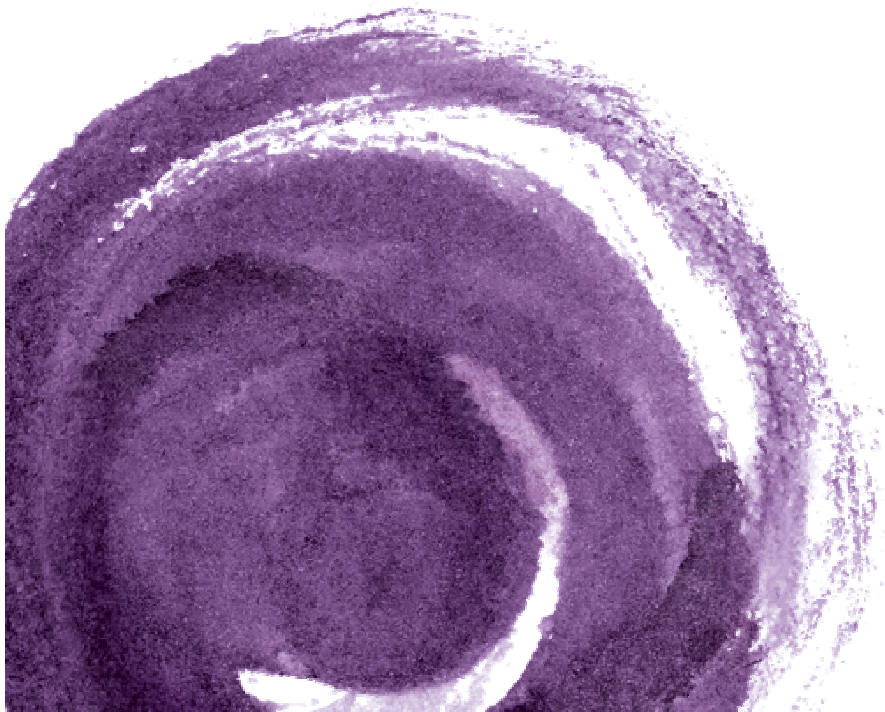




Residential housing construction in the financial crisis: The case of France

May 18, 2010

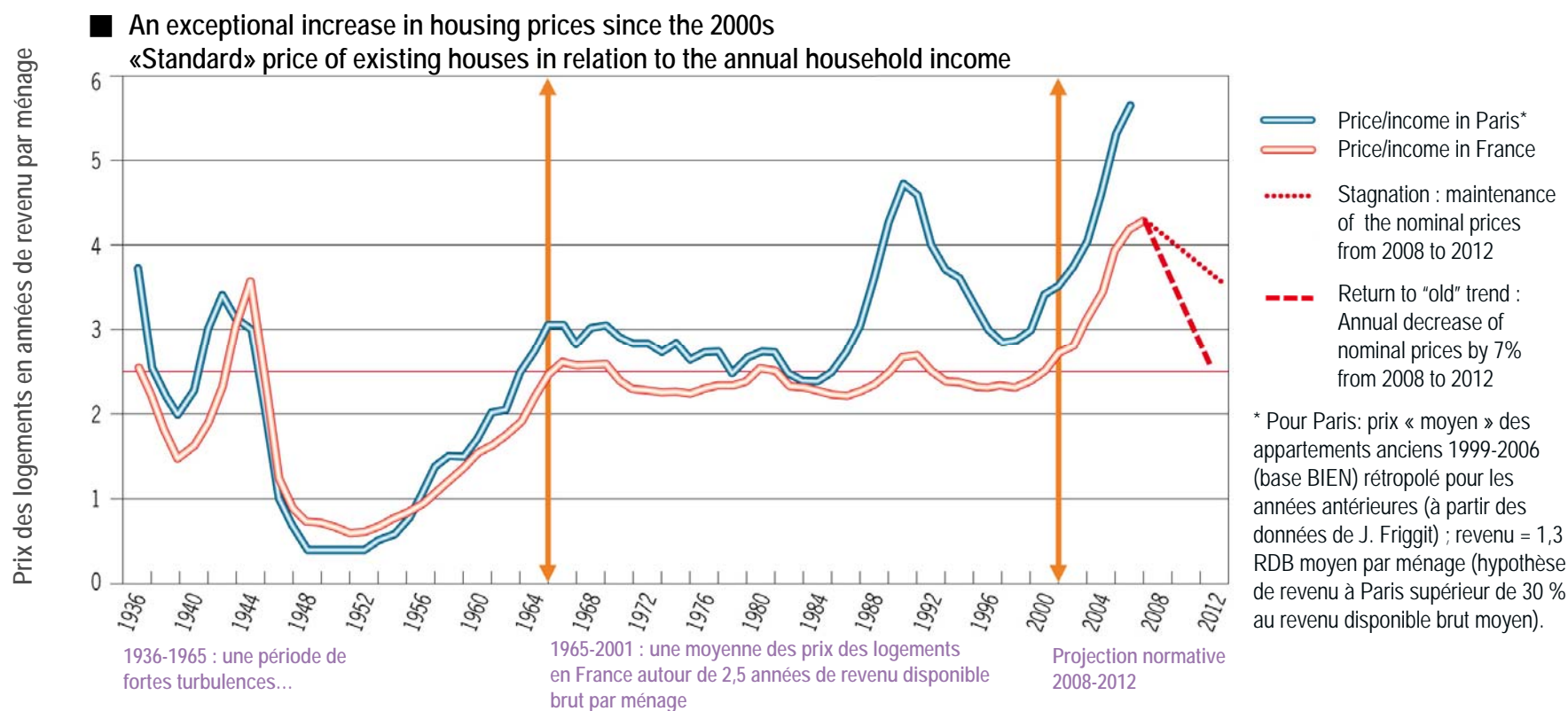
Alain TOURDJMAN



A bullish market phase of a very long cycle: a new price order ?



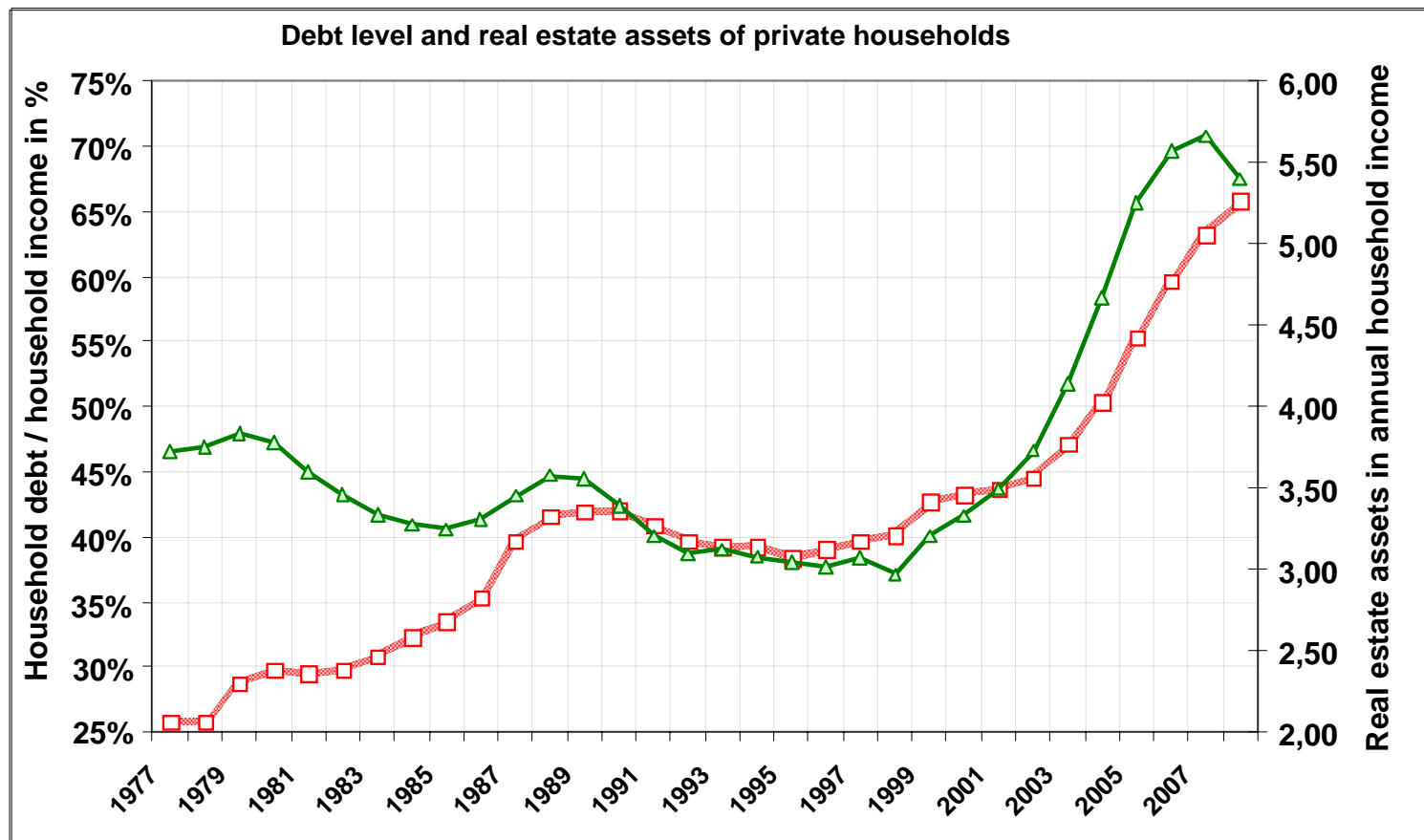
- Average price for residential housing: 2.5 times the annual revenue during 35 years, but more than 4 times the annual revenue since 2005
- A bull market or a new price order?
 - Beyond transition effects of a speculative logic...
 - ... there are the stabilising aspects of a shortage of housing in metropolitan areas and the effects of lower interest rates and longer repayment terms.



