which such data were available, had a pre-letting/pre-sales rate of over 20%;
- Stripping out financing for which data were not yet available, almost two-thirds of developers obtaining financing in H2 2015 had an equity-to-total balance sheet ratio of 20% or above;
- Three-quarters of loans granted in H2 2015 and for which data was available had a loan-to-value (LTV) ratio of less than 50%.

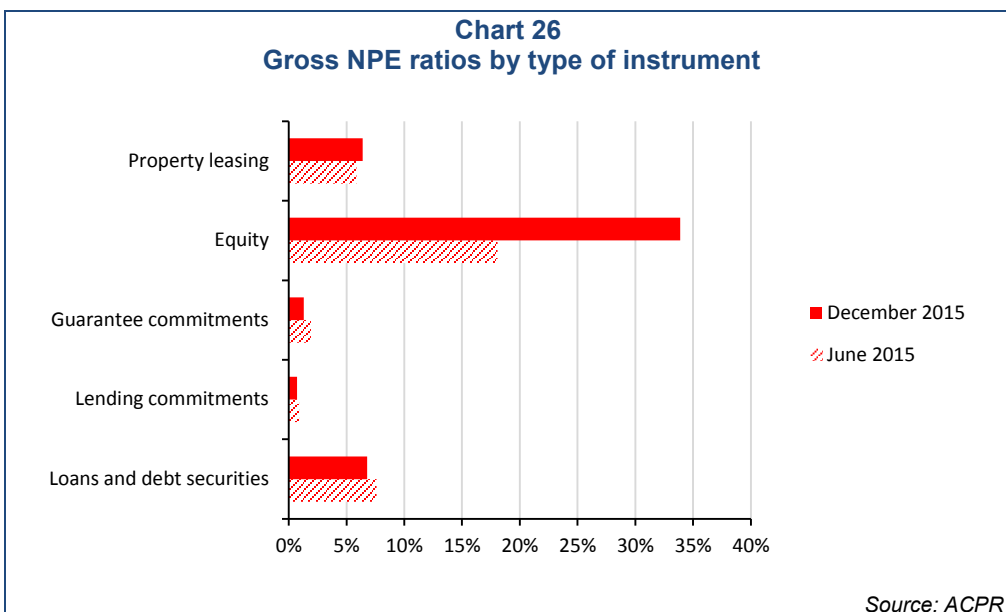
3.4.2 Non-performing exposures have declined in both absolute and relative terms

The total amount of gross non-performing exposures (NPEs) decreased by 3.4% in H2 2015 to EUR 8.7 billion. Furthermore, due to the rise in gross exposures, the gross NPE ratio fell even more significantly, from 6.03% to 5.37% between H1 and H2.

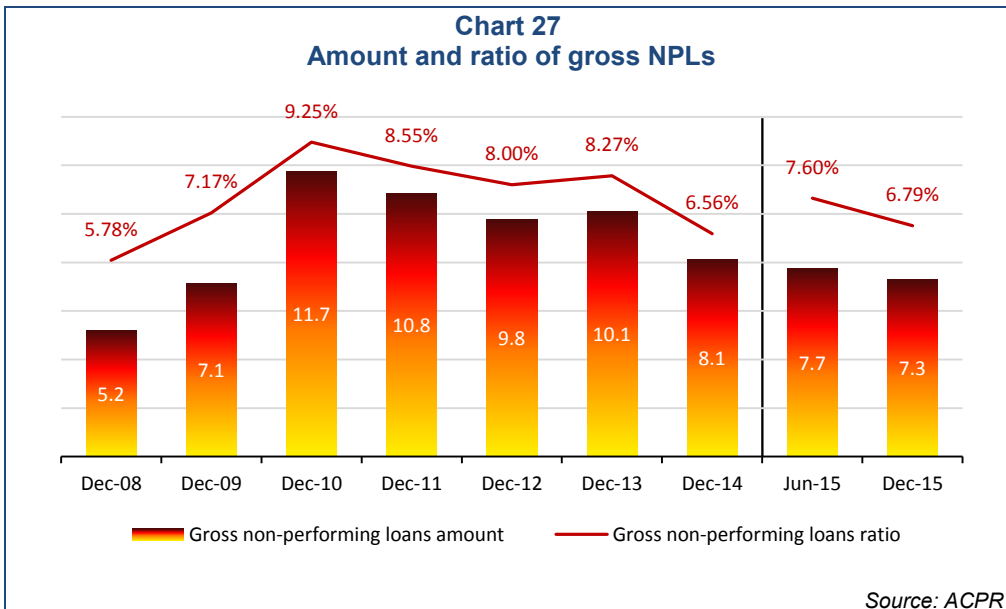
The dispersion gross NPE ratios nevertheless remains significant among banks (varying from 1.83% to 9.65% at end-2015) and across geographical areas, even though they are declining (Chart 25): the rest of the world continued to display the lowest level of risk, followed by France and the rest of Europe, whose situation remains relatively unusual, with two banks in particular displaying a gross NPE ratio of above 15% at end-2015 in this region.



