Foreign direct investments
into French real estate
Abstract

The purpose of this thesis is to draw the global trend of Foreign Direct Investments (FDI) in the French real estate market since 2008 and to understand foreign investors' behavior and the incentives which urge them to invest in French property market. This study relies on the numerous yearly reports released by consulting and real estate companies and gives an overview of FDI since 2008.

From a legal point of view, the French property market is extremely organized. Acquiring, holding and selling real estate property is allowed for international investors. There is no restriction on international and no authorization is needed. Foreigners can freely invest but may have to declare their operations to the French authorities in charge of foreign investments legislation. Both these simple requirements and its attractiveness make French real estate an appealing market for foreign investors which represent between 40% and 60% from year to year.

In five years, global economic context has changed and new actors have appeared on the international stage. With more than €25 bn real estate investments in 2007, total transactions plummeted to €8 bn in 2009 and then have stabilized at around €15 bn in since 2011. While developed countries attempt to solve their financial and economic issues, emerging country investors from Middle East and Asia have the opportunity to get into the French market and develop their investments. New foreign investors focus on either Parisian offices or trophy assets, in order to foster their exposure, whereas traditional investors from developed countries - such as Germany, the UK, the USA, etc - usually more risk averse, look for secured and core assets in Paris or its suburbs which guarantee few risks and regular returns. The financial crisis of 2008 and the European crisis of 2010 stopped the financialization of real estate assets which resulted to irrational prices in French and more precisely Parisian market. Investors have come back to initial use of real estate assets which is now considered as safe haven investments.
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1. Introduction

Foreign Direct Investment (FDI) is defined as the foreign purchase of 10 or more of voting stock of an asset in a foreign country (O’Connor, 2003). The International Monetary Fund defines FDI as “an investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor’s purpose being to have an effective voice in the management of the enterprise”.

With $40 billion, France is in 2011 the 9th FDI host country in the world and the 3rd one in Europe, behind England and Germany. Among the different components of FDI, real estate investments weigh around €6 bn ($7.8 bn) i.e. around 20% of the total amount of FDI. In ten years, the weight of real estate in FDI has doubled. This figure shows the attractiveness of foreign investors for French real estate. The main foreign actors investing in France were, five years ago, the industrialized European countries such as Germany, Belgium, England, and Netherlands. However, the financial crisis of 2008 and the European crisis of 2010 resulted in a change of foreign investors' features. From now on, emerging country investors from Middle East and Asia have the opportunity to get into the French market and to develop their investments thanks to huge amounts of liquidity coming from a strong growth or natural resources.

1.1. Problem analysis

After two years of a tremendous activity, French real estate market collapsed in 2008 with a 56% decrease of investments (DTZ, 2008). The deterioration of the banks and the hardening of financing an investment through loan have modified the investment market. Between 2008 and 2012, the features of foreign investors have changed in terms of asset types and origins. New players have arrived on French market, such as Qatari or Asian funds opting mainly for trophy assets. Meanwhile, usual investors like American or German funds have become more reluctant to invest massively in France.

Real estate seems to be a safe investment for investors, especially for those with a lot of liquidity as investment funds. In 2012, more than 6 billion euro were invested in the French real estate market by foreign investors, i.e. 40% of global investments (€ 14.9bn) (BNP Real Estate, 2012). It has been the best year since the beginning of the crisis in 2008, in terms of foreign investments.
1.2. Purposes and objectives

Numerous quarterly and yearly reports explain the situation of the French investment market. The main goal of this thesis is to draw a global trend of foreign direct investments in French real estate since the beginning of the financial crisis in 2008.

France has always been an attractive country for foreign investors, but the financial crisis of 2008 has modified the outline of investment market. Data about direct property transactions involving foreign investors have been analyzed and players have been interviewed in order to describe the different kinds of foreign direct investments in France and their driving motives. Throughout the thesis, next questions will be asked:

- Who are the main foreign direct investors in France? And where do they come from?
- Why do they invest in French real estate? And what are their incentives?
- In which segments do they invest?

To answer these questions, the study investigates investment opportunities on the French market, factors motivating foreign investors, cross-border agreements, and yearly tendency. The thesis only focuses on a specific type of real estate investments: the Foreign Direct Investments (FDI).

1.3. Disposition

The first stage of the thesis is to explain the methodological approach to solve the problem. I present the sources of both quantitative and qualitative data, and how they have been analyzed. The second chapter describes an overall view of the French economy and explains the situation of the French real estate market during the period 2008 – 2012. I use the quantitative data from previous studies to support the description.

The third step provides an overview of the theory of Foreign Direct Investments. This part is based on scientific literature and the knowledge acquired at the university.

The following part focuses on the results from several studies made by consulting companies and real estate investment companies in order to get qualitative data. It explains foreign investors’ point of view and will give an evaluation of the French real estate market. And the last part is a overall evaluation of French market thanks to a SWOT analysis. This ends with the conclusions and draws a global trend of FDI in French real estate.
1.4. Limitations

The most difficult part of the research was to find available, reliable and accurate data about FDI in France. The task is not complicated for usual investors such as Germany or the USA because numerous analyses have studied their investments. However, only a few carry out studies about new investors like Middle East countries. Therefore, figures given in tables are more or less precise according to the country but they are interesting to analyze their evolution and their proportions. This study tries to draw a global evolution of the investments and to understand the mechanism.

Besides, a questionnaire was sent out by mail to numerous companies, but I got only few answers from them. They usually try to keep low profile with their investments, especially with their results and the trade amounts. The only replies were from Scandinavian investors, who are seen as the most transparent actors in real estate global market. Therefore, I tried to evaluate French real estate market thanks to a SWOT analysis which is a strong method to identify the features of a market and its investments. Finally, the questionnaire can be found in the appendix at the end of the thesis.
2. Method

2.1. Choice of method to use

The method used in this thesis is the same as Olga Chernysheva (2011) and Brian O'Connor (2003) which is an empirical method. This approach is based on a theoretical part, a data part and an analysis part. The theoretical part provides information and knowledge in order to understand the topic. This introduces and describes the notions used throughout the study. In this thesis, the theoretical part explains the theory of Foreign Direct Investments (diversification, portfolio theory, etc) and the current situation of the French real estate market (different segments, evolutions of the prices, etc). It gives the tools and describes the background to analyze the data given in the second part.

The second stage presents the data gathered for the thesis. Two kinds of data will be treated: quantitative and qualitative data. Quantitative data are measurable, quantifiable, identifiable and numerical. In this study, they are the amount of transactions, the number of investors, the number of square meters, etc. If enough quantitative data are gathered, an accurate trend can be defined of the evolution of the market. On the other hand, qualitative data are descriptive information to which a numerical variable can be given. They are useful when we try to explain a behavior, an attitude or a situation. In this study, they are the origin of the investors, the types of assets, the incentives and the explanation of investors’ behavior.

2.2. Choice of data source

The theory of FDI provides from articles from scientific reviews, academic studies, textbooks and specific websites. A large literature, more or less recent, exists about this topic and gives the key-notions to understand the dynamic of investment theory and especially the one of FDI.

The quantitative study of FDI in France was run thanks to the OECD statistics and companies’ reports. Every real estate focused company publishes quarterly or yearly publications, explaining in detail the global situation of the market. I had to read through French reports to get relevant information. All the literature was found in KTH library, in my own French school library and on the internet. Companies’ publications are more or less available for non-professional public, especially for the oldest ones.

For the qualitative data, I have used reports released by audit companies such as Ernst & Young or Deloitte which give good analyses of the trend. They explain investors’ behavior from an financial and accounting point of view. Information about recent trends and developments was obtained from publications of real estate advisory companies like DTZ company, research institutions and official
web pages. Those official data enables to understand the situation and to get reliable information. Besides, a questionnaire was made so that obtaining direct answers from managers and to understand their underlying expectations and motivations. This questionnaire was sent by mail to the main players of real estate market. Most of their companies did or are doing transactions in France. I tried to directly get the professional email of the managers to get more accurate answers. In addition, I used the phonebook of the numerous alumni of my French civil engineering school in order to reach real estate managers. The questionnaire was made on the website SurveyMonkey, which is specially designed for creating questionnaire and collecting answers. My questionnaire is made on the model of the one created by Olga Chernysheva (2011) of her study about FDI in Sweden.