A bullish market phase of a very long cycle: a new price order ?



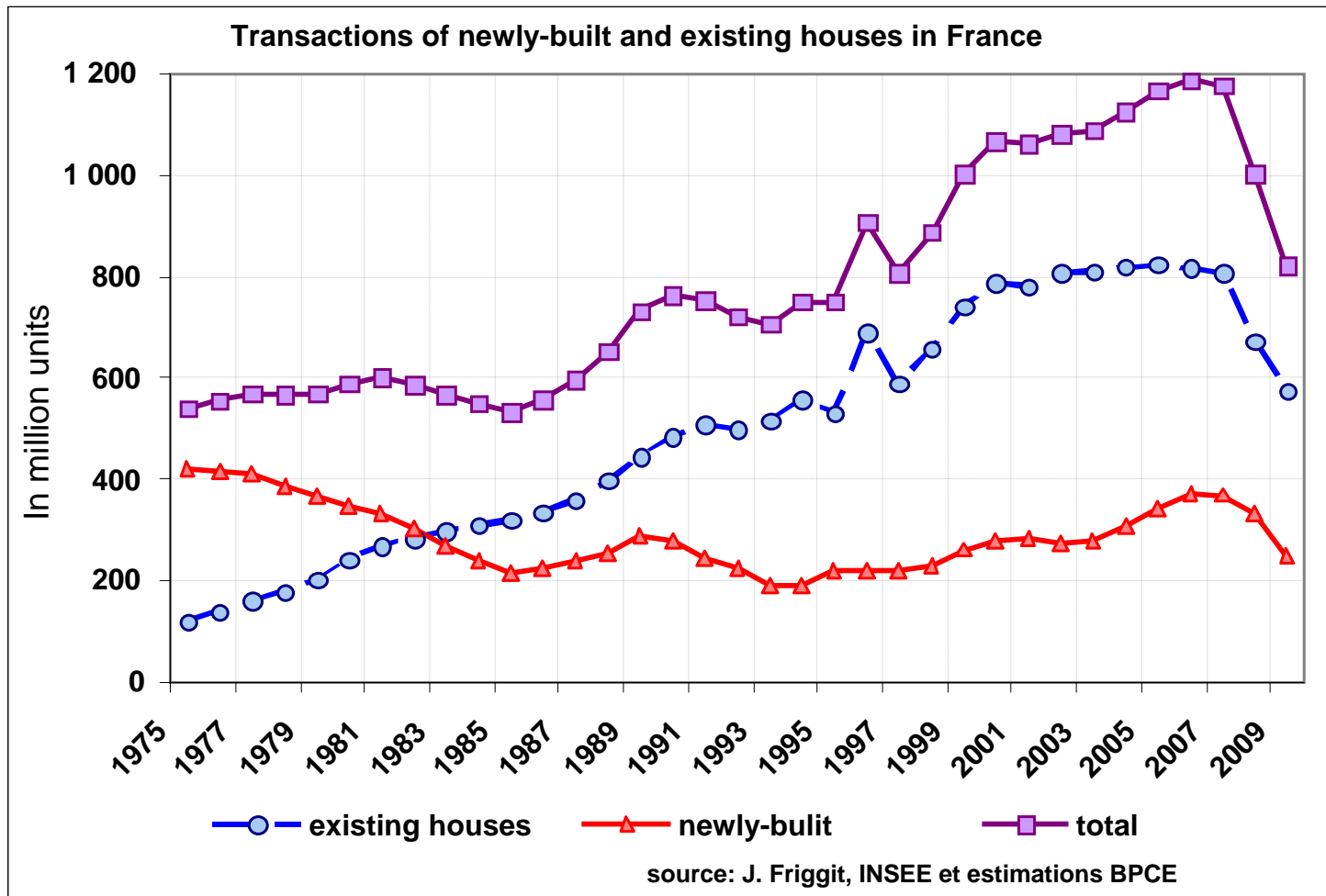
- The end of a debt cycle: the level of debt and the development of housing prices are linked together
- The debt cycle has contributed to an extraordinary and disproportionate increase in real estate prices, a correction is necessary ... but to which extent?



