FRANCE – RESIDENTIAL REAL ESTATE

MARKET RESILIENT IN THE CORONAVIRUS PANDEMIC

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WORKING EVERY DAY IN YOUR INTEREST AND FOR SOCIETY

ÉTUDES ÉCONOMIQUES GROUPE

KEY POINTS

2020-2021 RESIDENTIAL REAL ESTATE

Market contracted sharply in 2020 but did not derail

- The residential market stood up well to the severe shock delivered by the Covid-19 pandemic.
- In the second-hand segment, transactions fell during the first lockdown before bouncing back. Although down around 13% on an annual basis in 2020, transactions totalled a healthy 925,000 units. Prices in the third quarter rose 5.2% year-on-year although stabilising in the last months of the year.
- Performance was uneven across the new-build segment: sales of developer-led properties slumped by roughly 25% in 2020, while single-family home sales fared better at -12.5%.
- This led to a fairly moderate -5% year-on-year dip in new mortgage lending in 2020 (before renegotiated loans).

Factors holding back the recovery

- **The French economy has shrunk badly,** despite government fiscal support. People's disposable income has fallen at a moderate pace, while unemployment has risen steadily (in metropolitan France) from 7.8% at end 2019 to 9.2% at end 2020. It is expected to hit 9.8% by the end of 2021. Consumer confidence is muted.
- **Under-supply of new housing:** a feature before Covid-19 hit, new builds are now in even shorter supply. The flow of building permits fell in the second quarter as local authorities threw their weight behind efforts to tackle the pandemic and run the delayed municipal elections.
- **Slightly tighter credit conditions:** the High Council for Financial Stability (HCSF) recommends that banks cut the number of loans that represent a high affordability ratio, greater than 33% of income. The weight of those loans in new housing loans was gradually reduced, to 22.7% in Q3 2020 and 21% in September 2020, from 27.7% in 2019. The ultimate objective is to bring this weight down to 15%.

Positive factors

- **Structural support factors persist:** demography, planning for retirement and the search for a safe haven – an effect intensified by Covid-19. People see property as a secure investment. It is tangible and the market follows a fairly predictable path. Yields are relatively attractive and valuations are generally favourable over long periods.
- **Prudent model of French mortgage lending** that keeps risk in check. Generally low levels of NPLs before the coronavirus hit. We think the measures to help households and the option to possibly extend loan terms should limit defaults and help keep a steady ratio of non-performing loans.
- Credit rates should remain close to where they were in Q3 2020 at 1.3%, excluding insurance. 10yr OAT (French government bonds) rates will likely stay in slightly negative territory in 2021, **keeping credit rates attractively low.**
- Affordability is satisfactory and prices are not overvalued in France in general.

2021 forecasts

- **While sales should recover in 2021, they will not return to 2019 records.** We project 975,000 units in the second-hand market, a rise of 5.5% on 2020 and a decline of 9% compared with 2019, and a slight increase in sales of new-builds.
- **Prices will stay stable overall, or fall somewhat,** particularly in overvalued segments (Paris, Bordeaux, Lyon and Nantes). However, we see no sign of a significant drop as demand will remain robust in a market where supply is short.

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HOW IS FRANCE MANAGING THE ECONOMY AND THE PANDEMIC?

CAUTIOUS LIFTING OF LOCKDOWN RESTRICTIONS IN THE FIRST HALF OF 2021

The outlook for growth depends heavily on assumptions about how the pandemic will play out, which are dogged by uncertainty.

Following the second wave and second lockdown, these are our assumptions: the government is taking a guarded approach and announced a limited easing of restrictions as of 15 December 2020 ; most of those measures would remain in place in the first half of 2021. The first wave of vaccinations will target medical personnel and high-risk groups. It is hoped these steps will head off a serious third wave of the virus and a third lockdown in Spring 2021.

2020

- The rebound in Q3 2020 as restrictions were eased was better than expected. GDP bounced back 18.7% in Q3 (vs. Q2) after a 13.8% decline in Q2 (vs. Q1)
- The sheer size of the second wave prompted a second lockdown and tight restrictions in November. December saw a limited and cautious easing of these measures: shops and businesses reopened at the end of November with strict health protocols; lockdown will end on 15 December and a curfew is implemented; bars and restaurants are to stay closed; working from home is strongly encouraged.
- GDP would fall by 4.8% in Q4 (vs. Q3). **GDP is set to decline 9.2% on average in 2020.**

2021

- Gradual and cautious exit from lockdown in Q1 2021: curfew to remain in place; restaurants to reopen on 20 January with a strict health protocol; ban on large public gatherings. Vaccination programmes to commence prioritizing target groups. Extension of support measures for the most severely affected areas of the economy. Business picks up, but is still 5.5% below “normal”.
- Very gradual lifting of restrictions in Q2 2021.
- The vaccination drive will be widened to include more sections of the population in the second half of 2021. Restrictions eased but not lifted altogether as fairly strict guidelines remain in place and working from home is encouraged. The economy will pick up, but caution is the order of the day, despite stimulus measures: some industries still very exposed (including aeronautics, automotive, trade, tourism, hotels, restaurants and the culture sector). Investment returns but slowly, despite the stimulus plan; bankruptcies; continued high levels of precautionary savings as households shore up their finances amid rising unemployment figures. This trend will limit the release of surplus savings built up since Q2 2020. Forecasts put GDP at 2.2% below “normal” in Q4 2021.

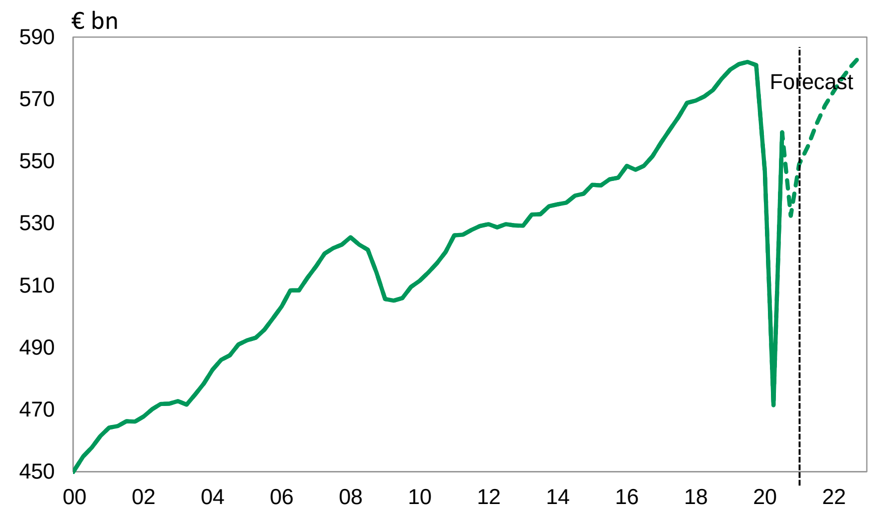
HOW IS FRANCE MANAGING THE ECONOMY AND THE PANDEMIC?

GRADUAL RECOVERY IN 2021

Annual real GDP growth

Sources : Insee, Crédit agricole SA / ECO

Quarterly GDP



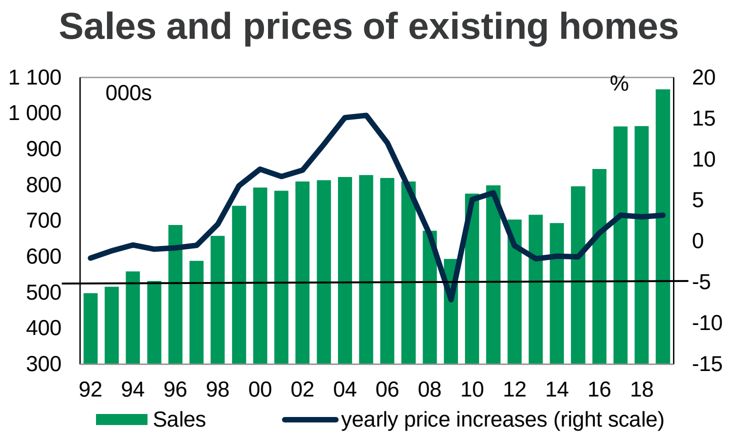
Sources : Insee, Crédit agricole SA / ECO

After GDP growth of 1.5% in 2019, the health crisis leads to a record recession in 2020 of 9.2%. GDP rebounded sharply in Q3 2020 to +18.7% after a 13.8% decline in Q2. Then a decline of 4.8% in Q4. Gradual recovery of activity in 2021 and 2022.

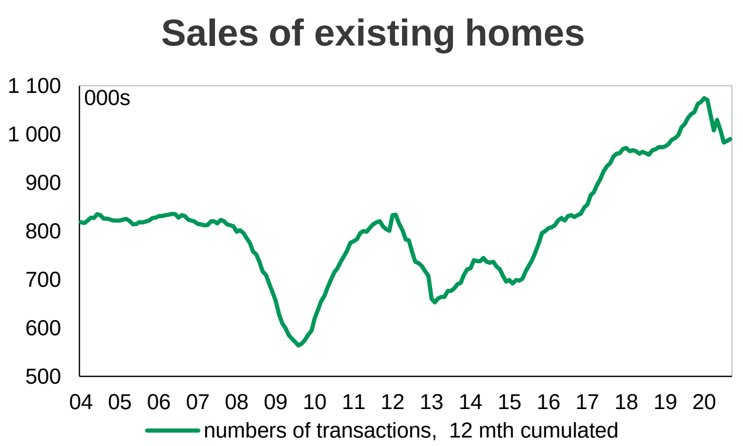
Average annual GDP growth of 5.9% in 2021. At the end of 2021, quarterly GDP would still be about 2.2% below its pre-crisis level (see graph above). It would only return to this level towards the end of 2022.