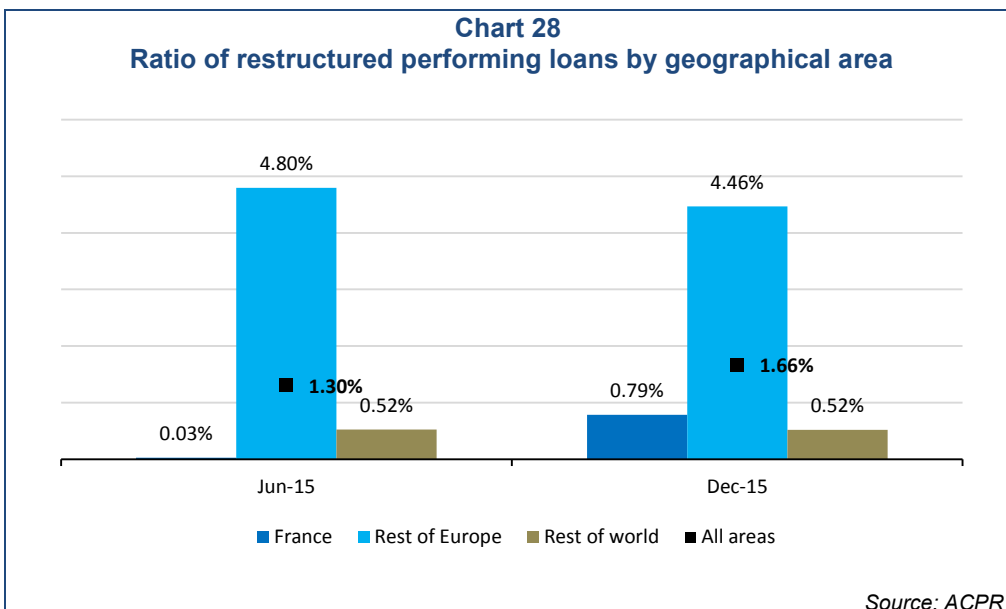
The breakdown of gross NPE ratios by type of instrument changed significantly in H2: while they fell on loans and debt securities as well as on off-balance sheet commitments, they rose on property leasing and almost doubled on equity due to the very sharp rise that occurred in the rest of the world on this type of exposure (Chart 26). As mentioned above, these developments should nevertheless be considered with caution given the differences in scope between the two periods (differences in the number of banks providing information, etc.).



In particular, the amount of gross non-performing loans and debt securities (NPLs) in H2 2015 continued to decline, falling by 5.8% to stand at EUR 7.3 billion, i.e. a slightly higher level than that reached in 2009. Furthermore, benefiting from the increase in performing loans, the gross NPL ratio fell from 7.6% to 6.79%, to a level lower than that of 2009 (Chart 27).

