




IS THE OFFICE REAL ESTATE OVERVALUED ? INSIGHTS FROM FRANCE

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Outline

- 
- Motivation
 - Method
 - Results
 - Conclusion



MOTIVATION (1/4): A SHORT PRESS REVIEW OVER LAST 3 YEARS

Vigilance sur l'immobilier commercial : les prix flambent-ils réellement ?

BUSINESS
IMMO
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Le marché de l'immobilier commercial continue d'inquiéter les autorités

L'AGEFI

L'ARGUS de l'assurance

Immobilier commercial : attention danger ?

Immobilier : le marché de bureaux francilien arrive à saturation

Le marché des bureaux bulle-t-il en Île-de-France

LA
TRIBUNE



Immobilier de bureaux : le marché parisien surévalué de 15% à 30%

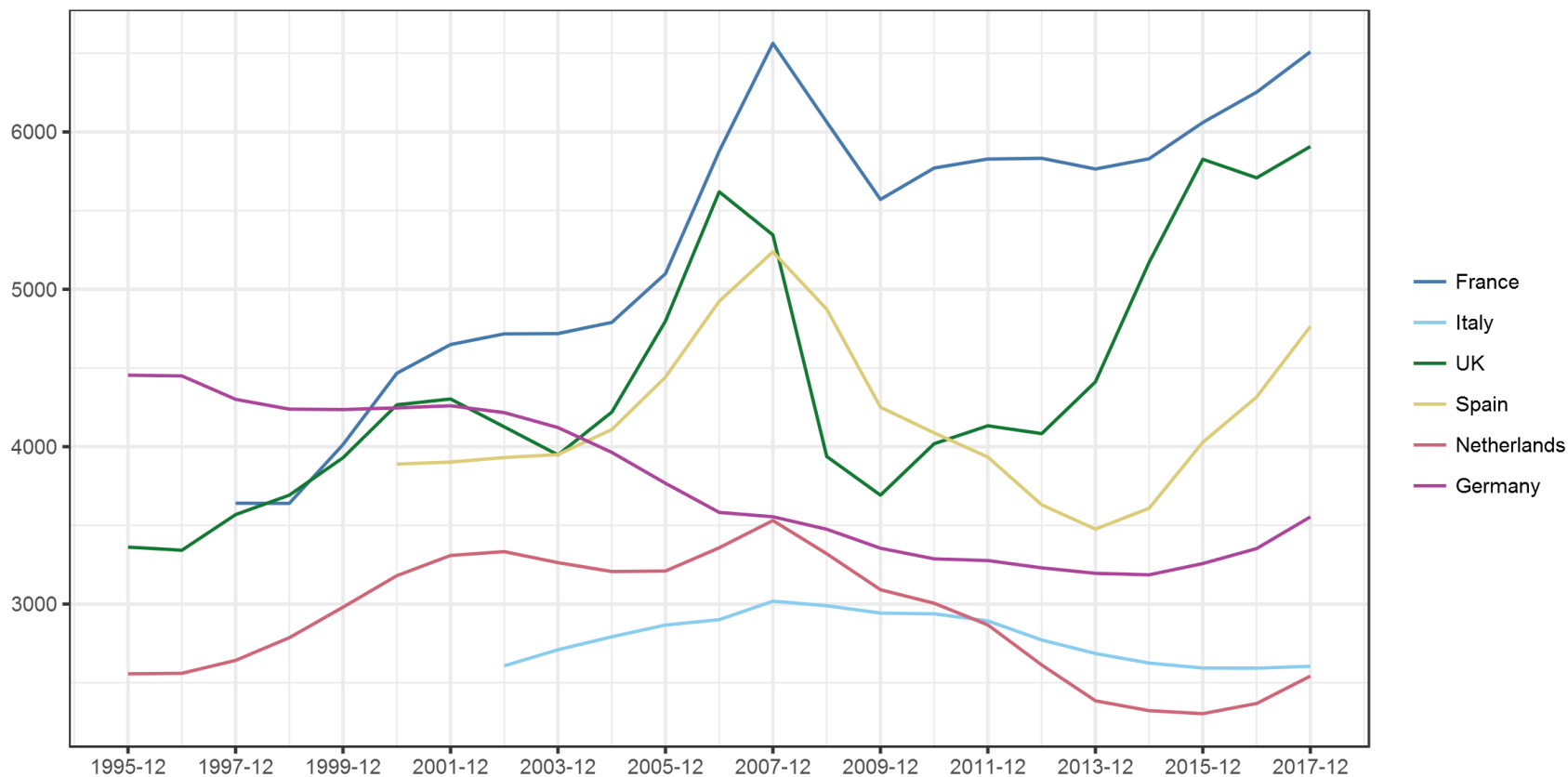
CBANQUE
L'info pour vos finances

MOTIVATION (2/4): INSTITUTIONAL ASSESSMENT

- The Haut Comité de Stabilité Financière (HCSF) is the macroprudential authority in France, able to decide on macroprudential measures (Countercyclical buffer, etc.)
 - September 2016: analysis of the commercial real estate market in France and public consultation
 - March 2017: updated diagnosis on the commercial real estate and results of the stress tests