RECENT DEVELOPMENTS

SALES OF SECOND-HAND PROPERTIES SLID 13% IN 2020



Sources : CGEDD, Notaries, Crédit agricole SA / ECO



Sources : CGEDD, Notaries, Crédit agricole SA / ECO

At 1,067,000 units, sales of second-hand properties were at record highs in 2019 (+9.7%, from 973,000 in 2018), easily topping the peaks of the previous boom in 2004-2006 when sales were at 825,000 units a year.

The market continued very brisk in January-February. **Sales fell sharply as of mid-March as lockdown was ordered in France.** The average number of sales plummeted 37% in March-April to 54,000 per month, from the 86,000 recorded one year earlier. Most people were confined to their homes, real-estate agents were closed and notaries' office hours pared back.

Lockdown restrictions were lifted in May and **demand bounced back from May to September**, boosted by a backlog of closures as pre-crisis sales agreements were finalised. Sales declined between May and September by a modest 4% year-on-year compared to the record performance in 2019.

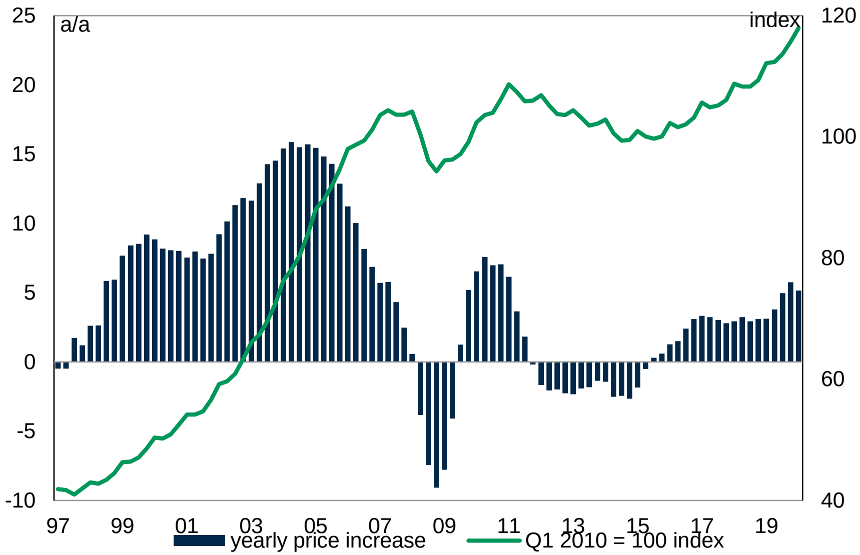
A second but less stringent lockdown was imposed in November. While real-estate brokers had to close their offices and potential buyers couldn't visit properties, they could conduct appraisals, sign mandates, sale agreements and sale contracts. As restrictions were eased in December, sales rebounded as offices reopened.

All in all, full-year 2020 sales declined a net 13% (925,000 units), the market avoided a collapse.

RECENT DEVELOPMENTS

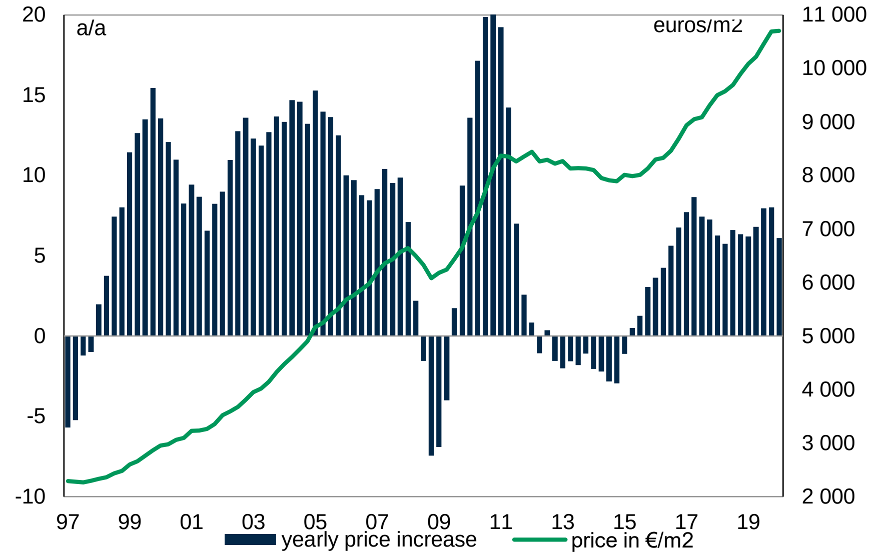
PRICES OF SECOND-HAND PROPERTIES ROSE CONSIDERABLY IN 2020

Prices of existing homes



Sources : Insee, Notaries, Crédit agricole SA / ECO

Housing prices in Paris

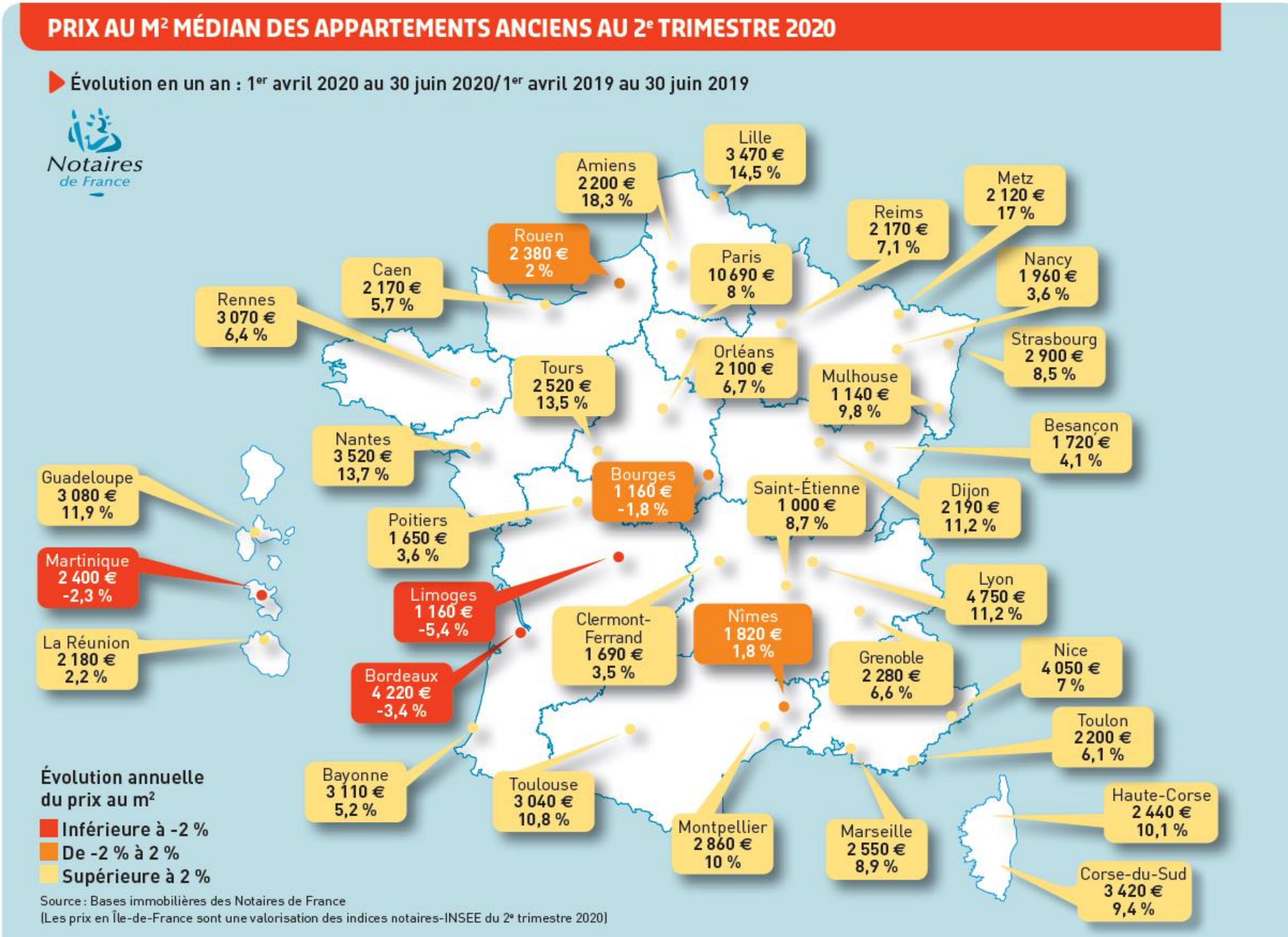


Sources : Insee, Notaries, Crédit agricole SA / ECO

After three years of prices increasing at a fairly steady 2.7% on average between 2016 and 2018, house price growth accelerated in 2019 to an annual pace of 3.7% in the fourth quarter. The first three quarters of 2020 confirmed this upward trend as prices kept on rising: +4.9% in Q1 2020, +5.6% in Q2 and +5.2% year-on-year in Q3 2020. The quarterly change tightened to 0.5%. Prices accelerated at an annual rate of 6.1% in Paris, 6% in Ile-de-France and 4.8% outside the Paris region.