A bullish market phase of a very long cycle: transaction and price indicator



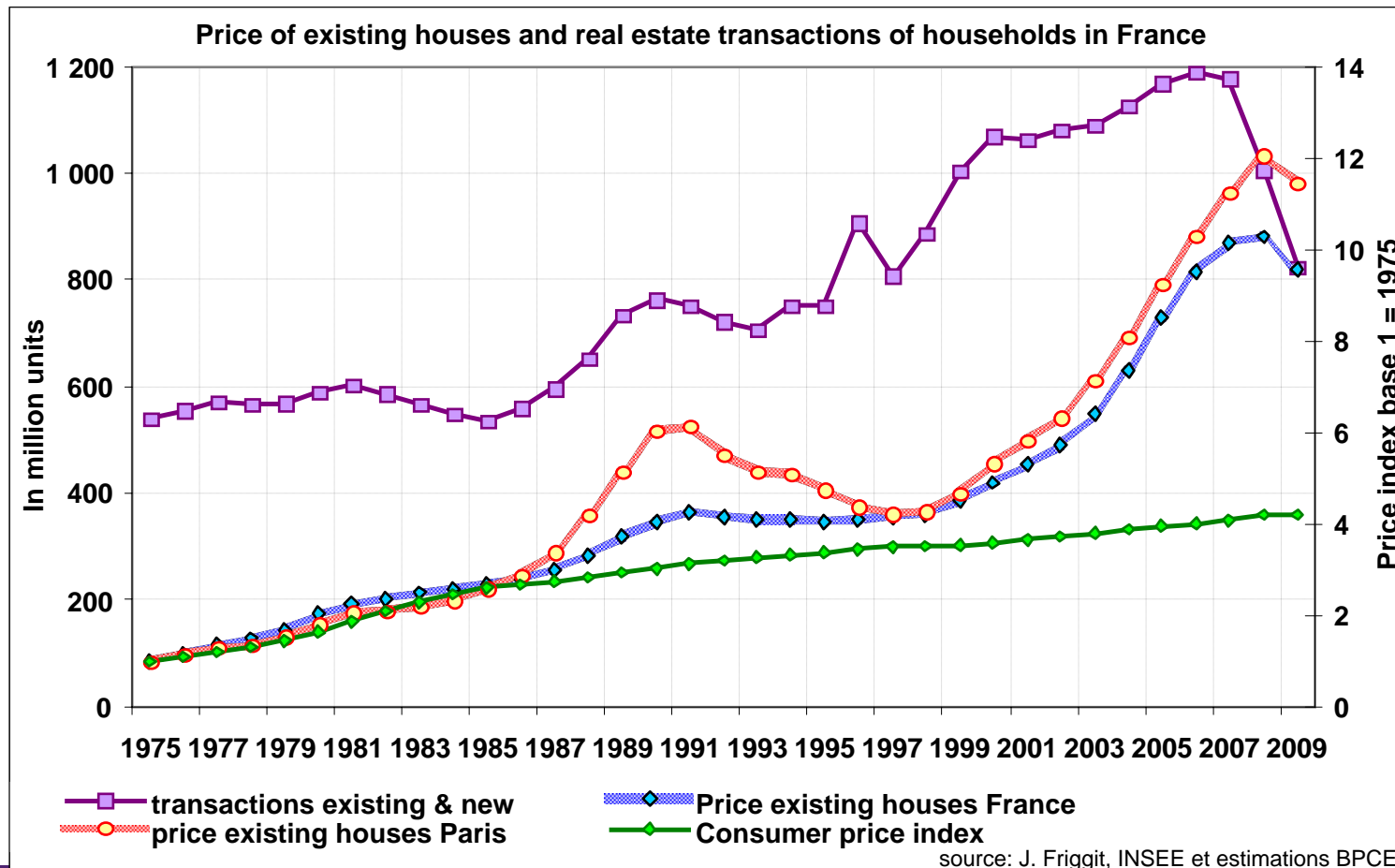
- A 13- year period of a bull market and 480,000 housing units, compared to 5 years and 230,000 additional acquisitions from 1985 to 1990
- Transactions stabilised around the year 2007, only to fall by almost 20% 2008-2009