The goal of the questionnaire is to obtain a maximum of relevant answers from real estate managers. I had to design an efficient questionnaire, which means accurate, understandable, and easy to fill. It was designed in the way that it requires less than 10 minutes to complete it. This questionnaire is easy to complete since respondents only have to click on the link I sent them and reply online.

To implement a relevant and efficient questionnaire, it is important to follow some elementary rules. First of all, the length of the questionnaire must be limited. If we want numerous people to complete the survey, it must be as short as possible. It means questions must be relevant, not redundant and without ambiguity. Then, the use of grids is usually easier for the respondent to answer, but the number of choices must be limited. Finally, the order of the questions is a key element of a good questionnaire, and it is better to start with general questions and then to ask more and more specific questions as respondent reads the questionnaire.

Even if I got only few replies, the theory of making questionnaire is interesting because many real estate advisory companies use them to draw investors’ point of view and to draw perspectives of the market. Besides, I can wonder why I got so few replies from investors. First, I think I didn’t sent them out to the best contact-people. In financial sector, little information is allowed to be released by employees. It is necessary to pick up people who are allowed to talk about financial data. Finally, foreign investors prefer to be low-profile, especially sovereign wealth funds from Asian and Middle Eastern countries.
3. Theories of Foreign Direct Investments

Foreign direct investment (FDI) is defined as “an investment in which a firm acquires a substantial controlling interest in a foreign firm (above 10 percent share) or sets up a subsidiary in a foreign country” (Chen, 2000). The International Monetary Fund adds “the investor’s purpose is to have an effective voice in the management of the enterprise”. FDI is not only a financial transaction between two foreign enterprises, in which one company invests in the capital of the other one. This transaction gives to the investor lasting management of the company and a direct control over assets. FDI investors take in whole or in part the control of the management of the firm and its strategy.

FDI is different from Foreign Portfolio Investment (FPI). FPI is an investment in a portfolio of foreign securities such as bonds and stocks, without getting any managerial control over the firms. Usually, FPI is considered as a short-term process whereas FDI is long-term.

Little literature focused on the FDI real estate has been written until today, as a result the theory won't be limited to FDI in real estate sector. We assume that determinants of FDI are significantly identical since we study them from a macroeconomic point of view.

There are numerous theories about FDI and their relevance depends on the context of the investments (Blonigen, 2005). According to Imad A. Moosa (2002), all these theories can be classified under the following headings: theories assuming perfect markets, theories assuming imperfect markets, other theories. Besides, we must keep in mind that the most important reason for undertaking FDI is profit making.

3.1. Theories assuming perfect markets

According to the book “Corporate Finance” written by J. Berk and P. DeMarzo, a perfect market assumes a set of conditions such as:

- There is no corporate or taxation cost
- Capital markets are efficient
- Interest rates are equal between lending and borrowing, individuals and businesses
- Capital structure doesn't affect management incentives

3.1.1 The differential rates of return hypothesis

This is one of the first theories to explain FDI flows around the world. This hypothesis assumes that capital flows from countries with low rates of return to countries with high rates of return. It postulates that the only variable influencing the investment is the rate of return and the risk is neutral. Risk neutrality is between risk-averse behavior and risk seeking behavior. This hypothesis implies that
investors perfectly substitute home country with host country without considering any risks. The differential rates of return hypothesis is arguable since it means capital only flows in one direction, from the low-rate countries to the high-rate countries (Moosa, 2002). Even in a perfect market, this makes no sense. Otherwise, only some countries would not get any FDI and would only invest abroad.

### 3.1.2 The portfolio diversification hypothesis

Contrary to the previous hypothesis, the portfolio diversification hypothesis takes risk into account which becomes one of the main variable as the rate of return. The goal of diversification is to reduce the global risk of the portfolio, and maximize its rate of return. Therefore, it is necessary to invest in several different markets, i.e. in different countries. Capital can flow from or to lower-rate countries, as soon as an arbitrage is possible. In a perfect market, it is possible to determine the risk of an investment. Risk can be measured by variance or standard deviation of former rates of return. This method is based on mean-variance portfolio calculations introduced by Markowitz (1952). By combining investments with different correlations, the desire of minimizing or reducing risk can be achieved, if the diversification is good. Even if this hypothesis is superior to the previous, some problems can be encountered. Indeed, risk and return are computed from historical data that is unlikely to equal current one.

For an asset, there are two kinds of risk: diversifiable risk and systematic risk. The first is considered as independent risk, since it is only related to the own risks of the assets. Thanks to diversification of a portfolio, diversifiable risk can be minimized by combining different assets which are not correlated (Berk and Demarzo, 2011) and so risks will average out. Portfolio managers have to combine the best assets to diversify risks. On the other hand, systematic cannot be diversified because fluctuations of asset’s return are due to market-wide common situations which would affect all assets and so the entire portfolio.

### 3.1.3 The market size hypothesis

According to this hypothesis, the market size of the host country influences the volume of FDI. Market size can be measured by the country’s GDP or the sales of a multinational company in that country. When the size of the market of the host country has “grown to a level warranting the exploitation of economies of scale, the country becomes a potential target for FDI inflows” (Moosa, 2002). Indeed, a market which is large enough enables focusing on the tools of production and therefore reducing overall cost. The main problem is to determine the best proxy which accurately describes the market size. Some studies such as the one of Moore in 1993 or Wang and Swain in 1995, using the real GDP (inflation-adjusted GDP) as proxy, found it as a relevant role for attracting FDI
inflows. Other researchers (Love and Lage-Hidalgo, 2000) took GDP per capita as proxy and discovered a significant relationship between it and FDI flows.

Finally, the most important variable is the size, no matter which proxy is used. A survey made by A.T. Kearney, asked 135 executives of the world’s 1000 largest companies to give a mark on a scale of 0-3 for the probability of investing in a specific country. The result shows that the top three countries for FDI consist of USA, China and Brazil, which represents some of the biggest market size. Even if the ranking doesn’t exactly match the one of countries in terms of size, we can consider market size as a significant variable.

3.2. Theories assuming imperfect markets

A market is imperfect when it does not meet the requirements of a perfect market. In real markets for example, there are financing costs which enables interest tax shields; taxes on the income they earn from their investments which lower assets’ return, or a lack of communication which avoid information to be released to all the investors. Therefore, some arbitrage can happen more often than in a perfect market.

3.2.1 The industrial organization hypothesis

According to Hymer (1976), Caves (1982) and Dunning (1988), the industrial organization hypothesis explains that companies are willing to spend their money in FDI only if advantages arising from intangible assets are large enough to overcome disadvantages of investing in a foreign country. These disadvantages come from differences in language, culture, behaviors, and other inter-country differences (Moosa, 2002). They are more or less significant depending on the knowledge of the investor about host culture habits. For example, management of team is different from one country to another. Japanese managers don’t behave as French managers because rules of conduct in a company are specific to a culture. There are some international caveats. Intangible assets are firm specific features which, in the case of FDI, must be transferable to a foreign subsidiaries (Kindleberger, 1969), such as a well-known brand name, patent-protected technology, managerial skills.

FDI arise when a company has very strong intangible assets which cannot be sell or lease. They are either inherent to a company or impossible to sell. Lall and Streenten (1977) made a list of the different advantages that cannot be transferred to another company: technology, marketing, management, bargaining and political power, marketing of scale. All these factors explain why a company prefer to invest as FDI rather than another cross-border operation. However, the choice of the host country is not interpreted by this hypothesis, which might be considered by next hypothesis.
3.2.2 The internalization hypothesis
This hypothesis explains that investors indulge in FDI in order to minimize marketing costs by replacing them with internal transactions (Coase, 1937). Forming one multinational entity gives the advantage of avoiding intermediates and therefore time lags or additional costs. The more external intermediates there are, the more willing to FDI investors are (Buckley and Casson, 1976). In that case, companies replace some of market functions with internal processes and avoid uncertainty. Besides, the internalization prevents sensitive information from being released. This is particularly true in companies based on high R&D expenditure, even though all their innovations are protected by patents. But this internalization occurs only if the benefits of internalization outweigh costs (Moosa, 2002).