It's not yet clear what impact Covid-19 will have on prices as it generally takes several months for developments in sales and housing supply to percolate through. The fall in the number of transactions should see prices stabilise or drop slightly in the months ahead.

RECENT DEVELOPMENTS



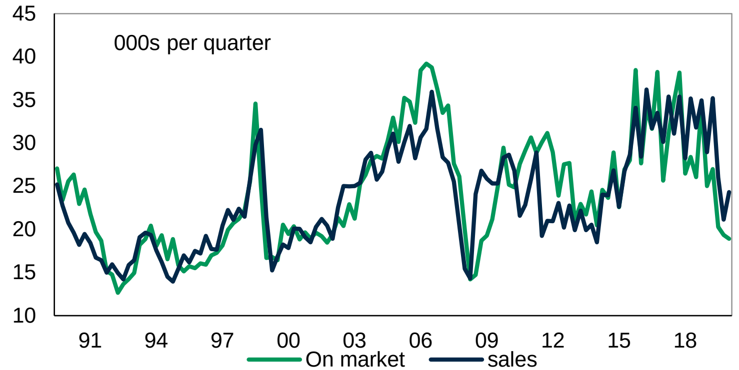
Price breakdown by city, Q2 2020. Prices of second-hand apartments grew an average 7% on an annual basis in Q2 2020. The increase was 7.3% in Ile-de-France and 6.8% outside the Paris region.

Map sourced from the French Property Market report issued by Notaires de France.

RECENT DEVELOPMENTS

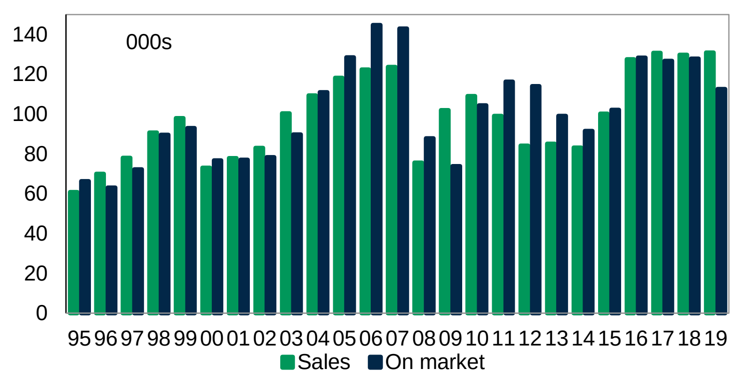
NEW-BUILD PROPERTY MARKET AVOIDS COLLAPSE AS SALES FALL SHARPLY

Sales of new homes



Sources: Ministry of Ecology, Crédit Agricole SA/ECO

New homes sold and placed on the market



Sources: Ministry of Ecology, Crédit Agricole SA/ECO

The steep decline in sales of new properties in 2020 did not constitute a sustained slump in the market.

New house sales (developer segment and retail sales. Source: Ministry for the Ecological Transition):

- 130,900 sales in 2019, practically unchanged form 2018 at +0.7%. Volume was fairly brisk topping the high points of 2006-2007 (123,000/yr) by 5%. A strong 4.2% increase in Ile-de-France.
- Sales contracted severely in the first nine months of 2020: down 25% on an annual basis, with Q2 recording a 40% fall as lockdown measures stopped the market in its tracks. Sales dropped 16% year-on-year in Q3 in a lacklustre performance, despite the easing of restrictions.

Block sales of new-build housing (developer): sales dipped 1% in 2019 to 33,700 units, compared to -5% in 2018 amid changes to how social housing is organised (Elan plan, cuts in housing benefit and rents, amongst other measures). Block sales lost 11% on an annual basis in the first three quarters of 2020 (source FPI).

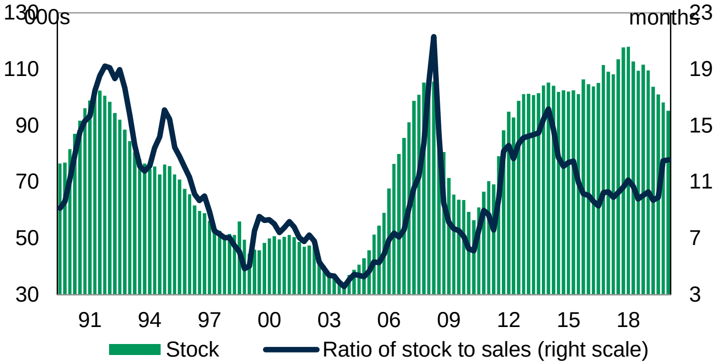
Non-developer single-family homes:

- In 2019, sales picked up 5% year-on-year to 125,600, way below the 2006-2007 record sales (189,000 a year).
- In 2020, the coronavirus pandemic depressed activity to a 12-month total of 113,500 units in September, -9% year-on-year. Sales fell 43% year-on-year in the three crisis months of March, April and May, but recovered in June-September with 5% yoy growth. The total would be close to 110,000 units for 2020, a decline of 12.5% year-on-year.

RECENT DEVELOPMENTS

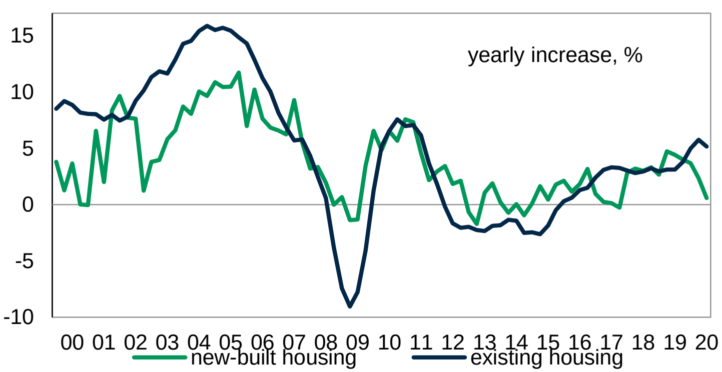
MUCH TIGHTER SUPPLY OF NEW HOMES FOR SALE

Stock of new homes



Sources: Ministry of Ecology, Crédit Agricole SA/ECO

House prices



Sources: Ministry of Ecology, Crédit Agricole SA/ECO

Fewer new homes (developers) for sale in 2019, 111,700 units, -12% year-on-year. The decline was 16.1% in 2019, down from 2.1% growth in 2018. This fall is linked to challenges starting up new developments related to scarce, high-priced land, strict standards, objections to proposed developments and the lead time to obtain building permits.

There were fewer properties for sale in 2020 as lockdown bit and new permits slowed (see page 11): -22% year-on-year in Q1 2020, -44% in Q2 and -24% in Q3. Estimates put the decline at 30% yoy in 2020.

Available supply of new-build homes (all new developer housing for sale and unsold):

- Falling gradually: 95,240 units in Q3 2020, -13.1% year-on-year (109,600 units in Q3 2019)
- The average time to sale was up as sales were down: 12.6 months in Q3 2020 (the historic average is close to 10 months).

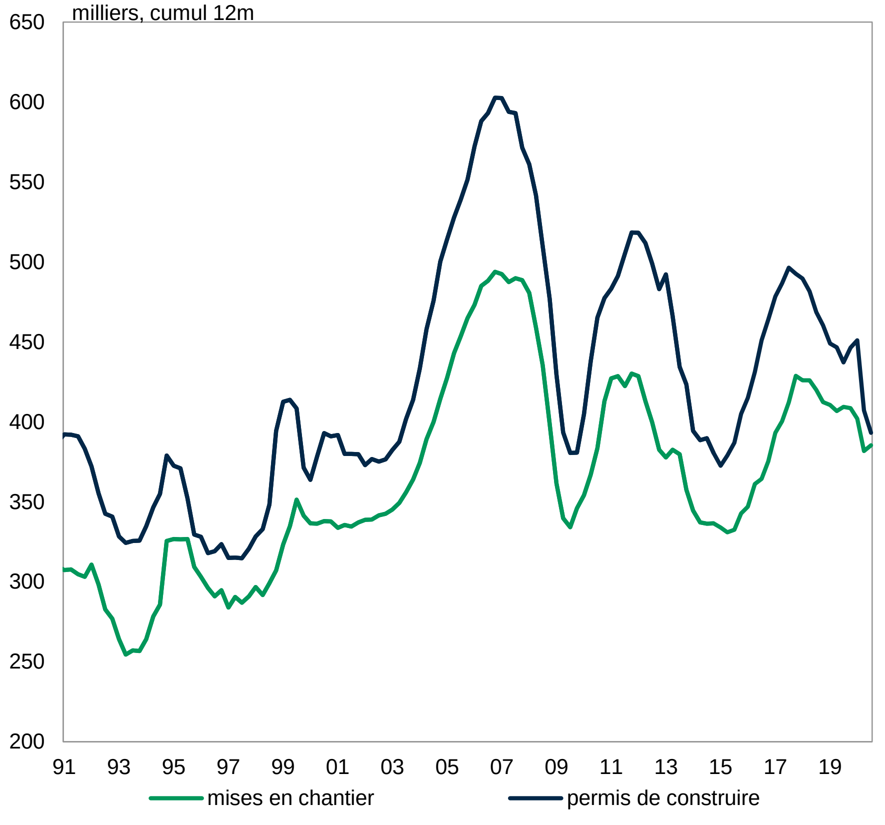
Prices stabilised or fell slightly (the decline in sales offset weak supply and higher construction costs):

- Apartments: +0.6% year-on-year in Q3 2020 (+2.4% in Q2 2020).
- Single-family homes (developers): -1.5% year-on-year in Q3 2020 (+10.5% in Q2 2020).