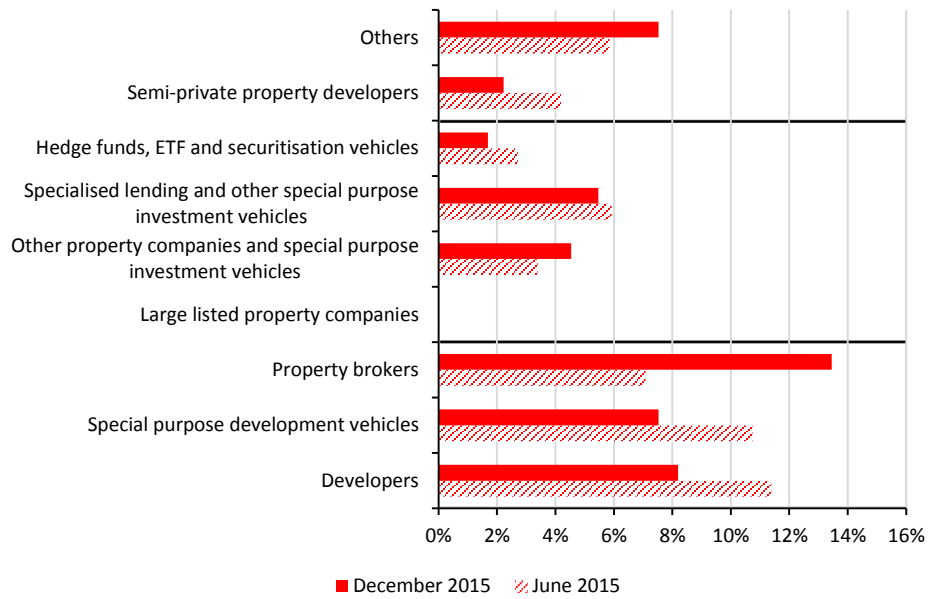


The decline in the amount of gross NPLs was accompanied by a rise in that of restructured performing loans, which increased from EUR 1.2 billion to EUR 1.7 billion, i.e. by 36%, between H1 and H2 2015. As a proportion of performing loans, the average rate of exposures to restructured performing loans rose by 36 bps to 1.66 %, with yet again marked divergences between the different groups (ranging from 0% to 5.39% at end-2015) and between different geographical areas, with the rest of Europe standing out once more (Chart 28). The increase in the restructured performing loan ratio, particularly acute in France, stems from a single bank that had not reported any restructured outstanding in H1; stripping out this outlier, the average restructured performing loan ratio fell from 1.83% to 1.79%, but nevertheless continued to rise in France, from 0.05% to 0.18%.



Lastly, the NPE ratios by type of recipient varied sometimes significantly between H1 and H2 2015: while they generally declined, they almost doubled for property brokers, from 7.08% to 13.22%, reflecting notably the sharp rise observed in the rest of Europe on this customer segment, and rose by 1.1 pt for other property companies and special purpose investment vehicles, to 4.51% (Chart 29).