The internalization implies vertical forms of FDI developing new upstream or downstream activities of the production chain.

3.2.3 The location hypothesis
This hypothesis comes from “the international immobility of some factors of production” (Horst, 1972), such as natural resources or labor, which creates location differences in the cost of production. One of the main location-related differences is the wages. The difference of wages between host country and home country of the investor is an important determinant of FDI. Developing countries such as China or India have much lower wages than developed countries, which attract FDI from them, especially for labor-intensive production, i.e. low value-added production. This hypothesis was showed by Moore in 1993 when he noticed that a rise in the host countries’ wages negatively affects FDI. Some studies as the one of Riedel in 1975 described relationship between low wages and export-oriented FDI. Countries with high wages invest and produced in countries with low wages, and then export production out of host country.

The location hypothesis not only comes from low wages. Location of raw materials such as copper or uranium mine affects the choice of investing in one country instead of another, since the company gets advantages of the proximity: it can avoid delivery delays and make savings in the delivery. Besides, one more advantage may be the lower cost of capital and therefore increase their profit (Love and Hidalgo, 2000).

3.2.4 The OLI paradigm or eclectic theory
The OLI paradigm attempts to form a global framework to explain why multinational enterprises prefer FDI to enter in a foreign market instead of using alternatives modes such as exporting, licensing, management contracts or joint ventures (O’Connor, 2003). The word “OLI” is the acronym of:
• “O” as owner-specific advantages, which represent competitive advantages specific to the ownership of the investing company such as trademark, economy of scale, production techniques (Twomey, 2000). Those specific advantages are transferrable abroad and usually improve the economy of scale.

• “L” as location-specific advantages. The firm must be interested in specific features in the foreign market such as the presence of raw materials, lower taxes, lower wages, or transport costs (Twomey, 2000).

• “I” as internalization, the firm tends to improve its competitive position by controlling the complete value-chain of its production. The company gets the advantages to have their own production instead of relying on an external partnership. It leads to FDI rather than joint venture, licensing or outsourcing (Dunning, 1993).

The OLI paradigm is also known of the eclectic theory of FDI since three groups of conditions determine whether a company has to use FDI (O’Connor, 2003).

3.2.5 The oligopolistic reaction hypothesis

The oligopolistic reaction can be defined as the follow-the-leader theory which means FDI of a company urge other companies of the same sector to do the same in order to keep their market shares (Knickerbocker, 1973). Companies try to maintain a competitive equilibrium and therefore refuse the initiating company to get any advantages thanks to its FDI. This behavior is especially true in a very competitive market in which non participant can avoid what the other companies are doing (Lall and Streeten, 1977). This theory explains companies invest as a reaction to the initiative of the first investing company, but it doesn’t clarify why the initiating firm uses a cross-border investment as FDI (Lizondo, 1991).

3.3. Other theories

3.3.1 The currency areas hypothesis and the effect of the exchange rate

This hypothesis tries to explain FDI in terms of the difference between strong and weak currencies (Aliber, 1970). It states that countries with a strong currency tend to invest overseas whereas countries with a weak currency do not. As a result, it means countries with strong currencies tend to be investing countries while the one with weak currencies tend to be host countries of FDI. Indeed, the strength of the home country currency lower the capital requirements and the cost of capital of foreign investments in domestic currency units (Liang, Yoon, 2011), what enables to raise capital easier. Besides, the depreciation of a currency tends to attract more foreign investors since the labor and asset costs in the host country are cheaper for them (Froot and Stein, 2011).
On the other hand, investing in a foreign country can be considered as an alternative to export (Moosa, 2002). If the currency of the home country is too high for a longtime, it can be interesting for a company to invest abroad in order to keep their competitiveness of exporting.

3.3.2 Political risk and country risk

Inflows of FDI are influenced by the political stability of the host country (Kamga Wafo, 1998). Dan Haendel defines political risk as “the risk or probability of occurrence of some political events that will change the prospects for the profitability of a given investments”. Indeed, political risk can lead to unexpected changes of the legal or fiscal framework in the host country which can modify the expected outcome of an investment. According to Stevens (2000), level of political risk in host countries affecting FDI can be evaluated by five main criteria: (1) relevant legislation, (2) system the number of years a government is in power, (3) specific governments hostile to FDI coming from the home country, (4) revaluation of the currency in a fixed exchange rate, (5) legislation repatriation restrictions on dividends to the parent firm. In that case, it is harder to get a clear vision of what host country’s government will behave in the future and this can discourage FDI inflows (Schneider and Frey, 1985).

3.3.3 Tax policies

The commitment of multinational companies in FDI is affected by domestic and foreign tax policies (Jun, 1989). Indeed, the net return on FDI is directly influenced by the tax treatment of income generated overseas since the higher taxes are, the smaller the net return is. Then, tax policies influence the relative cost of capital of domestic and foreign investments since the higher taxes are, the more expensive the cost of capital is.

However, in order to regulate FDI inflows, governments are able to adapt their policy with the aim of encouraging or discouraging inward FDI by either offering incentives or disincentives (Moosa, 2002). There are several kinds of incentives but the main ones are financial, fiscal and taxes incentives, but also market preferences and flexible conditions. This encourages FDI especially for the smallest companies (Reuber, 1973). Disincentives enable the host country to decrease FDI either to save local companies or to maintain a total state control. Governments can use several tools or mechanisms such as slowing the process of getting an administrative authorization or not allowing foreign companies to invest in certain areas. Besides, some rules can be set like employing a minimum numbers of local workers or limiting profit repatriation.
3.4. Effects of FDI

FDI implies financial capital flows, technology transfer and other skills such as marketing, accounting, management. For both the investing country and the host country, it results in costs and benefits. Therefore, a FDI is acceptable and can be initiated if the expected benefits are greater than the costs to be borne. Researchers have distinguished on one side developed countries and on another side developing countries, since the inflow of FDI can result in modifications of inner country market (Chernysheva, 2011). Even though some consequences of FDI can be negative (financial incentives for foreign investors can weaken local companies for example), main FDI effects are positive for both home and host countries:

- **Transfer of technology and knowledge**: investing companies introduce research and development in the host country, and transfer their knowledge to local workers or domestic companies (subcontractor or suppliers for instance). They also transfer techniques for quality control or standardization to their suppliers. Besides, they introduce new know-how by training workers who may work in a local company later. (Blomström and Kokko, 2003).

- **Foster capital flow**: FDI can add liquidity to a market and foster development of the market thanks to available cash. Finally, it can increase tax and fiscal revenues for the government. Some recent studies state that inward FDI have a significant positive impact on economic local growth in the recipients countries (Dimelis and Louri, 2002).

- **Develop local market**: the presence of a foreign company with a new knowledge can trigger the establishment of local industries dealing with it. Local firms will have to improve their managerial efforts and meet the standards used by the foreign company, especially for subcontractors.

- **Stimulate competition and so improve the efficiency or the creativity of local companies**, by stopping a situation of monopoly and establishing competition between local and foreign companies.

To conclude this part about FDI theories, we have to bear in mind that no single theory can fully explain the mechanism and the process of FDI. Obviously, the real world and market cannot be described through previous simplifications and hypothesis such as notions of perfect or imperfections markets. However, they give us an approximate explanation of investors’ behavior and their incentives. We have to considerer none measurable data such as historical or cultural issues, and the evolution of host economy. That is why next part will draw a global situation of the French economy and its real estate market for the last few years.
4. French real estate market

4.1. Background

France is the 5th largest economy in the world, just behind the USA, China, Japan and Germany. In 2010, it was the 5th largest importer and the 6th largest exporter. The financial crisis in 2008 has affected French economy and caused its recession in 2008 and in 2009, during four quarters, with 0.5% decrease of the French real GDP (scoreboard attractiveness). The economic recovery has taken place since 2010 with an average annual growth of 1.7% of the French GDP (World Bank) in 2010 and 2011, but a virtual flat growth in 2012 (Insee). Since 2008, the unemployment rate has constantly increased, going from 7.5% of the working population in 2008 to 10.5% in 2012 (Insee, 2012) i.e. 3.13 million people. This is the highest rate for 15 years.