A bullish market phase of a very long cycle: transaction and price indicator



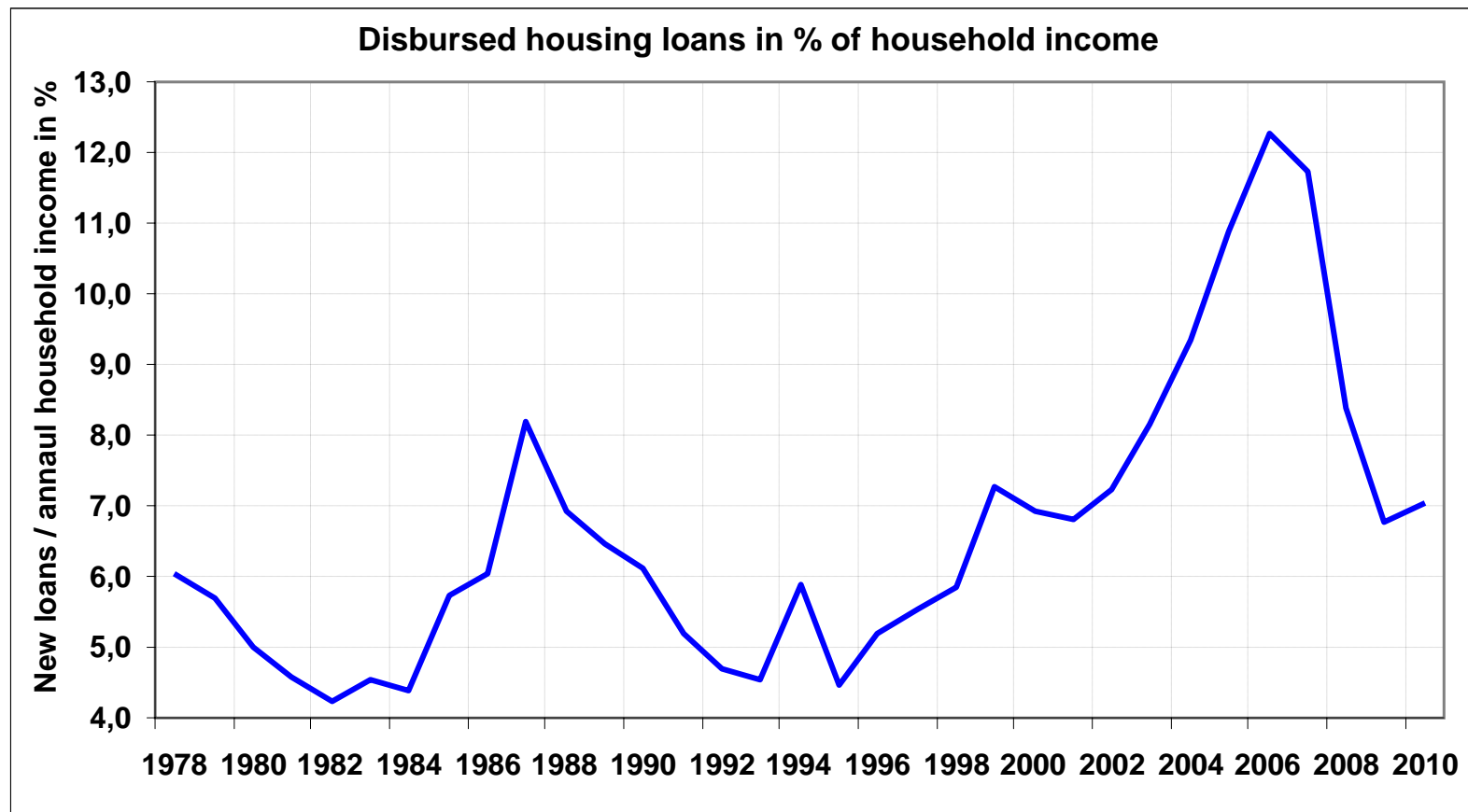
- Higher prices for the whole country: in constant Euros, the prices increased by a factor of 2.1 (France) and 2.4 (Paris) from 1997 to 2008 compared to 1.3 (France) and 2.1 (Paris) from 1985 to 1991
- The price correction in real estate set in comparatively late and turns out much weaker than the decrease in transaction volume