RECENT DEVELOPMENTS

CLOUDS OVER CONSTRUCTION IN 2020

Building permits and housing starts



Sources: Ministry of Ecology, Crédit Agricole SA / ECO

The construction sector contracted slightly in 2019. The lag of several months between signature of sale agreements and the start of construction a gradual impact on the industry of lower prices for new builds. New housing starts fell back 0.9% to 409,000 year-on-year and there were 3% fewer new permits issued (446,500).

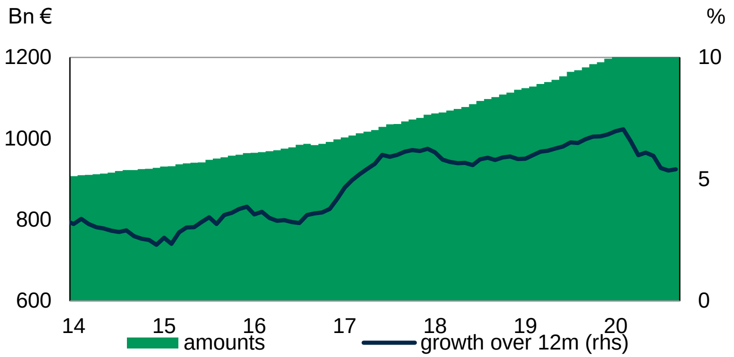
The picture brightened early in the year, especially for building permits. Then Covid-19 hit and building sites virtually came to a halt (around 80% of sites were shut in the first few weeks, then 70% in mid-April, implementing Covid-safe work practices).

The sector recovered bit by bit in May-June and in the third quarter. Housing starts numbered 78,000 in Q2 2020, down 21% year-on-year. 66,000 building permits were issued, a fall of 40%. 92,000 new housing construction sites began in Q3 2020, a 4% year-on-year increase. Permits remained in negative territory, -12% year-on-year.

The slowdown in housing starts and building permits should be stark in 2020 at around -12% and -20%, respectively (*see slide 16*).

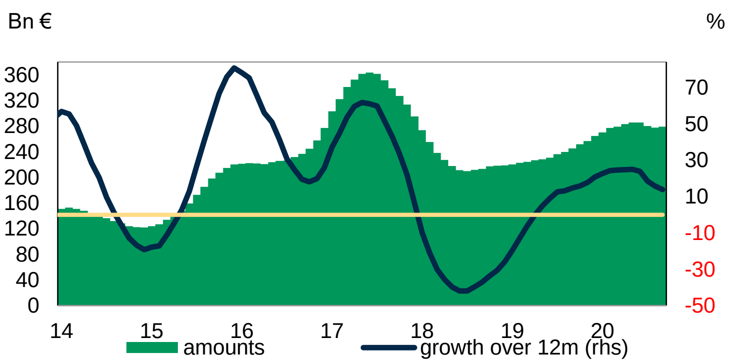
MORTGAGE LENDING SLOWS IN 2020

Stock of mortgage loans to households



Sources : Banque de France, Crédit agricole SA / ECO

Home loan production
(cumulative over 12 months)



Sources : Banque de France, Crédit agricole SA / ECO

- The mortgage lending outstanding slowed gradually to 5.4% year-on-year in September 2020, from 6% in May/June/July and 6.8% in December 2019.
- The 12-month total of new loan production rose by 13.9% year on year in September, compared with 20.8% in December 2019. Excluding renegotiated loans, mortgage lending production was down 3% year-on-year in the first nine months of 2020.
- We expect a 5% decline in new mortgage lending for full-year 2020 (excluding renegotiations), reflecting the impact of Covid-19. Because house prices have increased, the decrease is less than the decline in house sales.
- Total repayment flows may reduce slightly as repayment could be partially deferred.
- Fairly sharp slowdown in mortgage loans outstanding: +4.7% year-on-year in December 2020 (+6.8% at end 2019).
- We expect both new mortgage production and mortgage loans outstanding to increase 5% in 2021.

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3 FAVOURABLE FUNDAMENTALS

ANALYSIS AND OUTLOOK

MAIN FACTORS

What will the market look like after Covid-19?

The residential market stood up well to the severe shock delivered by the Covid-19 pandemic. Transactions in the second-hand market fell by around 13%, but are still at record high levels. Prices also rose sharply. The picture is different in the new-build segment. Sales slumped 20% and are back to the lacklustre levels of 2015.

But, it's important to remember that the shock comes from outside. It is not a crisis inherent in the real estate market as in 1991 or 2008 caused by runaway prices, credit, or construction, leading to a substantial rise in risks on the housing market and among lenders. We are not looking at the bursting of a real estate bubble.

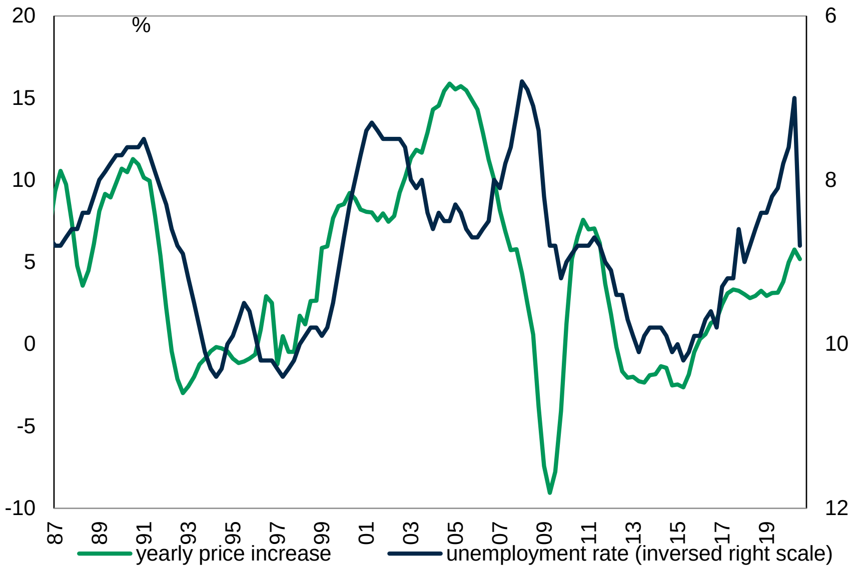
What will 2021 bring? A sober recovery with sales well below the highs of 2019 and prices steadying. Yes, there are a number of positive fundamentals, but other factors – not least the economic fallout from the virus – will exert a negative pull on the market.

negative factors	positive factors
increasing unemployment rate	demographic, retirement
low confidence levels	safe haven effect
risk of slight tightening in credit approvals	cautious lending model
weak supply	low level of lending rates
	acceptable home purchasing power

FACTORS HOLDING BACK THE RECOVERY

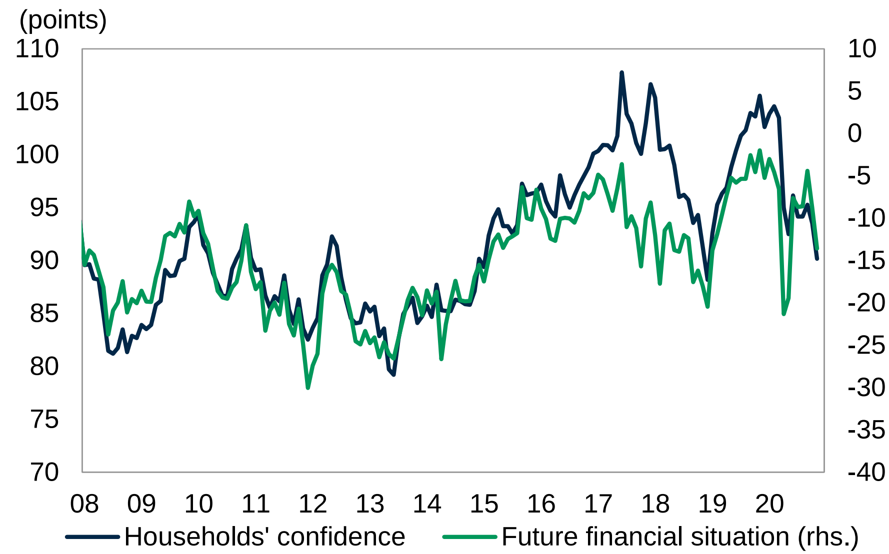
VERY CHALLENGING ECONOMIC ENVIRONMENT AND LOW CONSUMER CONFIDENCE IN 2020

Real estate prices and unemployment rate



Sources : Insee, Notairies, Crédit Agricole SA / ECO

Consumer confidence



Sources : Insee, Crédit Agricole SA / ECO

Disposable income fell around 1% in 2020. The huge uptake of furlough schemes helped stem job losses but lowered income for many. Despite these job-retention programmes, unemployment took a definite upward turn in Q2 (for temporary and fixed-term staff). Pressures remained in the second half. After falling in the first half of 2020 (reflecting the decline in the labour force), the jobless rate in Metropolitan France should be 9.2% at end 2020, rising to 9.8% in December 2021. Real income should recover by around 1.5% in 2021.