![Graph 1](image)

French economy is based on two main sectors:

- First, the tertiary sector: it represents roughly 70% of the GDP thanks to the tourism (first visited country in the world with more than 80 million tourists in 2011), financial services (BNP is the third biggest firm in France), and insurance services (AXA is the second biggest French company)

- Second, the industrial sector: It weighs 20% of French GDP, thanks to nuclear companies (Areva), military research (Thales), luxurious industries (L'Oreal, French fashion houses) and the food-processing industry (Danone). For 10 years, industry has been a sector undergoing changes. While heavy industries are disappearing with approximately 1300 plant closures, high-technology industries are developing thanks to constant innovation (Insee).
France has a key role in the international investment arena. About 30,000 French companies have done a deal abroad whereas 20,000 foreign companies have set up business in France (France attractiveness scoreboard). In 2011, France was ranked 4th in the world for FDI outflows with 5.3% of global flows, and 9th in the world for FDI inflows with about $40 bn. In Europe, France is the third recipient of FDI, just behind Belgium and the UK.

According to OCDE forecast, the expected growth of the French economy in 2013 will be close to zero. This is can be explained by the constant increase of unemployment and the decrease of consumer purchasing power, due to structural reforms and the requirements of the reduction of public debt (CBRE, 2012). Despite these dark expectations about French economy, the France government bonds yield is still low, about 2% for 10-year bond (Banque de France), meaning investors trust French debt and are willing to invest in this debt. Therefore, property loan rates have reached the lowest level of the history (Observatoire Crédit Logement / CSA).

4.2. Real estate market in France

Development of French property market is strongly related to and influenced by the general economic cycles. Thus, we can notice, on the graph 1 below, the fall of investments in 2008-2009 just after subprime mortgage crisis. The first consequence of this crisis was a 56% decrease of global investments in commercial real estate (DTZ, 2008). Cross-border investments shrank as foreign investors tried to limit the damage by focusing on their own domestic market. Besides, the difficulties in obtaining financing through loans limited the number and the nature of investors. The total amount of investments fell in 2012, notably because of the end of the tax incentive established by the article 210 E which allowed a reduced taxation rates on capital gain (Legifrance). From 2006 to the end of 2011, the article 201 E of the French tax laws enables the sellers to get a reduced taxation rate on capital gain from the purchase of property assets to Real Estate Investment Trusts (REIT). Its goal was to urge companies to outsource their real estate assets (Jones Lang LaSalle, 2011). This tax incentive could be only used by domestic investors.
French corporate real estate is a geographically-focused market in which Paris and its suburb are overwhelming present – about 77% of new investments took place in Paris area (graph 2 opposite). As risk-averse people, especially since the crisis, investors mainly seek core and prime safe opportunities (DTZ, 2012). These requirements urge to focus on offices in Paris and town-center shops in major urban centers. As a result, the market was split in two: sluggish in the French provinces and the large suburbs of Paris, but extremely active in central business district (CBD) in Paris.

The average size of investments recorded from 2008 to 2011 is about €21 million. The difficulty of financing in 2008 caused the fall of mega-transactions over €200 million to only 3. In 2012, the number of this kind of deal was 12, thanks mainly to foreign investors which look for symbolic purchases such as middle-western funds (DTZ, 2012).

4.3. FDI into French real estate

Foreign direct investments play a considerable role in the French economy. Since 2008, about 700 projects a year have been running by foreign investors in France (L’expansion, 2013) and so FDI net inflows have amounted on average to 1.5% of French GDP (Worldbank, 2013). In 2007, FDI into French real estate weighed 60% of property investments. But after the crisis of 2008, the features of the French real estate have changed and the trend was reversed. The share in volume of FDI into real estate has decreased whereas the one of French investors have increased, reaching almost 75% in 2010 (DTZ, 2011).
However, in 2012, even though French investors were the most active, their market size fell by more than 7%, to 55% of global transactions. New unusual foreign investors have been involved in transactions and increased their exposure to the French real estate market, such as Middle Eastern and Asian sovereign funds. The biggest transactions were basically carried out by rich foreign investors. These new investors focused on trophy assets which are sold by French institutional investors because of increasing financial tensions (DTZ, 2012). Their strategy is to secure their capital by investing in core assets. Indeed, 87% of the transactions exceeding €200 million were made by international investors (CBRE, 2012).

<table>
<thead>
<tr>
<th>Asset type</th>
<th>City</th>
<th>Vendor</th>
<th>Purchaser</th>
<th>Price (€million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail/Office</td>
<td>Paris 8th</td>
<td>Groupama</td>
<td>QATAR INVESTMENT AUTHORITY (QIA)</td>
<td>515</td>
</tr>
<tr>
<td>Office</td>
<td>Paris 9th</td>
<td>Kan Am</td>
<td>QATAR INVESTMENT AUTHORITY (QIA)</td>
<td>312</td>
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<tr>
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<td>Kan Am</td>
<td>QATAR INVESTMENT AUTHORITY (QIA)</td>
<td>300</td>
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<tr>
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<td>Crédit Agricole</td>
<td>ABU DHABI INVESTMENT AUTHORITY (ADIA)</td>
<td>252</td>
</tr>
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<td>Office</td>
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<td>AXA</td>
<td>UNION INVESTMENT REAL ESTATE, german</td>
<td>240</td>
</tr>
<tr>
<td>Office</td>
<td>Paris 13th</td>
<td>AEW Europe</td>
<td>DEKA IMMOBILIEN EUROPE, german</td>
<td>169</td>
</tr>
<tr>
<td>Office</td>
<td>Neuilly-sur-Seine</td>
<td>Foncière Massena</td>
<td>ING REAL ESTATE, dutch</td>
<td>110</td>
</tr>
</tbody>
</table>

Table 1
In the aftermath of the financial crisis, foreign investor profile has changed. German investors, who used to be involved into the French real estate market, started investing less and less in France. Indeed, 13 real estate German funds are going bankrupt (Option finance) and have to sell their assets. The total amount of these compulsory sales represents about €20 bn i.e. 8% of European global volume (DTZ, Q2 2012). On the other hand, the share of American investors shrank between 2007 and 2009 because of sub-prime crisis, but it is slowly improving for 4 years, and represents 8.5% of total investments.

Before 2009, Islamic investors were absent from French economy, especially in the real estate sector, even though they were less affected by the crisis and had a lot of capital. Indeed, before this year, France didn't have legal framework adapted to business sharia rules, what Great Britain did. The implementation of a sharia-adapted legal framework in 2009 has urged Islamic investors to do business in French real estate. In 2012, Middle Eastern investors corresponded to 15% of investment volume.

The strategy of diversification depends on investors’ nationality but office and retail are the most searched assets for investments by foreigners. Only English investors tried to diversify by purchasing different kinds of asset types, especially retail and industrial types (see graph below), whereas Asian investors only deal with office. All together, more than 70% of transactions are made with office, regardless the period or the current financial situation.
4.4. Legal features for FDI into French real estate

From a legal point of view, the French property market is extremely organized. Acquiring, holding and selling real estate property is allowed for international investors. There is no restriction on international and no authorization is needed. Foreigners can freely invest but may have to declare their operations to the French authorities in charge of foreign investments legislation (law 2005 – Mazars 2008). Indeed, every purchase higher than €15 million have to be declared to the Banque de France and the ones higher to €1.5 million to the ministry of finance, in order to be counted in statistics. This enables to get global statistics and to draw more accurate outlooks of property market.