A bullish market phase of a very long cycle: the credit indicator



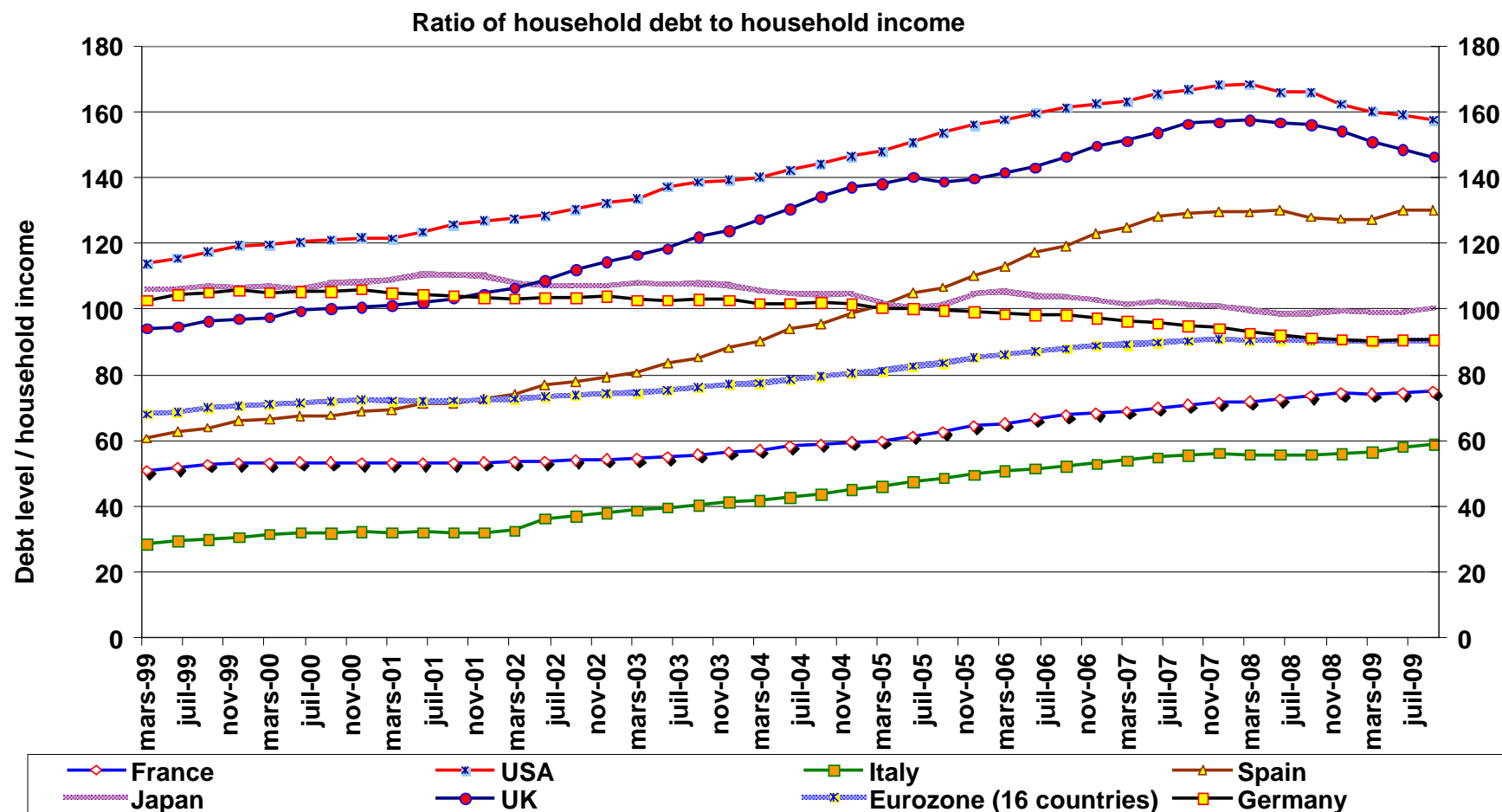
- A decade of growth, compared to the five years before
- A swell of new loans, that reached up to 12% of household income in 2006 and 2007, compared to 8% for the year 1987 alone
- Drastic decline in 2009, but no real breakdown: borrowing was 7% of household income which equals the peak of the last cycle → why this resistance ?