Chart 29
NPE ratios by type of recipient



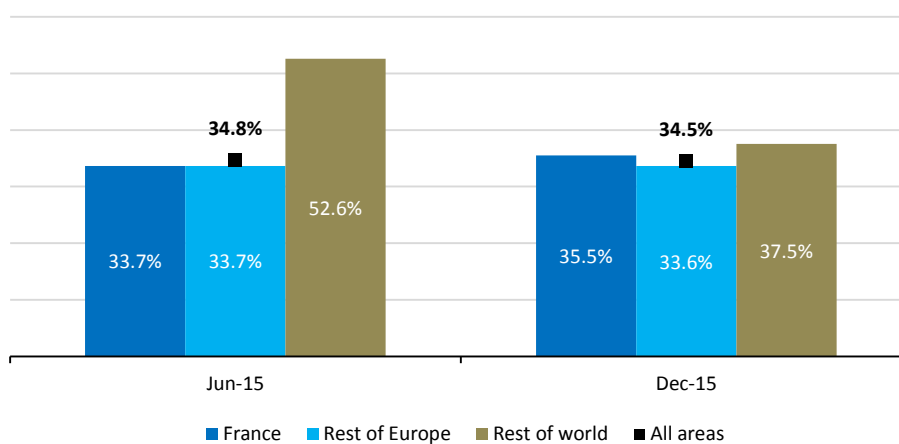
Source: ACPR

3.4.3 Slight decline in coverage ratios

Due to the slight decline in total impairments, which fell from EUR 3.1 billion to EUR 3 billion between H1 and H2 2015, the gross NPE coverage ratio contracted by 0.3 pt to stand at 34.5% at end-2015.

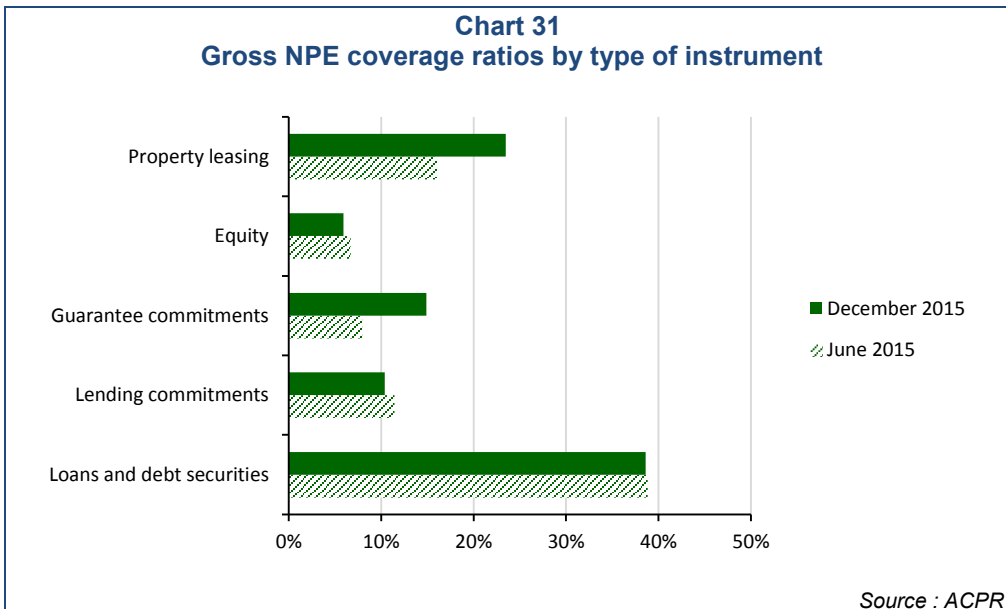
Like above, the dispersion of NPE coverage ratios nevertheless remained significant across banks (varying from 25.7% to 56.4% at end-2015); however, in H2, when all groups submitted the expected data, they appear very homogeneous across geographical areas (Chart 30).