- Banque de France issues in November 2018 Digest: “Commercial real estate: is there a risk of a financial bubble?”

MOTIVATION (3/4): COMMERCIAL REAL ESTATE PRICE EVOLUTION

Price evolution of commercial real estate for selected countries



Source: MSCI

MOTIVATION (4/4): AIM OF THE PAPER

- Quantify the potential overvaluation of the office market prices in France and in Paris region
- Provide explanations for the recent trends and assess their sustainability
- Run some adverse scenarios so as to evaluate the reaction of prices to negative shocks
- In the end, assess the effect of such adverse scenarios on financial stability at large

METHOD: PRESENTATION OF THE MODEL AND DEFINITION OF THE OVERVALUATION

- Equation of the model focused on the office sector

$$\Delta Y_t = c + \alpha \beta^T Y_{t-1} + \sum_{k=1}^2 \Phi_k \Delta Y_{t-k} + u_t$$

→ In our case: $Y_t = (\log GDP_t, \log Price_t, \log Rents_t, \log Stock_t, \log Supply_t, EUR6_t)$

- Hansen decomposition of trend and cycle:

$$Y_t = T_t + C_t$$

with $T_t = C \sum_{s=1}^t u_s + \tau(t) + A_0$ and $C_t = C(L)u_t = \sum_{i=0}^{\infty} C_i L^i u_t$

→ We define the overvaluation as the stochastic component:

$$R_t := C \sum_{s=1}^t u_s$$

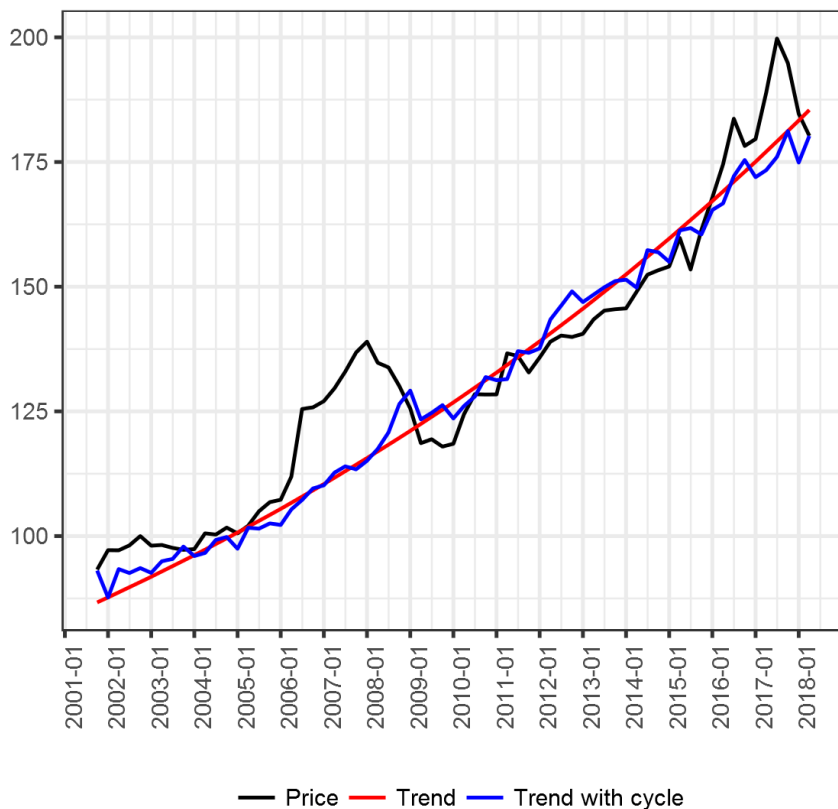
And we have:

$$R_t = Y_t - C_t - \tau(t) - A_0$$

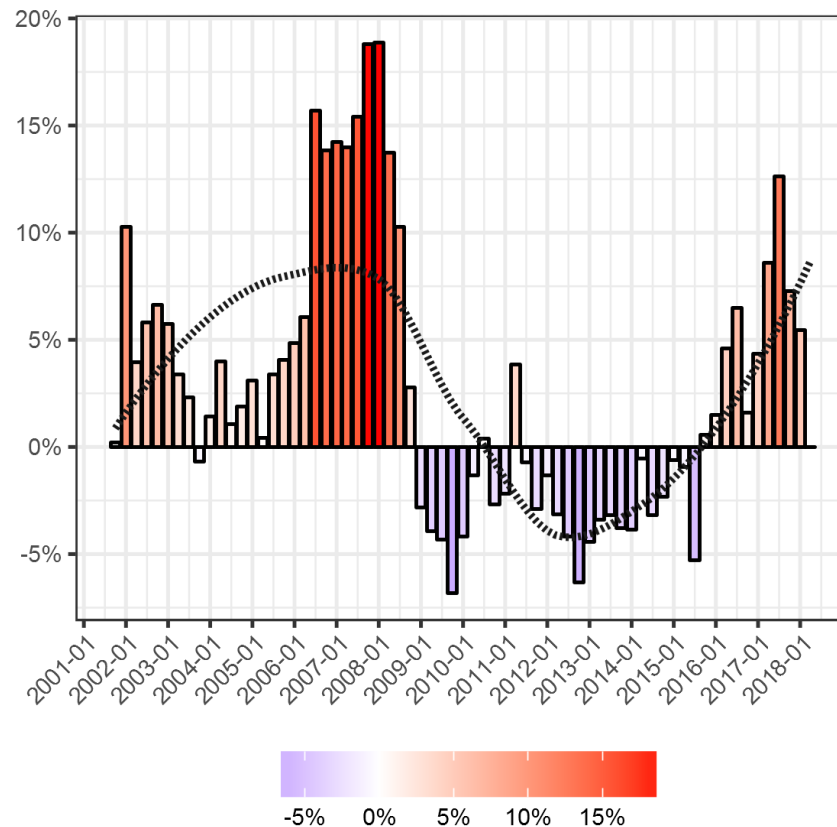


RESULTS (1/3): OVERVALUATION MEASURES

Trend and cycle decomposition of price



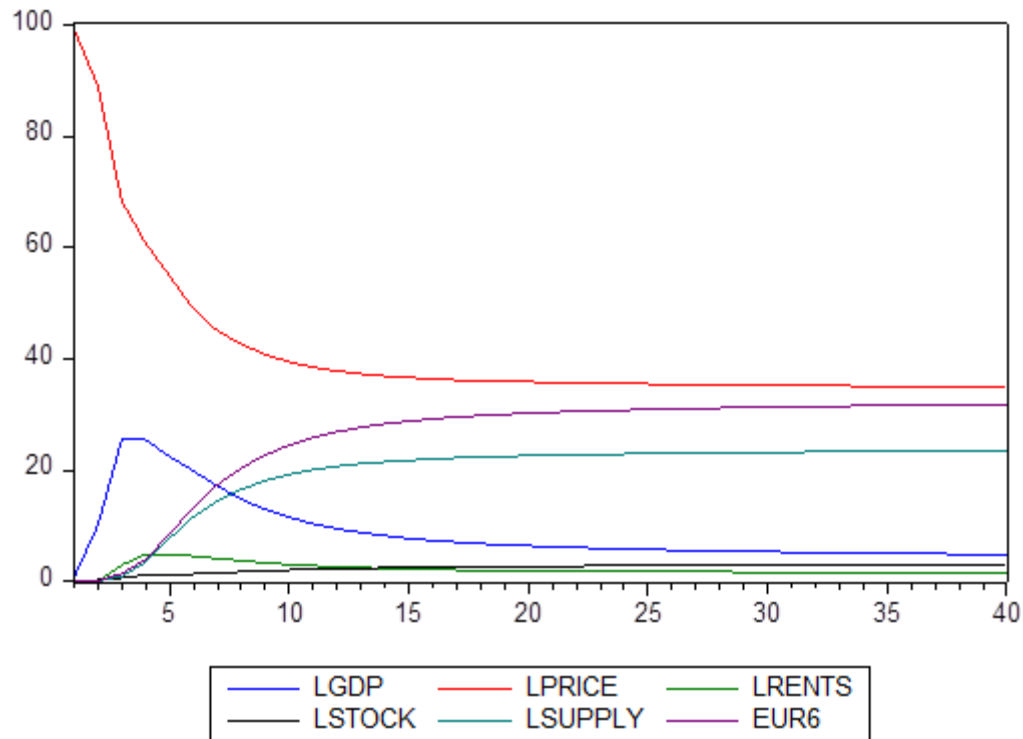
Measuring overvaluation



- Rewriting these relationships makes it possible to measure the difference between the observed level of prices and that, considered as a price of equilibrium, given by the observed evolution of the fundamentals (the variables of the model).
- This difference measures the overvaluation of office prices in France with an associated confidence interval: it would be around 5% at the end of 2017, with a return to equilibrium in early 2018.