The structural factors of stability: A still stable model for the acquisition of assets



- A household debt ratio which is equal to the median of the Euro zone and among the lowest of the developed countries ... Despite the sharp increase in the 2000s



The structural factors of stability: A still stable model for the acquisition of assets



■ A balanced model for the acquisition of assets as limiting factor

- High savings of households and a systematic use of this financial potential in combination with a relatively low dependence on credit

Financing of households in Europe in 2007

In % of household income	Belgium	Germany	Spain	Italy	Netherl.	Austria	Portugal	Finland	Sweden	UK*	France
Gross resources											
Rate of gross savings	13,8	17,0	10,2	14,3	14,3	16,3	6,7	5,5	12,8	2,6	15,6
Rate of recours to credit	6,3	-1,1	14,5	4,4	15,5	4,1	10,5	9,3	6,9	15,0	7,0
Transfers and adjustments	5,9	0,7	2,6	1,3	0,9	-0,8	4,1	2,4	5,0	1,7	-0,3
Rate of gross accumulation	26,0	16,5	27,3	20,0	30,7	19,6	21,2	17,3	24,6	19,3	22,3
Gross usage											
Gross investment rate	11,1	9,4	15,3	9,8	14,7	8,0	7,7	11,7	6,1	9,4	10,2
Rate of financial investments	14,9	7,1	12,1	10,2	16,0	11,6	13,5	5,6	18,6	9,9	12,1
Rate of gross accumulation	26,0	16,5	27,3	20,0	30,7	19,6	21,2	17,3	24,6	19,3	22,3

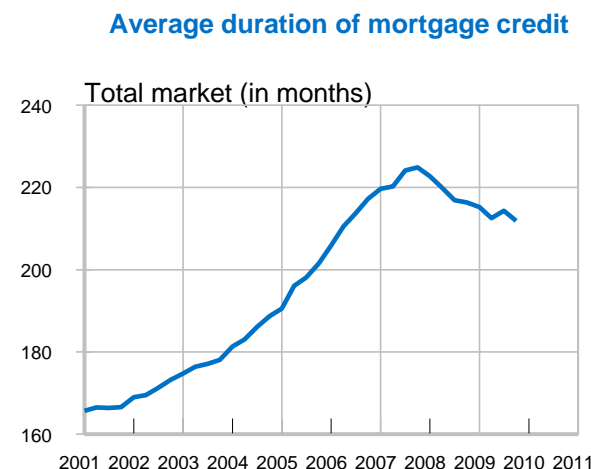
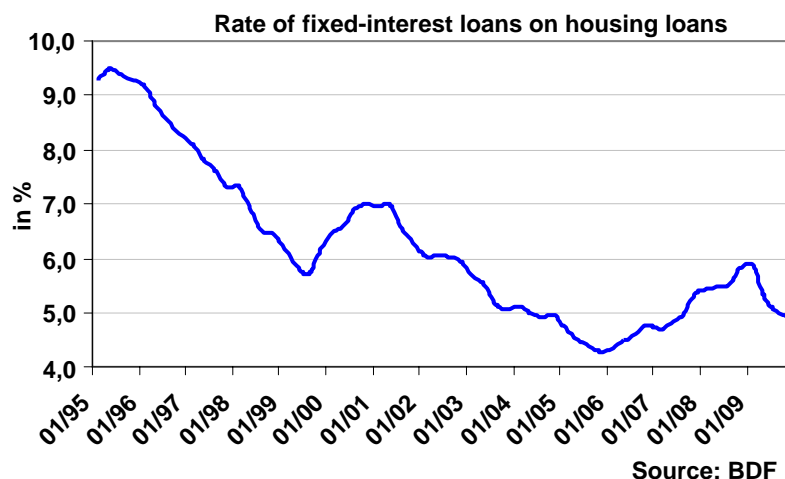
* estimation BPCE