Foreign investors could invest in French property in different ways:

- Directly
- Through a local company: either SARL (Société à responsabilités limitées), or a SA (Société Anonyme), or a SAS (Société par actions limitées)
- Through a non resident company
- Through a SCI (Société Civile Immobilière)
- Through a two-tier structure: a French company owns the property asset, and the shares of this French entity are held by the foreign holding company (usually in Luxembourg or Belgium). With this kind of system, the sales of the shares are not taken into account the French capital gains taxation.
Below, the general legal features for FDI into French real estate (PWC, 2011):

- **Rental income**

  In France, net rental income is taxable at a rate of 33.33%. The corporate income tax is 34.43% if taxable income exceed € 2,289,000.

  However, the effective tax rate is usually lower since local and non-resident companies are allowed to deduct from their taxable income interest expenses related to loans borrowed from a third parties and property-related costs. Besides, investors are allowed to deduct other types of business costs such as acquisition costs.

- **Depreciation**

  Companies have to individually book each component of a property and depreciate accordingly, such as structures, facades, heating system, interiors, etc. With particular entities like SCI (Société Civile Immobilière), the amount of net rental income (difference between rents and property-related costs) may limit the deductible depreciation charge.

  Moreover, under certain circumstances, buildings are treated as inventory, not depreciated assets, especially for developers or brokers.

- **Capital gains on the sale of property**

  Local and foreign companies which realized capital gains on the sales of French properties or French real estate shares are taxed at 33.33%. However, a reduced corporate tax of 19% is used for the capital gains realized upon sales of listed real estate shares, held for at least 2 years.

  Besides, for foreign companies, a 33.33% withholding tax is used for capital gains realized upon sales of French properties or shares in entities in which French properties are their main assets. If listed shares are sold, the 19% withholding tax is used.

- **3 % tax**

  When French or foreign entities owning either directly or indirectly real estate properties in France only perform a professional rental activity, property tax figures up to 3% and is levied once a year, based the French real estate property market s at 1 January.

- **Real estate transfer tax / Value added tax**

  Depending on the use and the characteristics of the property, the tax for the acquisition of the legal title of a French property is either the real estate transfer tax at 5.09% or the real estate value
added tax (VAT) at 19.06%. During the disposal of shares in foreign companies and the purchase of shares in French or foreign real estate companies, a 5% transfer tax is applied.

- **Exceptions**

  Article 210 E: enables taxation at the reduced rate of 19% (instead of 33%) on capital gains on assets sold to an SIIC (listed real estate entity). In exchange, the company is required to hold the property assets for a minimum of five years. This tax incentive was available until the 31st of December 2011 (CFI France, 2011).

  In 2008, French government and Qatari government signed a tax treaty which exempts Qatari investors from taxation on their capital gains on real estate assets located in France. Therefore, they made a lot of deals with French real estate, especially with symbolic assets such as Virgin Megastore located on the main avenue “Les Champs-Elysées”. (Geopolis, 2013).
5. Evaluation of the French real estate market

For the two last decades, in addition to traditional investors (insurances, banks …), new entities have appeared enhancing the financial aspect of corporate real estate (listed trust, investment fund…). Property has become asset as financial asset which urge real estate to an important financialization. Therefore, some investors focus on short-term return doing short-term capital gain at the time of the disposal. Besides, the use of huge debt, with easy access to credit, enabled to increase substantially short-term return thanks to leverage (Focus, 2010).

The financial crisis of 2008 and the European crisis of confidence in 2010 have stopped the excessive use of leverage and the aspect of short-term return at the time of the disposal. With a lack of visibility and a liquidity shortage, demand has fallen while supply has increased, resulting in downturn of prices. Investors have required stricter standards in order to make sure of their return.

5.1. Return of real estate assets

5.1.1 Definition

The main definition of return is the ratio between incomes and the upfront investment. There are several kinds of return, but only the total return and the income return will be used in this section.

The total return is the sum of capital growth and the income return (IPD, 2013). It is fairly accurate to estimate the return of a corporate real estate asset.

\[
\text{Total return} = \text{capital growth} + \text{income return}
\]

The capital growth is defined as the estimation of the real estate asset. Indeed, the value of a real estate asset changes over time related to several factors (Investirama, 2012). It can increase or decrease based on macroeconomic factors (national growth, current situation…) and microeconomic ones (supply and demand, localization…). Even if the quality of the asset is good, its price can be volatile and may easily differ over time from its initial value. Therefore, capital growth measures the difference between the initial value \(V_i\) and the disposal value \(V_t\) of the asset. It can be computed without a real disposal than to the use of national indexes such as IPD index. The formula is:

\[
\text{CapitalGrowth} = \frac{(V_t - V_i)}{V_i}
\]

For the income return, it is defined as the ratio between the annual rent \(R_t\) (tax and charge excluded) and the upfront price \(V_i\) of the asset. This return only depends on the rent required by the lease and the value of the asset at the purchase (Finucci, 2009). The formula is:

\[
\text{IR}_t = \frac{R_t}{V_i}
\]
Moreover, the evolution of the prime office yield will be analyzed. It is defined as the “ratio of rental income excluding charges to the asset’s acquisition price including commission and fees, i.e. the lowest profitability observed during a given period, after eliminating outliers (fewer than two occurrences)” (DTZ, 2012).

Then, in order to evaluate the return of real estate assets, it is relevant to define the importance of French 10-year bonds, called as Bond Yields 10 Years (Obligations Assimilables du Trésor). These 10-year bonds are issued by the French Treasury, they are used as a reference to compute the rate of risk-free investments. As a result, we can define the “spread” which is the difference between the return of an asset and the one of the 10-year OAT.

5.1.2 Evolution since 2008

- **Total return**

As shown in the graph at right, the total return significantly increased in 2010. Indeed, the levels of return were disastrous in 2007 and 2008. Because of the global economic slowdown in 2008, the income return plummeted since tenants bargained to reduce their rent. The increase of the return and the decrease of the income return caused the drop in real estate asset prices. In a difficult economic environment and with the bursting of the housing bubble, the supply was higher than the demand which caused the drop of the capital growth in 2009. Therefore, the total return scored negative numbers (IPD, 2010). Reaching an unsustainable low point in 2009, the total return increased in 2010 for all property types. Investors focused on core assets, which, despite lower returns, are secured
assets (IPD, 2011). Since 2011, the total return is gradually reducing, due to the decline of the capital growth.

As shown in the table above which summarizes the total return according to the type of property asset, the global trend of 5-year annualized total returns is positive, despite the financial crisis of 2008 and the European crisis of 2010. Besides, the 3-year annualized return is higher than the 5-year one, thanks to a return to classic prices.

- **Prime yield**

  **Between 2008 and 2009**

  Before 2008, investors had an « irrational » behavior which urged to purchase an asset at overestimated prices, in order to speculate on the market. They hoped to get huge capital gain at the disposal. Therefore, prime yield of the assets was extremely low since the rents were not high enough (CBRE, 2009). Since 2008, the financial crisis has caused the bursting of the housing bubble, which has made property assets back to rational prices, and so has increased the prime yield in 2008 and 2009. Either in Paris or in the French provinces, yield primes started in 2008 and confirmed in 2009 an upturn (see graph below), thanks to a review of the rents and the asset prices. The only exception is central business districts in the western of Paris. From 2009, investors have been really interested in these core assets which caused the reduction of the returns.

  **Since 2010**

  Since 2010, institutional investors, property funds and foreign investors are interested in real estate assets. As they are risk averse, they focus on core assets, i.e. “assets with an attractive geographical location and guaranteed rental returns due to tenant quality, lease terms, low vacancy rates, and low tenant turnover” (DTZ, 2012). This investment strategy and the lack of core assets result in a quick drop of the return of secured assets (La Française AM, 2011). Thus, the evolution of the prime located in West Parisian CBD keeps decreasing in 2011 and 2012, and reaches 4.25% which is the lowest level since 2008. This is also the case for CBD located in the largest French cities as Lyon or Lille, where the prime yield fell below 6%. Finally, foreign investors such as sovereign funds provide liquidity to the real estate market and sustain the decrease of prime yields by purchasing Parisian core assets at high prices (La Française AM, 2012).
Among all the assets, industrial assets and warehouses (type B and C) give the best prime yields, reaching 9% (see graph above). Indeed, the return is higher because investing in industrial assets is riskier than other real estate assets. Industrial properties are less liquid assets and their activity is strongly correlated to the economic situation of the country (Transports internationaux et logistique, 2010). Their life cycle is usually shorter and the market less deep. Investors avoid to taking too many risks and may prefer to invest in corporate or core assets, which is 70% of all the investments.