Confidence suffered a real blow in the second quarter, recovered in the third quarter before being shaken again in November as France ordered a second national lockdown. Long-term investment and borrowing decisions depend on a degree of visibility. As consumer confidence is undermined by fewer jobs, the spectre of unemployment – with fear at its most intense since the 2009 crisis – and uncertainty about what the future means for their finances, the knock-on effect on decisions about buying a home is palpable.

FACTORS HOLDING BACK THE RECOVERY

NEW HOUSING SUPPLY SHOCK

Supply was short even before Covid-19 hit

The shortage of supply in the developer segment of the new housing market was a problem before the pandemic, especially in the most tight areas. A mixture of scarce, high-priced land, strict building standards, spurious objections to proposed developments and the lead time to obtain building permits are the main factors in keeping supply down.

Covid-19 delivered another supply shock

Sales and construction of new homes were severely affected by Covid-19 during the first lockdown. Potential buyers were kept indoors, agents' offices shuttered and sites brought to a standstill in the early part of the crisis. Work resumed on 30% of building sites in mid-April, with strict Covid-19 protocols in place. As a result, activity in the sector was only 30% below what it would have been in normal circumstances in June.

Yet, two main problems continue to weigh on the new-build segment:

– Delivery of building permits came to a partial halt between March and June as local authority (responsible for issuing permits) resources were diverted to coping with the pandemic and the second round of the local elections, due to take place in March, was postponed until late June. The flow of permits slowed to a trickle in the second quarter and some backlog will remain.

– The process of digitising deeds and official documents is far from complete, which matters for both building permits and signature of sale agreements.

These factors go some way toward explaining the slowdown in permits and in new homes for sale. We're on track to see a steep drop of around 20% in the number of building permits issued to 90,000. Shackled by limited supply, lockdown measures and a challenging economic backdrop, sales of new developer homes are set to contract by 25% year-on-year in 2020.

New stimulus measures

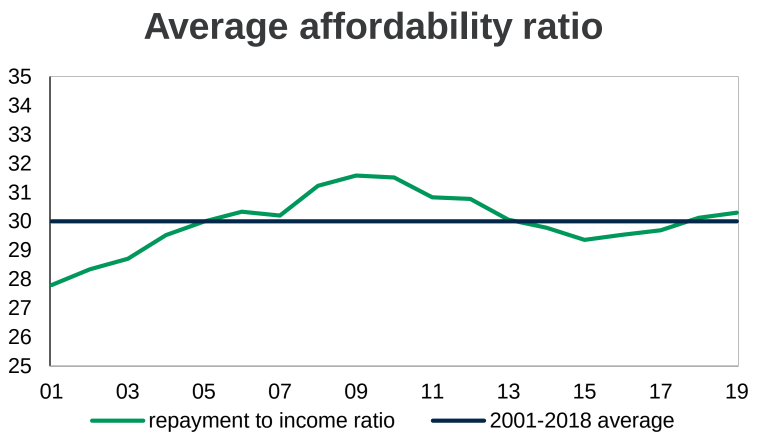
The government announced new steps to prop up building and public works in June. They include spreading social security charges for the period March to May over three years ; €1 billion in extra construction investment by local authorities. The September 2020 stimulus package also targets housing with incentives for green energy upgrades worth €2.5 billion, €350 million to encourage local authorities to build and €300 million in funding for converting brownfield industrial sites into building land for homes.

What's more, the Pinel invest-to-rent tax rebates and the zero-interest loan (PTZ) programme to boost sales of new homes in tight zones will be extended into 2022, beyond their original end date of December 2021. Pinel is due for an overhaul in 2023-2024.

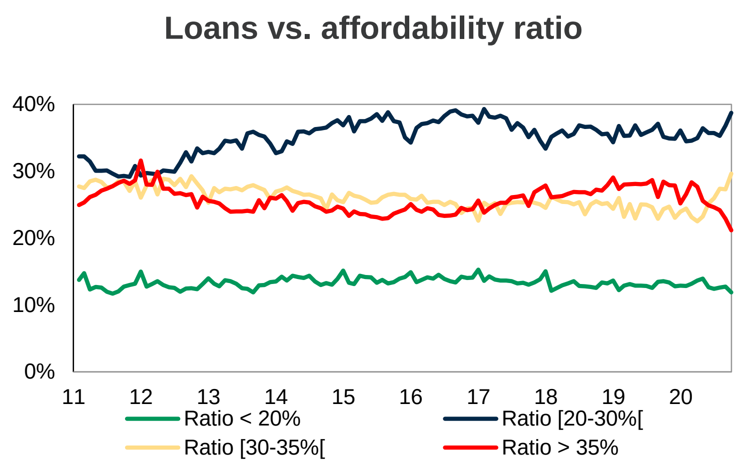
These incentives were introduced in addition to other crisis measures to protect incomes and business during the pandemic (state-backed loans, furlough schemes). Although they will reduce risk of business failures and rising unemployment in construction and help cement the gradual recovery expected in the second half of the year, they probably won't be enough to give a significant lift to sales of new homes.

FACTORS HOLDING BACK THE RECOVERY

SLIGHTLY TIGHTER CREDIT CONDITIONS



Sources : ACPR, Crédit Agricole SA / ECO



Sources : ACPR, Crédit Agricole SA / ECO

The High Council for Financial Stability (HCSF) warned in December 2019 about the deterioration in some conditions for granting loans and issued recommendations for banks, which were reiterated in September 2020.

- The average DSTI ratio or debt service to income ratio (1), which is an affordability ratio, is more or less stable over the long term at close to 30%, but the share of loans with a higher ratio (>35%) has risen since 2015. It increased from 23.6% in 2015 to 27.7% in 2019. The share is fairly volatile and was 25.8% on average in the period 2011-2019.
- The average term for new loans has increased steadily in recent years from an average of 18 years in 2015 to 20.4 years in 2019. 5% of new loans are taken out over more than 25 years.

➔ HCSF recommendations for banks

- 33% as the maximum DSTI ratio
- Maximum 25-year loan term
- Banks can only make exceptions from these criteria for 15% of their loan production
- Three-quarters of these 15% must go to first- and second-time buyers buying their main residence

(1) : Debt service to income ratio encompasses both capital and interest

FACTORS HOLDING BACK THE RECOVERY

SLIGHTLY TIGHTER CREDIT CONDITIONS

Loan production at a DSTI ratio > 35%

% of overall housing loan production

current situation	2019 average	Q3 2020
First-time buyers	4,4	3
Second-time buyers	13,3	11,9
Rental investors	5,4	3
Others	3,1	2,6
First/second-time buyers	**17,7**	**14,9**
Investors/Others	**8,5**	**5,6**
Total	**27,7**	**22,7**
HCSF's recommendations to banks		
First/second-time buyers	**11,25**	
Investors/Others	**3,75**	
Total	**15**	

Source: Crédit Agricole SA/ECO estimates, based on the ACPR survey data

Initial effects of these recommendations

Before coronavirus ravaged the economy and all else being equal, the HCSF's recommendations could have reduced loan production by around 10% in 2020, given the extent in the cut of high LTI component from 27% to 15%.

But the reduction could have been less steep. Some high DSTI borrowers could have dug into their savings (life assurance policies and home savings accounts) to up their deposit and bring the DSTI stil back below 33%.

In the first nine months of 2020, new mortgage loan production fell a little, a development that clearly has to do with the pandemic – which hasn't dried up credit – more than anything else.

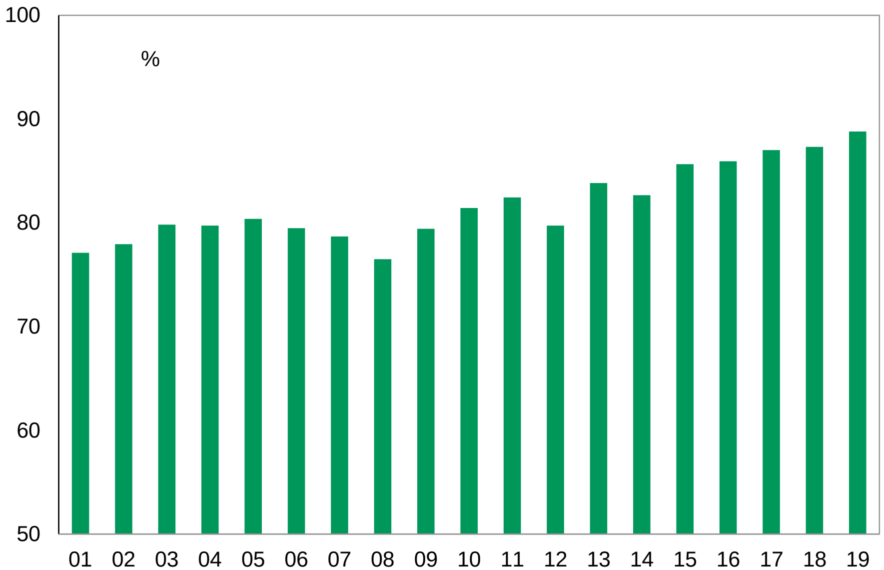
But the recommendations are starting to make themselves felt. Witness the findings from the surveys conducted by the French Prudential Supervision and Resolution Authority (ACPR): high DSTI loans as a percentage of loan portfolios are down to 22.7% in Q3 2020 and 21% in September, from 27.7% in 2019, 27.5% in Q1 2020 and 25% in Q2.