RESULTS (2/3): VARIANCE DECOMPOSITION

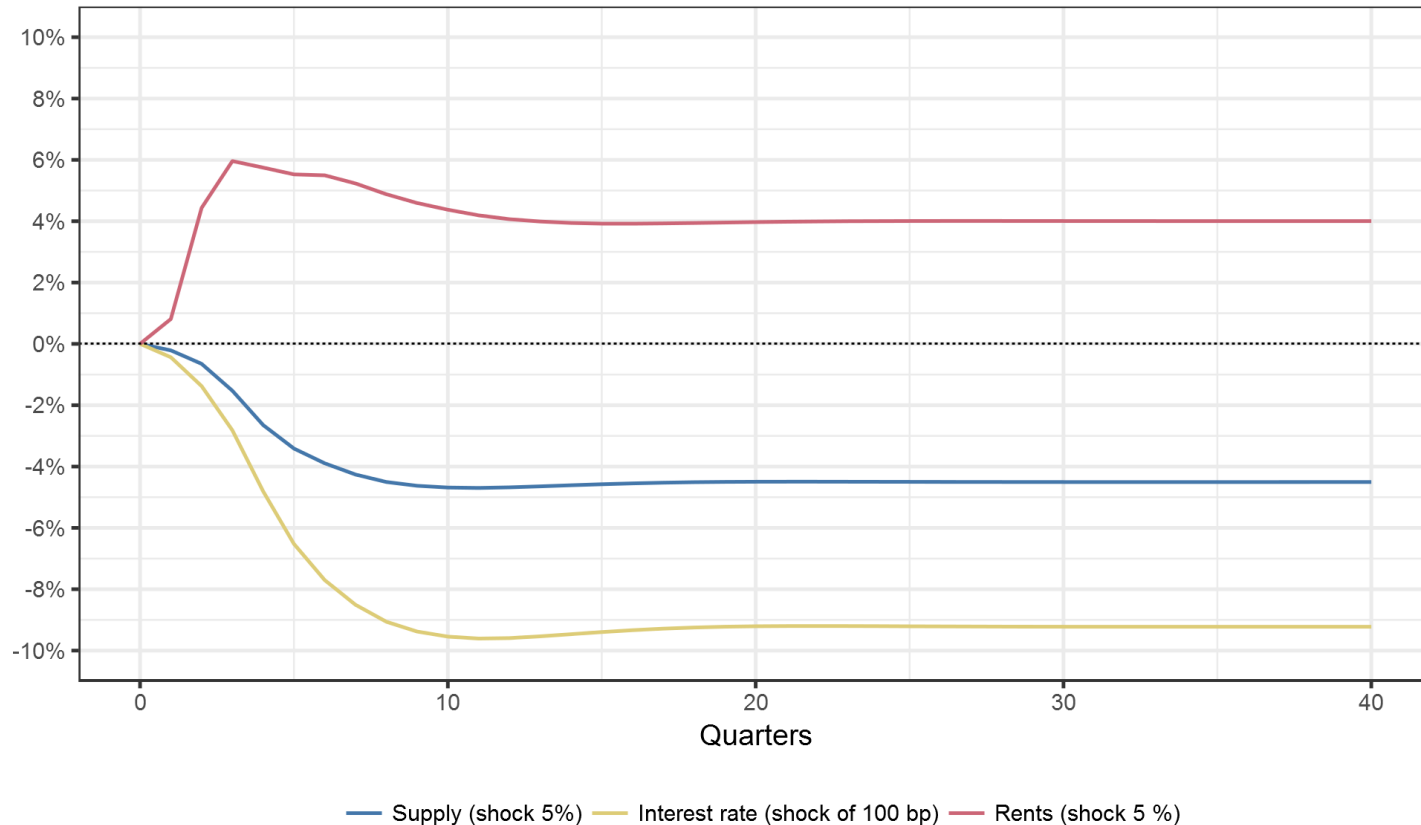
Variance Decomposition of LPRICE



- While economic growth shocks mainly explain the price variance in the short term, it is essentially the changes in interest rates and supply that determine them in the longer term (between 20% and 40%).
- The decline in the supply of offices (the available office space per unit of GDP has thus decreased by 6% since 2011) and the very low level of interest rates can explain an increase in the prices of the offices without significant difference during recent years between the equilibrium level and the observed level of prices.

RESULTS (3/3): IMPULSE RESPONSE FUNCTIONS

Response of the price level to a given shock on selected variables



- The econometric model makes it possible to evaluate more precisely the impact of permanent shocks:
 - a 5% increase in the immediate supply of office space would lead to a price decrease of around 4% over ten quarters;
 - a 5% rise in rents would result in an increase in office prices of around 4% over a four-quarter period;
 - an increase in interest rates of 100 basis points would result in a decrease in office prices of 9% over 10 quarters.

CONCLUSION (1/2): MAIN RESULTS AND POLICY ISSUES

- Valuations appear consistent with the low interest rate environment and the tight supply side of demand in some market segments
- There is a risk of a downward price correction: a rise in interest rates of 1pp could result in a price decrease of 9%
- The systemic consequences of such a reversal should remain limited
- Impact of a price correction on financial stability
 - Limited impact on the balance sheet of financial institutions as exposures are low (3% of the aggregate balance sheet of banks)
 - Significant growth in banking activity in the sector (+ 13.1% of production in the broad sector in France in 2017)

» CONCLUSION (2/2): APPLICATION TO BREXIT

We consider a maximalist shock of about 100,000 jobs, representing 2.5% (respectively 3.6%) of all jobs in Paris Petite Couronne (respectively Paris and Hauts-de-Seine)

→ we get a positive shock on office prices of about 6 points (8 percentage points) respectively.



THANKS FOR YOUR ATTENTION!