Between 2008 and 2012, the prime yields of Parisian office core assets plummeted by 150 basis points, that is the most important fall among all the assets. On the other hand, the increase by 50 basis points of prime yields of business parks can be noticed.
5.1.3 Evolution of the spread

Real estate is considered as a long-term investment. So, its return can be compared with the one of the French bonds, 10-year OAT, which are almost similar to a risk free investment. Therefore, the return of real estate assets has to be equal to the risk-free return (as the 10 year OAT) increased by a risk premium related to asset. The risk premium depends on its features - localization, type of asset, quality, availability... With a few exceptions, the evolution of the returns has more or less the same trend. Besides, since about 70% of the investments have been realised in the office market, it is interesting to analyse the spread between the yield prime of the office assets and the return of the 10-year OAT (see graph on the right).

In 2007, core asset market was totally irrational, reducing significantly the risk premium. Therefore, the prime yield of core assets was lower than the risk-free return of the 10-year OAT, which caused a negative spread! It would have been less risky to invest in a core asset than in a 10-year OAT bond, which is irrelevant. It is only at the end of 2008 that the spread returned to a regular level with positive value, reaching 200 basis points (CBRE, 2009). However, the year 2009 was affected by a credit crunch in a difficult economic environment which prevented investors from an increase of the risk premium. Because of the European crisis in 2010, the spread between the two returns reduced, reaching only 100 basis points, since the bond yield 10 years skyrocketed during the last quarter in 2010 and the first quarter in 2011.

Finally, since 2011, the bond yield 10 years is moving into a downturn. The Spread Bond Yields 10 Years/Paris Prime Office Yields reached at the end of 2012 an exceptionally high level with 275 basis points, which urge investors to invest in real estate sector.

Graph 12
5.2. Paris market compared to London and Stockholm

5.2.1 Investment evolution

Real estate investors have different priorities and goals. Their behavior depends on their risk-aversion, the return they want to develop (capital growth or income yield) and the notion of supply/demand (Ernst & Young). Therefore, they invest in different countries in order to diversify their assets and to minimize their risk. The cross-border activity by country (graph on the right) gives the different main trends. The activity in the UK, France and Germany, which focus the main part of the investments, is close to the European average (about 35%). They are wide and relatively liquid markets, which have secured assets and so urges foreigners to invest there, especially after the financial crisis. On the other hand, in the Nordic Countries (Sweden, Finland, Norway, Denmark and Iceland), domestic investors benefit from a large position, which limits foreign investments in real estate, between 10% and 20% of total amount.

In Europe, Paris and London are the two main host cities for real estate investments, with around €11 bn and €19 bn respectively, whereas Stockholm received around €5.5 bn in 2012. London and Paris's foreign purchasers have become more and more diverse, with investors coming from Eastern countries who invest in large portfolios and trophy assets. Instead, more regular investors look for more secured assets (BNP
Real Estate, 2012). Thanks to a liquid market and stable occupancy levels, Stockholm remains an attractive city for risk-averse investors. Stockholm is the first choice for foreign investors among Nordic cities thanks to its transparent property market.

Paris and London were affected by the financial crisis in 2008 and 2009 because of the withdrawal of foreign investors, whereas Stockholm had a one-year lagged with a huge downturn in 2009: investment amounts went to €8 bn from less than €2 bn. The last three years were a period of slow recovery (see graphs above).

5.2.2 Prime yield evolution

If we compare the evolution of income returns for Paris, London and Stockholm, they are more or less stable during the last decade. The higher income returns are found in Stockholm with around 6%, Paris with almost 5% and then London with 4%. This can be explained by real estate prices which are lower in Stockholm, and very high in London. Besides, Paris and London are the most mature market in Europe. However, capital growth is much more different from a city to another. London was the first city to be affected by the financial crisis since it is the first European financial place. In 2007, London investments' capital growth was negative whereas Paris and Stockholm's one exceeded 10%. But, in 2008 and 2009, the crisis pushed down capital growth to negative values, especially in London where it reached -25%, while it went down until “only” -8%. After 2009, capital growth went back to positive values, yet inferior than before. Finally, the total return is strongly affected by the variations of capital growth. The weight of capital growth is much more important than the income return. Therefore, total return was negative in 2008 and 2009.

The financialization of real estate assets has made investors more influenced by capital growth than income return, which took part in the development of the housing bubble. But, from 2010, the importance between capital growth and income...
return has become more well-balanced, and investors take the latter into consideration. It results a contraction of prime yields in Paris and London because the undersupply of secured assets (Bnp real estate Europe, 2012), especially in CBD. According to BNP Real Estate, prime yield in Stockholm has “bottomed out” in 2012, at 4.5%.

5.3. **SWOT analysis**

A SWOT analysis is a strategic planning process used to evaluate the Strengths, Weaknesses, Opportunities and Threats of a business investment or a project. This method enables to identify internal (strengths, weaknesses) or external (opportunities, threats) factors that are positive or unfavorable to achieve the goal. After achieving the SWOT analysis, it is easier to find a solution either by improving strengths and opportunities, or by reducing weaknesses and threats.

As my thesis focuses on foreign investments into the French real estate market, a SWOT analysis give the opportunity to describe precisely and to evaluate the reasons why foreigners invest in French real estate.

**5.3.1 Strengths**

French real estate market has a lot of internal advantages which make it interesting and attractive for foreign investors. These strengths influence foreigners to choose French real estate as main host country of their investments. Some of these attractiveness criteria have been previously listed in this thesis, such as:

**French market**

- **Secured and core assets**

  France and especially Paris offer a wide range of secured and core assets which are located in attractive places and guarantee rental returns thanks to tenant quality, low vacancy rates and good lease terms. Paris is one the most major cities in Europe in terms of core and secured assets.

- **Trophy assets**

  Paris is one of the most famous cities in the world, and some particular sites are well-known all around the world such as “Les Champs-Elysées”, “le musée du Louvre” or “la Tour Eiffel”. Therefore, buildings which are located in these areas attract foreign investors such as Middle Eastern and Asian, who try to increase their exposure in France and in the world. The most recent trophy asset trade was made by Qatar Investment Authority which purchased the building hosting the Virgin Megastore on the famous avenue *Les Champs-Elysées.*
• La Défense: first CBD in Europe

La Défense, located close to Paris, is the main French business district in France and the first business district in Europe, before London and Frankfurt, with more than 150,000 daily workers, 1,500 companies and 3,500,000 square meters of offices. Multinational companies have their headquarter in La Défense such as Total, Ernst & Young or Axa. In this place, investors can find most of secured office assets thanks to a low vacancy rate and low tenant turnover.

• Deep and liquid market

• Diversification

A wide range of assets are available such as offices, retails, warehouses, hotels, light industrials, and so on. Foreign purchasers have the opportunity to find different assets depending on their diversification in order to minimize risk. Investing in different locations like the city of Paris, its suburbs and the other French regions is a good way to diversify a portfolio and to limit risk.

French economy

• Cheap long-term debt, large spread

For two years, the rate of the French long-term indebtedness with maturity of 10 years (OAT 10 ans) has been really low, roughly 2%. Therefore, the spread between prime office yields and 10-year OAT rate has reached approximately 270 basis points, which helps and urges investors to invest in French real estate. If they meet financial requirements, investors can use leverage and so improve their return.

• Hotel industry

➢ First visited country in the world

France is the most visited country in the world with more than 70 million visitors a year. Paris remains the first destinations for Chinese tourists which spend on average €5,400 during the stay (Veille Info Tourisme, 2013). Therefore, hotel industry is prosperous and growing, especially for luxury hotels and palaces.