Chart 30
Gross NPE coverage ratios by geographical area

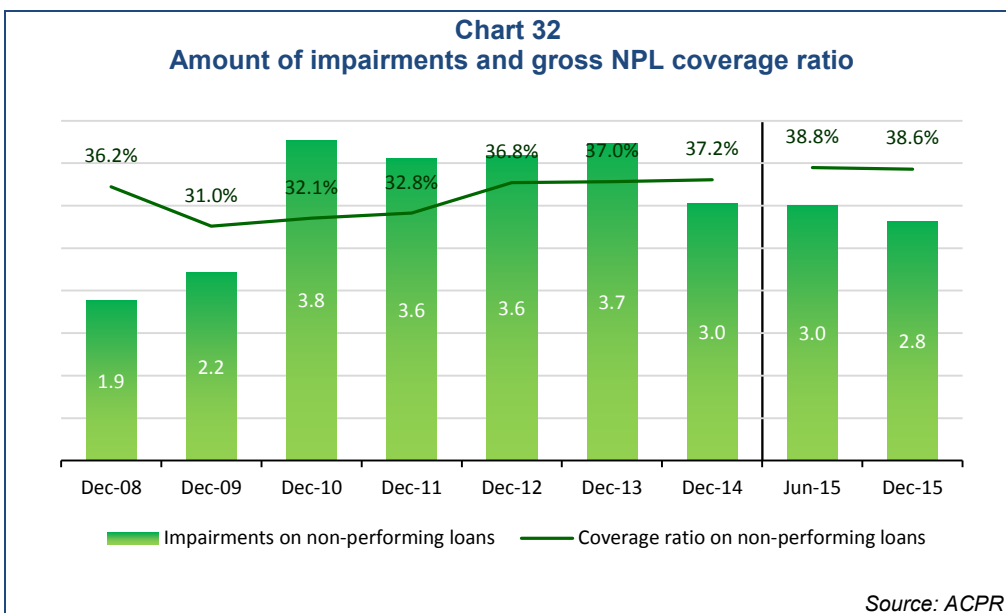


Source: ACPR

With the exception of guarantee commitments and property leasing, gross NPE coverage ratios by type of exposure fell slightly in H2 (Chart 31).

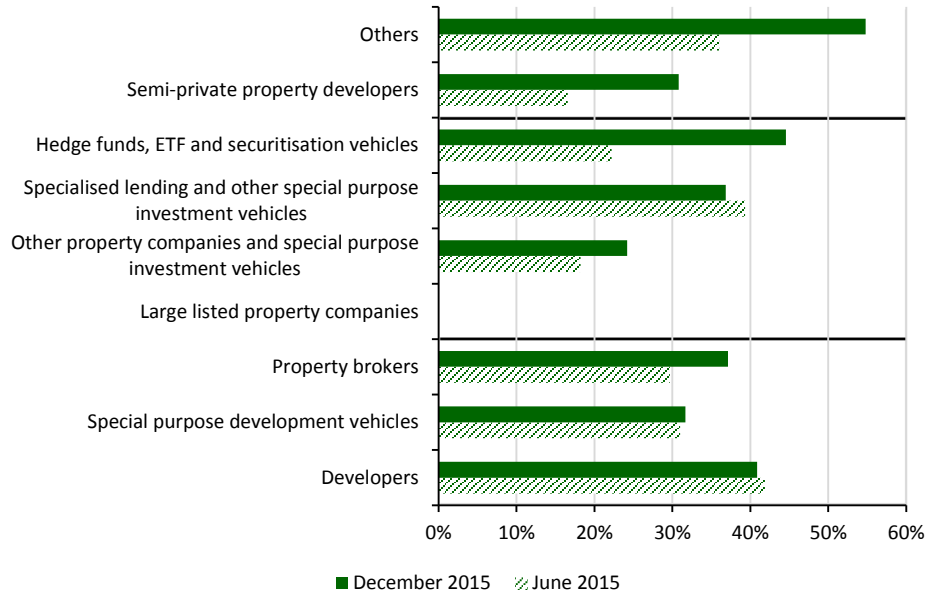


In particular, the impairments on non-performing loans and debt securities fell in H2 2015 by 6.4% (more than that for gross non-performing loans and debt securities) to stand at EUR 2.8 billion. Consequently, the coverage ratio was down slightly by 0.2 pt to 38.6%, which is nevertheless a relatively high level compared with previous years (Chart 32).



Lastly, with the exception of developers as well as specialised finance and lending and other special purpose investment vehicles, which accounted for half of gross NPEs, coverage ratios rose for all types of recipient (Chart 33).

Chart 33
Gross NPE coverage ratios by type of recipient



Source: ACPR

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