We should continue to see the effect of these recommendations as they gradually pare back the percentage of lending at high DSTI ratios.

FACTORS HOLDING BACK THE RECOVERY

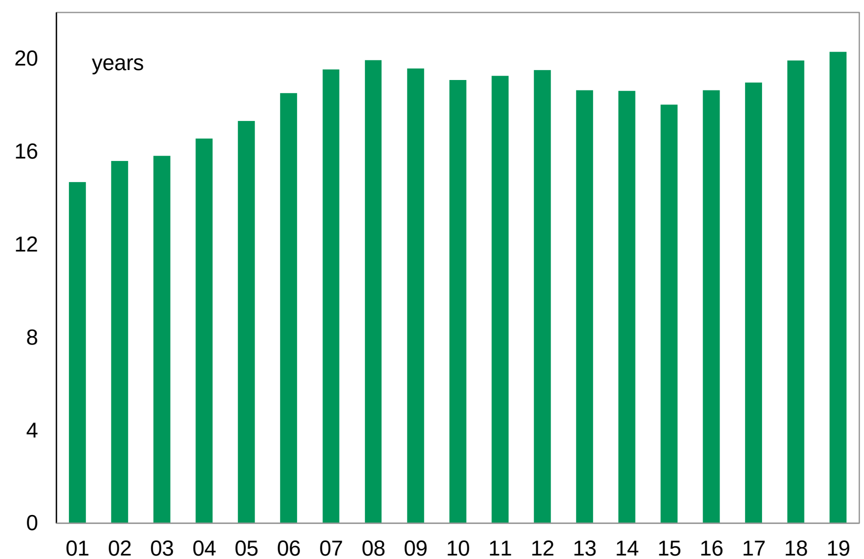
SLIGHTLY TIGHTER CREDIT CONDITIONS

Loan-to-value ratio at approval



Sources: ACPR, Crédit Agricole SA / ECO

Initial home loan term



Sources: ACPR, Crédit Agricole SA / ECO

The HCSF's recommendations and the hit to the economy (lower household income and higher unemployment) from Covid-19 could also tighten two aspects of lending conditions:

- term: the average loan term stretched to 20.3 years in 2019 from 19 years in the period 2011 to 2018; it very slowly shortened in 2020 to 20 years in Q1 and 20.1 years in Q2, but went back up to 20.3 years in Q3. We expect terms will shorten somewhat in the coming months.

- down payments: borrowers' personal contribution fell to an average of 11.2% in 2019, compared with 15.7% in 2011-2018. Q1 2020 saw deposits increase back to 13.6%, before falling again to 12.7% in Q2 12.5% in Q3. Deposits provided by borrowers are expected to increase in the next few months. The graph above shows the loan-to-value on the grant date. Down payment rate = 100% - Loan to value.

SUMMARY

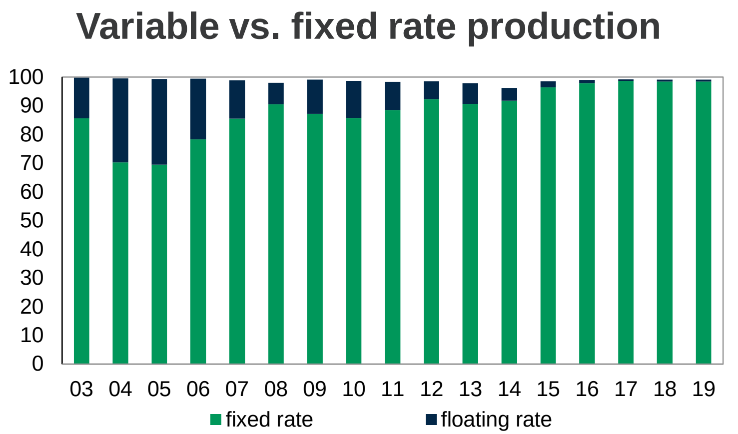
1 RECENT DEVELOPMENTS

2 FACTORS HOLDING BACK THE RECOVERY

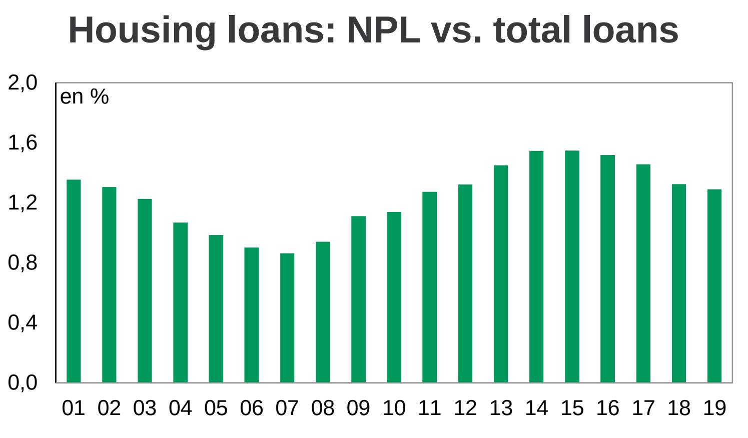
3 FAVOURABLE FUNDAMENTALS

FAVOURABLE FACTORS

MORTGAGE LENDING RISKS UNDER CONTROL



Sources : ACPR, Crédit Agricole SA / ECO



Sources : ACPR, Crédit Agricole SA / ECO

Despite the sharp decline in the economic environment, the tightening of home loan originations is expected to remain fairly moderate. This is not a property bubble bust (see slide 24). The model of French mortgage lending is a prudent one that keeps risk in check.

– Loans are granted based mainly on borrower solvency (rather than the property value)

– The average DSTI ratio is pretty stable over a long period at around 30% (see slide 15)

– “Reasonable” initial loan terms , even though it increased to 20.3 years in 2019

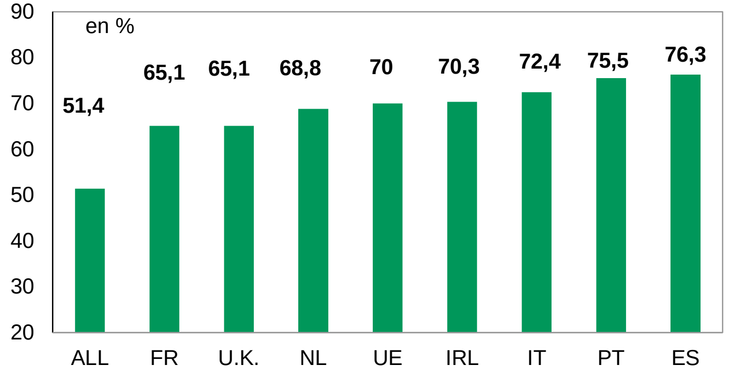
– 98.5% of loans in 2019 and 2018 were fixed rate

– Non-performing loans will increase in 2021 as the jobless rate rises. But it was a low 1.29% in 2019, down from 1.32% in 2018. Moreover, we think the support measures for households and potential payment deferrals should limit defaults and help keep NPLs at a reasonable level in 2020-2021. In our view, we are unlikely to see a credit crunch.

FAVOURABLE FACTORS

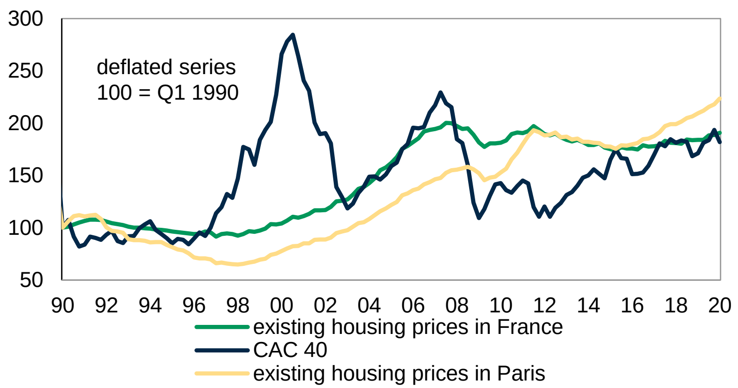
STRUCTURALLY HIGH DEMAND

Homeownership rate



Sources: Year 2018, Eurostat, Crédit Agricole SA / ECO

Real Estate and Stock Market



Sources: Notaries, Insee, Datastream, Crédit Agricole SA / ECO

There are many structural factors to support demand, which will continue in play despite pandemic and ensuing recession:

- the desire to own a home (65% of French own their homes, compared to an average of 70% in the EU);
- dynamic demographics;
- change in household structures (more single and divorced households);
- retirement planning;
- a saturated rental market.