• Sharia compatible and taxation agreement with Qatar

The implementation of a sharia-adapted legal framework in 2009 has urged Islamic investors to do business in French real estate. In 2012, Middle Eastern investors corresponded to 15% of investment volume. Besides, in 2008, French government and Qatari government signed a tax treaty which exempts Qatari investors from taxation on their capital gains on real estate assets located in France.
Perspectives

- Greater Paris project

This project, launched in 2007, plans to build a new transportation master plan in order to link several business areas of the great suburbs of Paris thanks to the modernization of the current commuter train (RER) and the construction of new lines between Paris and the suburbs, for a total amount of €30 bn. This would be the opportunity to create new business districts, to invest in their construction and to foster foreign investments in French corporate real estate.

5.3.2 Weaknesses

However, even if France has plenty of strengths and internal advantages, the financial crisis of 2008 and the European crisis of 2010 have resulted in a worsening of the global economic situation which affected real estate market. Some of these problems are listed below:

- High unemployment

  Since 2008, the unemployment rate has constantly increased, going from 7.5% of the working population in 2008 to 10.5% in 2012 (Insee, 2012) i.e. 3.13 million people. In April 2013, the French jobless total has reached the number of 3.2 millions, its highest value since 1997. The rate represents a 1.2% increase compared to the previous months and 11.5% higher than last year. Besides, it was the “23rd straight month to record a rise in unemployment” (RTE, April 25th 2013). According to the OECD, France can reverse the rising trend only with a growth of more than 1%

- Flat growth

  The financial crisis in 2008 has affected French economy and caused its recession in 2008 and in 2009, during four quarters, with 0.5% decrease of the French real GDP (scoreboard attractiveness). In 2013, French government plans a quasi flat growth of 0.1%, whereas European Commission plans a negative growth of -0.1% i.e. a recession.

- Low income returns for core assets

  Because of financials tensions since 2008, most of investors have been focusing on core and secured assets. Investors do not look anymore for huge capital growth of their assets, but prefer to be sure of their investments. This situation has led investors to choose Paris by 60% to invest their money, particularly in the Paris CBD. Investors have become more and more risk-averse, and in this global situation, corporate real estate remains a secured investment. The consequence is that as the risk is lower, the risk premium and so the return is lower as well.
Besides, the demand in core assets is getting higher than the supply, so their prices increase or at least remain constant while regular assets' prices are decreasing. Therefore, core assets' prime yield such, as Parisian offices located in La Défense, is reducing until 4.5%.

- **The end of the article 210-E**

The goal of this article was to urge companies to outsource their real estate assets. In December 2011, the article 210-E stopped to be used which resulted to an increase of trades at this period. But, this article stipulated that the buyer had to keep its new asset for 5 years at least. The end of the article might affect the market and decrease its liquidity.

### 5.3.3 Opportunities

French market benefits from external conditions of its environment and opportunities from international economic situations which may improve the performance of investments. Thanks to the globalization of the market, political and economic decisions or behaviors can positively affect French real estate.

- **Sovereign funds with a lot of liquidity**

For five years, emerging market sovereign wealth funds, such as Middle Eastern and Asian, are totally involved in the international business market. The financial crisis gave them the opportunity to invest in developing countries where traditional investors couldn't because of a lack of liquidity. While developing countries try to save their economy and drive economic recovery, emerging sovereign funds have huge amounts of liquidity thanks to a strong growth or natural resources like petrol and gas. According to a study from IEIF (2012), sovereign funds have spent the last two years more than €4 bn in French real estate, more precisely in Paris. Only in 2012, sovereign wealth funds from Asia, Middle East and Azerbaijan invested in French real estate for €2.3 bn. They are interested in trophy assets, offices and luxury hotels. For example, in early 2013, a Qatari fund bought a portfolio of four luxury hotels for €650 million.

- **Real estate: safe haven investment**

Thanks to the quality of French real estate assets and due to recent financial crisis, real estate remains safe haven investments for investors. Risk premium may be lower than classic financial assets, but the risk is very small, especially for long-term investments. French market consists of many core assets which guarantee secured and stable returns. Thanks to attractive geographical location, good tenant quality, low tenant turnover and low vacancy rates, French assets located in central business districts are wanted by foreign investors.
• **Low ECB interest rate**

In February 2013, the European Central Bank lowered its interest rate from 0.50% which enabled real estate loans to remain stable and low. Its goal is to boost the economy, increase the growth and finance companies by bring down sort-term loan interest rates and giving the opportunity to develop companies’ business.

• **Top 5 city of opportunities**

According to a PWC survey (2012), Paris is the fourth city opportunity in the world, just behind New-York, London and Toronto. More precisely, Paris is the first city relative to demographics and livability, and the third one concerning intellectual capital and innovation. Therefore, Paris is the absolute window of French market, and gives the opportunity to foreign investors to discover its market.

• **New environmental standards**

In 2008, among the 50 million square meters of Parisian offices, about 48% were built before 1975 and only 500,000 square meters are renovated each year. Therefore, investors have the opportunity to modernize their assets in order to improve returns and to attract new tenants.

5.3.4 **Threats**

However, external elements can adversely affect business development and cause investment troubles, especially for foreign investors. In real estate market, macroeconomic situations or decisions can result in a risk of reduced profitability. Several threats are listed below:

• **Strong euro currency**

With the restoration of confidence in Europe, financial markets are getting back to invest in Euro currency. Therefore, Euro currency is strengthening and reached in early 2013 an exchange rate of €1.35. Euro currency has always been a strong currency because of the ECB policy. The consequence is that investing in Europe is getting more expensive. When foreign invest in France, the real investment cost can vary according to Euro exchange rate, and higher Euro currency is, more expensive investments are.

• **European crisis**

Even if the worst of European crisis is over, some countries such as Spain, Greece or Ireland are still weak. European countries, including France, have to find solutions in order to limit government deficit but on the other hand have to revive the economy. Therefore, the stabilization of Europe is in progress which makes foreign investors risk averse.
• **Increasing competition**

Since early 1999, France and especially Paris have to compete with new opponents who are Asian cities such as Singapore, Shanghai, Kuala Lumpur, Hong-Kong. They offer a lot of real estate assets which can compete with French ones.

5.4. **Evaluation**

Thanks to the SWOT analysis, foreign investors have a overall view of the current situation of French real estate market and so are able to improve their strategy in order to foster global return. Investors usually own several real estate assets belonging to a portfolio. Their goal is to diversify the portfolio to minimize the risk. This SWOT analysis gives the keys to reduce risk related to real estate investments, either by lowering weaknesses and threats, or by developing strengths and opportunities.

If investors want to invest in French market, they have to weigh the pros and the cons and evaluate the investments in the entirety of their portfolio. However, French market is a major market which cannot be excluded from investment strategy. The table below summarizes this approach:

<table>
<thead>
<tr>
<th>Helpful</th>
<th>Harmful</th>
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<tr>
<td><strong>STRENGTHS</strong></td>
<td><strong>WEAKNESSES</strong></td>
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<tr>
<td>• Many secured and core assets</td>
<td>• High unemployment</td>
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<td>• La Défense : first CBD in Europe</td>
<td>• Flat growth</td>
</tr>
<tr>
<td>• Cheap long-term debt, large spread</td>
<td>• Low income returns for core assets</td>
</tr>
<tr>
<td>• Hotel industry</td>
<td>• The end of the article 210-E</td>
</tr>
<tr>
<td><strong>OPPORTUNITIES</strong></td>
<td><strong>THREATS</strong></td>
</tr>
<tr>
<td>• Sovereign funds with a lot of liquidity</td>
<td>• Strong euro currency</td>
</tr>
<tr>
<td>• Real estate : safe haven investment</td>
<td>• European crisis</td>
</tr>
<tr>
<td>• Low ECB interest rate</td>
<td>• Increasing competition</td>
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<td>• Top 5 city of opportunities</td>
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</table>
6. Conclusion

The first goal of this study was to provide an insight about foreign direct investments in French real estate market since the beginning of the crisis in 2008. The second one was to analyze changes of cross-border investments due to difficult economic context and draw a global trend of foreign investments on the corporate real estate market. This study sheds light on foreign investors’ behavior in French market and tries to summarize the evolution of their investments since the beginning of the crisis five years ago.