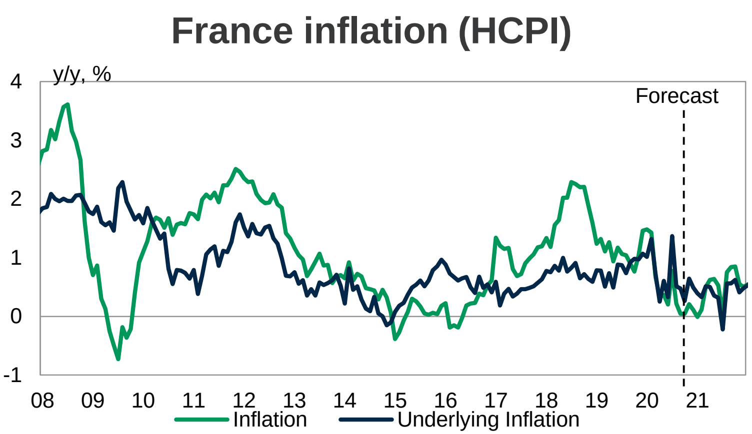
One vital factor will be even more decisive in 2020-2021 – the search for safe havens especially in a downturn amid volatile and uncertain financial markets. Stock markets plunged in the early days of the pandemic (the CAC40 hit a low on 18 March shedding 30% of its value at end February). Markets have recovered since, but remain very volatile. Financial investments earn little with rates at rock bottom or negative. As yields on rental properties are higher, at 3% in Paris and 4.5% outside the capital (gross yield for taxes and works),

French households will turn to real estate. Bricks and mortar give people a sense of security. They are tangible and the value of property is fairly predictable. Yields are pretty good and valuations are generally favourable over the long term.

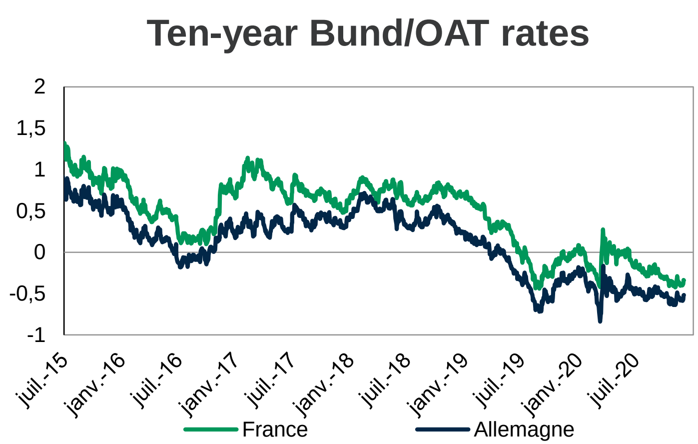
We see demand staying strong. It could tilt more towards greener homes (houses with gardens) as people spend more time working from home.

FAVOURABLE FACTORS

LONG RATES REMAIN AT ROCK BOTTOM



Sources : Insee, Crédit Agricole SA / ECO



Sources : Banque de France, Crédit Agricole SA / ECO

The yield on 10-year OATs fell again in 2019 to average +0.11% and again to negative -0.15% on average in the second half of the year. The yield stayed negative in the first six months of 2020 at -0.08% on average before declining further in the second half to -0.28% from July to November.

Our near-term view is for the 10-year OAT yield to stay extremely low: -0.3% at end 2020 and -0.2% at end 2021.

Why are yields so very low?

– The ECB's very accommodating monetary policy in response to the sheer scale of the economic and health challenges and the sharp deterioration in public deficit and debt ratios. Increase of net purchases of assets under the Pandemic Emergency Purchase Program (PEPP), set to €1,350 billion in June 2020, from the €750 billion set in March. They were scheduled to end in June 2021, but our scenario assumes that the ECB will increase its purchase programs covering the second half of 2021 and 2022.

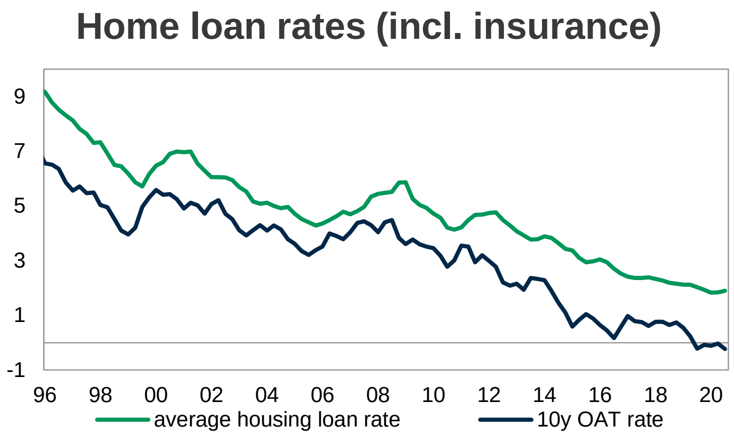
– Investor risk aversion and poor visibility producing an appetite for low-risk or risk-free bonds.

– Absence of inflationary pressures (sharp recession; risk of excess production capacity; falling commodity prices; rising unemployment and no pressure on wages).

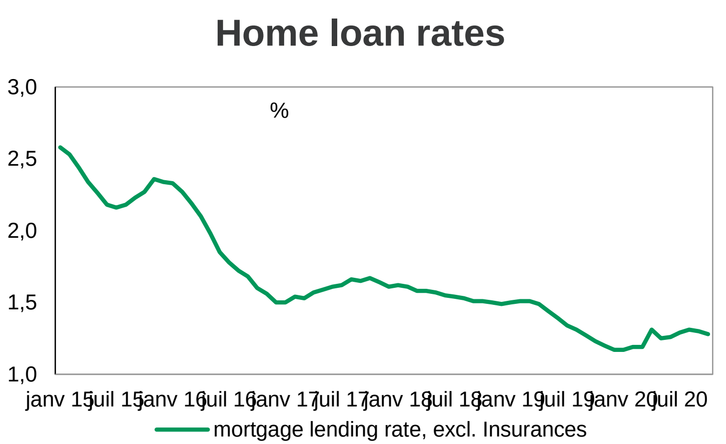
All of which has kept Bund rates negative, at close to -0.55% at the end of 2020 and -0.4% at the end of 2021. The OAT/Bund spread should contract to 20 basis points, keeping 10-year OAT rates very low, in a range of -0.20%/-0.30%.

FAVOURABLE FACTORS

ATTRACTIVE LOAN RATES



Sources : Banque de France, Crédit Agricole SA / ECO



Sources : Banque de France, Crédit Agricole SA / ECO

At 4.6% in 2012, the average fixed-rate mortgage (APR, including insurance, quarterly change) has fallen steadily since then: 3.1% in 2015, 2.05% in 2019, 1.8% in Q1 2020 and in Q2 2020. The rate ticked up to 1.9% in the third quarter.

– The pattern was the same on a monthly basis (fixed long-term loan rate before insurance). From an average of 3.9% in 2012, interest rates slid to 1.55% in 2018 and 1.36% in 2019. Rates hit a low of 1.17% late in 2019.

– They edged back up in 2020 to 1.27% in Q2, 1.30% in Q3 and 1.28% in October. Stripping out renegotiated loans, the pattern is similar: 1.28% in Q3 and 1.26% in October, from 1.14% at end 2019.

This gradual fall in lending rates stems from the steady drop in the 10-year OAT yield (the baseline for home loan rates) and stiffer competition between lenders as they seek higher volume to offset the lower rates.

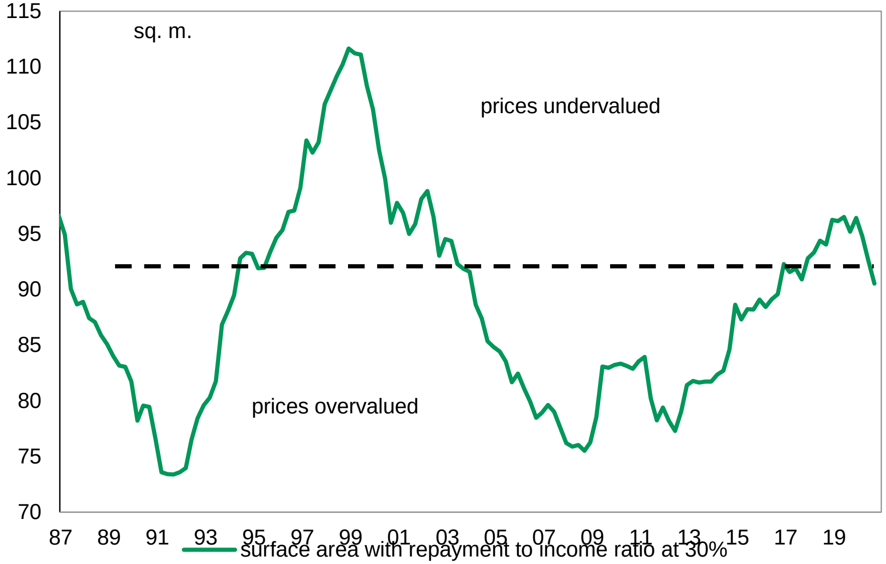
10-Year OATs should be close to -0.20/-0.30% at end 2020 and in 2021; competition is still fierce; on the other hand loan approvals are a little more cautious. We see mortgage rates remaining very low, not far from their Q3 2020 levels.

Still-low and attractive rates → the windfall effect and support for the real estate market remain in place.