First of all, some of the different theories about foreign direct investments describe in the chapter 3 can explain investors’ behavior in French real estate, whereas other ones are irrelevant for real estate industry. As reality is much more complicated than theoretical behaviors, several theories are necessary to understand why foreigners are willing to invest in French property market. The most relevant theories and hypothesis are “the portfolio diversification hypothesis”, “political risk and country risk”, “tax policies hypothesis” and “location hypothesis”. Indeed, French market is considered as a stable and secured market, thanks to core assets located in Central Business Districts close to Paris. Investing in these assets guarantees minimum risks and enables foreign investors to diversify their portfolio. At the same time, French market is expected to be stable thanks to the very low level of political risks. Despite the European crisis and its economy in recession, France remains one of the stable countries in Europe. Therefore, foreigners are not afraid of investing, in the long term, in its real estate market. Then, even if French tax policy is not the most favorable in Europe, foreign investors can find solution in order to reduce it, such as a two-tier structure. In some cases like Qatari investors, official agreements give foreigners the opportunity to use advantages of reduced taxation which urges to invest in France. Finally, France and especially Paris attract a lot of foreign investors only because of their great fame. They look for trophy assets in order to make them more well-known in the world. Other FDI theories are less relevant because real estate is different than other industries. It doesn't require production techniques or labor so it cannot use internalization or economy of scale like other industries. However, FDIs in French real estate affect the local market and have positive effects on property market. They foster capital growth and bring liquidity and available cash in the market. They develop property markets thanks to their investments in French assets or portfolios.

In five years, global economic context has changed and new actors have appeared on the international stage. With more than €25 bn real estate investments in 2007, total transactions plummeted to €8 bn in 2009 and then have stabilized at around €15 bn in since 2011. While developed countries attempt to solve their financial and economic issues, emerging country investors from Middle East and Asia have the opportunity to get in French market and develop their investments. New foreign investors focus on either Parisian offices or trophy assets, in order to foster
their exposure, whereas traditional investors from developed countries - such as Germany, the UK, the USA, etc - usually more risk averse, look for secured and core assets in Paris or its suburbs which guarantee few risks and regular returns. The financial crisis of 2008 and the European crisis of 2010 stopped the financialization of real estate assets which resulted to irrational prices in French and more precisely Parisian market. Investors have come back to initial use of real estate assets which is now considered as safe haven investments. The most coveted assets are Parisian offices located in central business districts, considered as the best core assets.

Thanks to Paris and its great fame, foreign investors are attracted by French market. It is the second city in Europe to receive real estate investments. Compared to London and Stockholm, Paris received from domestic and foreign investors €12 bn, London €20 bn and Stockholm roughly €5.5 bn. With a transparent and deep market and government bonds at a low level, French real estate attracts foreign investors and is more or less resilient in these tough economic conditions. The year 2013 might be in line with 2012 with a strengthening of investors with available liquidity such as insurer, hedge funds and sovereign wealth funds.
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FDI into French real estate

Introduction

The purpose of this questionnaire is to get information for analyzing changes that have taken place in the French property market for foreign direct investments (FDI) after 2008. The aim is to collect data for a Masters thesis being conducted by Arthur BRIZARD, a French student at The Royal Institute of Technology in Sweden. This research focuses on current investment conditions for foreign market participants and its dynamics within the indicated period.

The questionnaire is estimated to take about 5 minutes of your time to answer and we are grateful for your participation.

All the answers will be treated confidentially and no single answer will be identified to you.

Background information

1. The company name

2. Which category best describes your company’s main business?

   - Insurance company
   - Real Estate Development company
   - Real Estate Fund
   - Pension Fund
   - Financial institution
   - Real Estate Consultancy/Advisory Firm
   - Other (please specify)

3. How long has your company been active on the French property market?

   - 0-5 years
   - 6-10 years
   - > 10 years

4. How long have you been employed in the company?

   - 0-1 year
   - 1-5 years
   - > 5 years

5. On average how has the share of your companies’ FDI into France changed during the following time periods?

<table>
<thead>
<tr>
<th>Year</th>
<th>Increased</th>
<th>Remained stable</th>
<th>Decreased</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000-2007</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008-2012</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### FDI into French real estate

6. How are the following property markets in your opinion correlated with the French property FDI market? (several answers are possible)

<table>
<thead>
<tr>
<th>Country</th>
<th>Highly</th>
<th>Slightly</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scandinavia</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>UK</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>Belgium</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>Germany</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>Italy</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>US</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>If Other (please specify)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### General investment conditions

Below is a number of statements on the changes in FDI in the French property market during the period 2008 - 2012. To what extent do you agree with the statements? The answers in this section will be used for analysing general investment conditions and their dynamics.

7. Micro economical conditions (property tax, operating expenses, transaction cost etc.) in France have improved
   - I agree
   - No opinion
   - I disagree

8. Macro economical conditions (interest and exchange rates, inflation, GDP etc.) in France have improved
   - I agree
   - No opinion
   - I disagree

9. Cultural issues (business environment, language etc.) for foreign investors in France have improved
   - I agree
   - No opinion
   - I disagree
FDI into French real estate

10. Political factors (stability, regime) have gained more influence on FDI investors' decision

- I agree
- No opinion
- I disagree

Sectoral investment conditions

Questions in this section help to analyze general sectoral investment conditions for FDI real estate investors and their change during the 2008 - 2012 period.

11. How in your opinion have the following characteristics and opportunities of the French property market for FDI changed during the period 2008 - 2012?

- Yield level
- Risk level
- Tenure regime
- Liquidity
- Transparency
- Access to financing

12. Investors in the French property market for FDI have become more long-term oriented in recent years

- I agree
- No opinion
- I disagree

Company specific issues

Questions in this section help to analyze the point of view of particular companies on investment conditions for FDI real estate investors and their change during the 2008 - 2012 period.

13. How has the share of your company's FDI investments in the French property market during 2008 - 2012 changed?

- Office
- Retail
- Residential
- Industrial
- Hotel
- Other

Increased | Remained stable | Decreased
### FDI into French real estate

14. Where does your company invest in France? (in descending order)

- [ ] Paris
- [ ] Parisian suburb
- [ ] Lyon
- [ ] Bordeaux
- [ ] Marseille
- [ ] Lille
- [ ] Other

15. My company has become more involved in portfolio transactions than in single property transactions

- [ ] I agree
- [ ] No opinion
- [ ] I disagree

16. My company has backed out of some planned investments in the French property market in recent years

- [ ] I agree
- [ ] No opinion
- [ ] I disagree

17. The global financial crisis has changed the opportunities for FDI in France for my company due to:

<table>
<thead>
<tr>
<th>Reason</th>
<th>I agree</th>
<th>No opinion</th>
<th>I disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increased difficulties with financing</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increased difficulty in finding suitable investment properties</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FDI is no longer the best investment alternative</td>
<td></td>
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<tr>
<td>Other (please specify)</td>
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</table>

**Perspectives of FDI in France**

Questions in this section aim to define investors' general expectations about the perspectives of FDI into French property and plans regarding their own possible future activities in the market.
18. How will your company investments into France change in the future?

☐ Increase
☐ Remain stable
☐ Decrease
☐ No opinion

19. Changes in the following factors could improve the attractiveness of FDI into the French property market: (several factors are possible)

<table>
<thead>
<tr>
<th>Changes to taxation regime</th>
<th>I agree</th>
<th>No opinion</th>
<th>I disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Better access to financing</th>
<th>I agree</th>
<th>No opinion</th>
<th>I disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Simplifying transaction process</th>
<th>I agree</th>
<th>No opinion</th>
<th>I disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Enhancements in the translation of legislation</th>
<th>I agree</th>
<th>No opinion</th>
<th>I disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td>☐</td>
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</tr>
</tbody>
</table>

Other (please specify)

Closing word

Thank you very much for your cooperation and participation in this survey!

Please, feel free to contact me any time if you have any questions/comments.

Arthur BRIZARD
brizard@4thse
+48 76 714 89 27

20. In case you are interested in the results of this survey please write your e-mail adress here