FAVOURABLE FACTORS

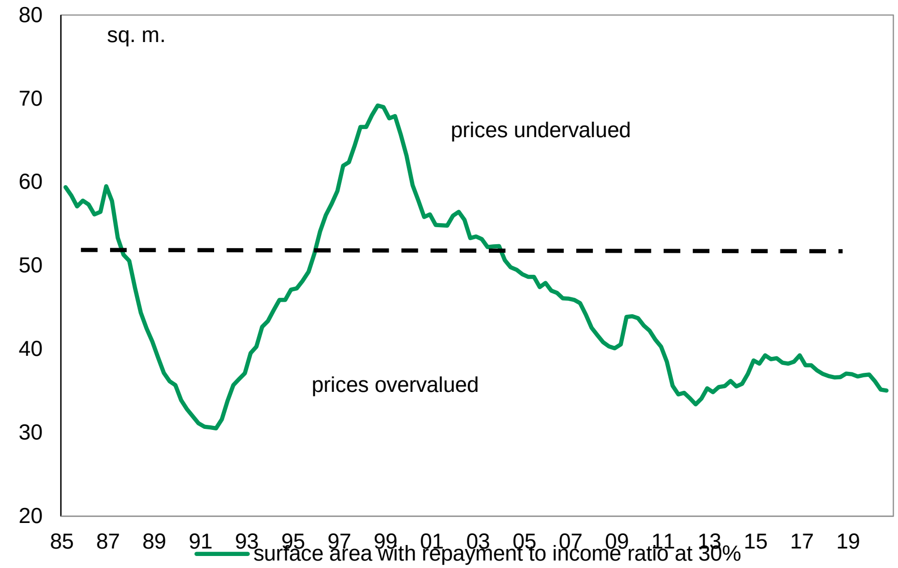
SATISFACTORY AFFORDABILITY IN FRANCE

Purchasing power in France



Sources: Clameur, Insee, Banque de France, Crédit Agricole SA / ECO

Purchasing power in Paris



Sources: OLAP, Notaries, Banque de France, Crédit Agricole SA / ECO

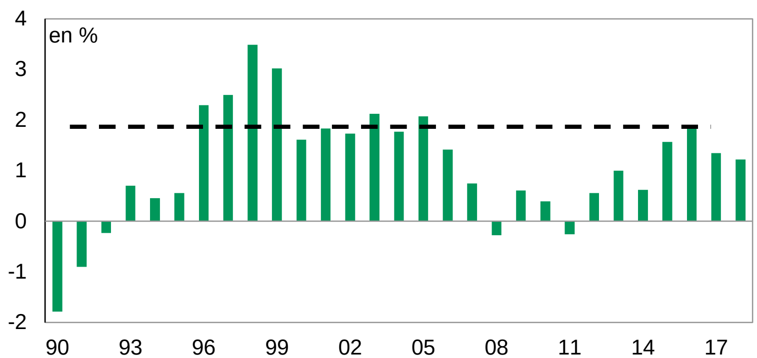
Home purchasing power = surface area that a first-time buyer on average income is able to purchase over time under market conditions with a DSTI ratio of 30%.

What people can afford to buy in France is satisfactory and close to the average over time. It even improved a little in recent years, as interest rates fell and terms lengthened. Prices are not overvalued. The level of purchasing power is not expected to hinder the market's recovery. What's more, as prices soften at the end of this year and in 2021, the purchasing power should improve.

But the picture is different in Paris and some other large cities where prices are definitely overvalued, which could take the bounce out of the rebound.

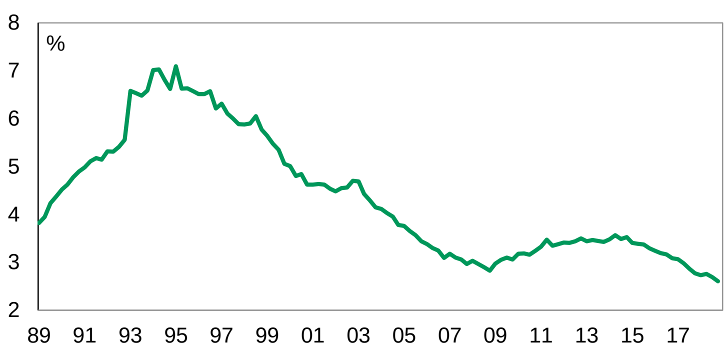
IS THERE A RISK OF A PROPERTY BUBBLE IN FRANCE IN 2021?

Risk premium Paris (residential)



Sources : Banque de France, Crédit Agricole SA / ECO

Household loans: NPL vs. total loans



Sources : Banque de France, Crédit Agricole SA / ECO

In general, prices are not overvalued and there is no major risk of a property bubble in France as a whole. But prices are very high and clearly overvalued in Paris and in some large cities like Bordeaux Lyon or Nantes.

Prices in these large urban areas are set to fall or stabilise under the impact of the pandemic and the slowdown in sales as a result. Yet the property boom of recent years in these cities is not like the speculative bubble of 1985-1991. A big drop in prices seems unlikely.

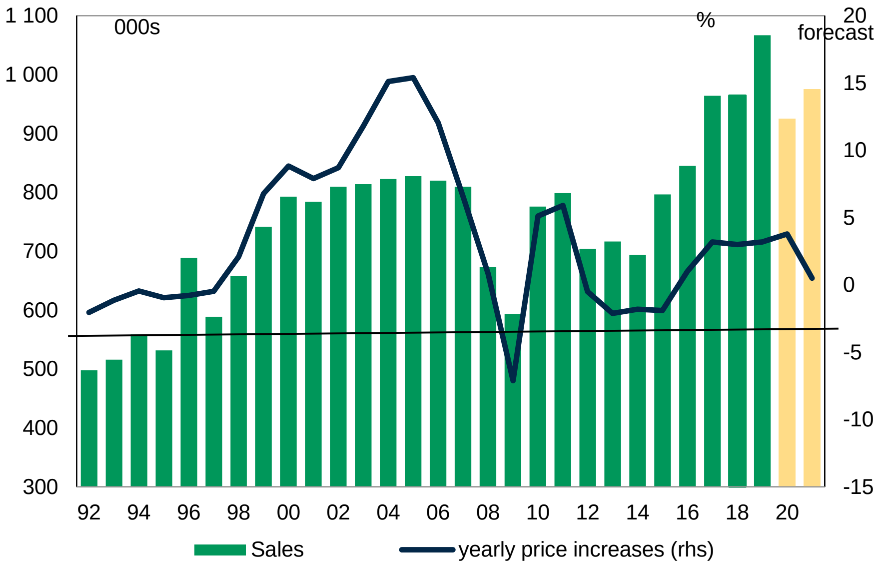
In 1985-1991, there were many signals of a speculative bubble, especially in Ile-de-France:

- Shortcomings in banks' risk control measures,
- High percentage of developers and real estate agents in the market, together with clearly speculative behaviour and a rush to short-term gains,
- Negative risk premium in Paris,
- Overblown forecasts (for rents, prices and income) by "traditional" buyers,
- Overheated sales, markets and lending,
- Very steep price increases (+17% a year in Paris),
- Sharp increase in non-performing loans.

None of these signals are evident in the current cycle.

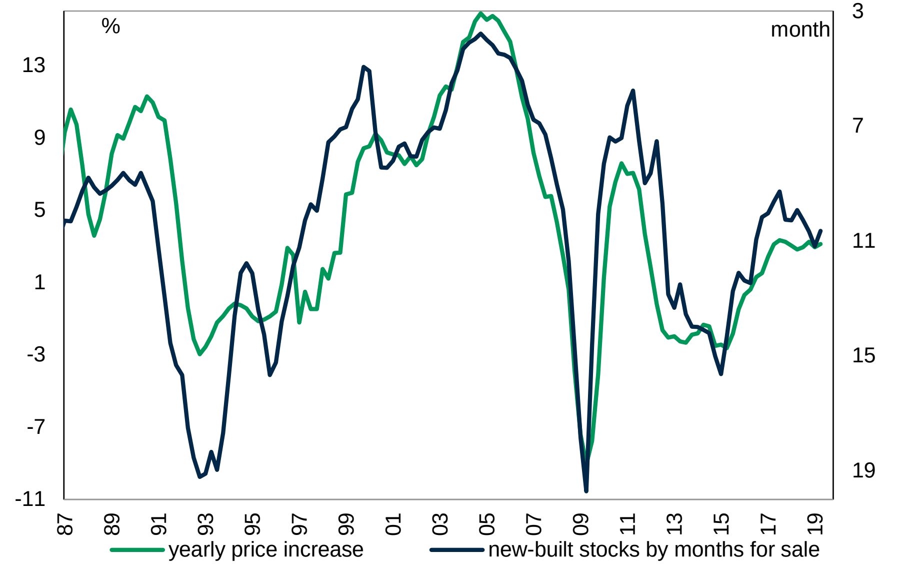
CAUTIOUS AND GRADUAL RECOVERY IN 2021

New build sales and prices



Sources: CGEDD, Notaries, Insee, Crédit Agricole SA / ECO

Prices of existing homes and stock of new builds



Sources: Ministry of Ecology, Notaries Crédit Agricole SA/ECO

We expect a 13% year-on-year decline in sales in 2020 in the second-hand segment and a 20% drop in sales of new builds (-25% for developer new builds sold on the retail market and -12.5% for all single-family homes).

Sales should pick up to a degree in 2021, particularly in the first half of the year, in a weak economy and with continued restrictions in place. Our forecast is for 975,000 units sold in the second-hand market, a rise of 5.5% on 2020 and a decline of 9% compared with 2019, and a slight increase in sales of new-builds.

Prices will stay stable overall in 2021, or fall somewhat, particularly in overvalued segments (Paris, Bordeaux, Lyon and Nantes). However, we see no sign of a significant drop as demand will remain robust in a market where supply is short.

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