➔ From a macroeconomic perspective, the risk of default of French households is relatively low

The structural factors of stability: the loan features support solvency



- Marginal role of variable-rate loans: only 5% to 10% of all loans
- A prominent and original role of the surety as guarantee instrument
 - It is cheaper and more flexible than a mortgage, it covers 55% of loan production
 - It is the buyer's ability to pay that is estimated not the value of the property → this encourages compliance with the solvency rules by both parties
- Change in credit conditions in the last 10 years
 - Declining interest in loans (from 8% to 4%) accompanied an increase in duration (from 12 to 18 years) → Annual instalment of avg. loan declined by ca. 40% from 1995 to 2006



- But since 10 years a declining role of *épargne-logement*: Low interest rates made this instrument less attractive as its lending rates are higher than the market ones

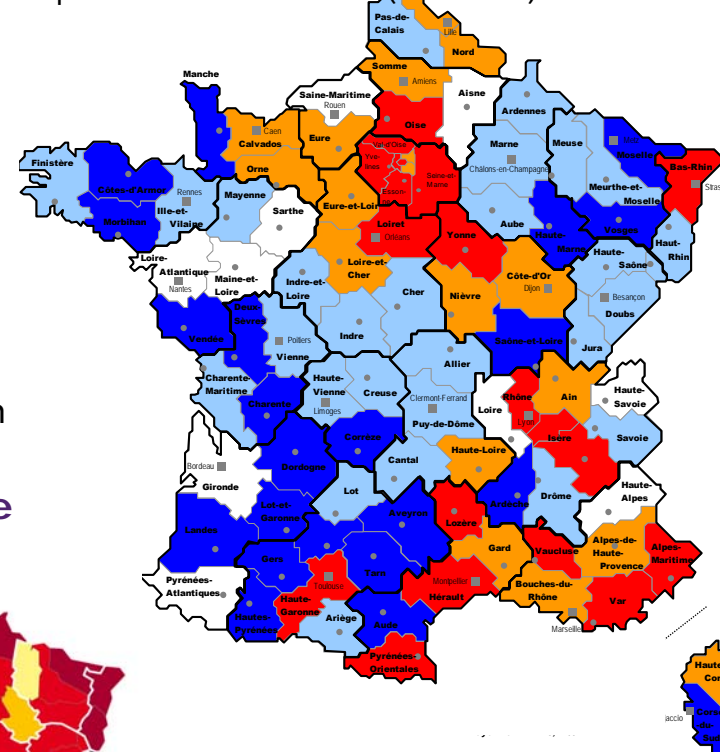
The structural factors of stability: persistent housing shortage in densely populated areas



- Estimated need of 450,000 housing units per year, but since 2000 only 350,000 construction starts
- The housing shortage is severe in areas with high social and demographic pressure
 - Areas with poor housing conditions (poor, overpopulated) overlap with areas with too little construction activities
 - In urban areas (Ile de France, Rhône-Alpes...)
 - In regions that are most affected by poverty (Nord, Sud-Est...)
 - In certain regions with high population growth through migration (Sud-Est...)
- The shortages have been even exacerbated by the decline in construction 2009-2010

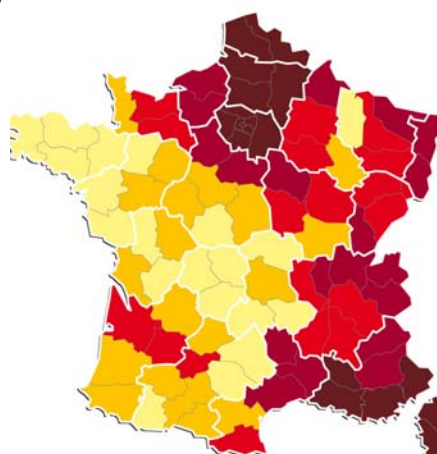
Indicator of construction deficit

Difference between the 2003-2006 construction level and the scenario of low potential demand for 2005-2015 (in % of stock)



Overcrowding and poor housing
In % of number of households in 1999

- Supérieur à 2,98
- Compris entre 2,5 et 2,98
- Compris entre 2,21 et 2,5
- Compris entre 1,87 et 2,21
- Inférieur à 1,87



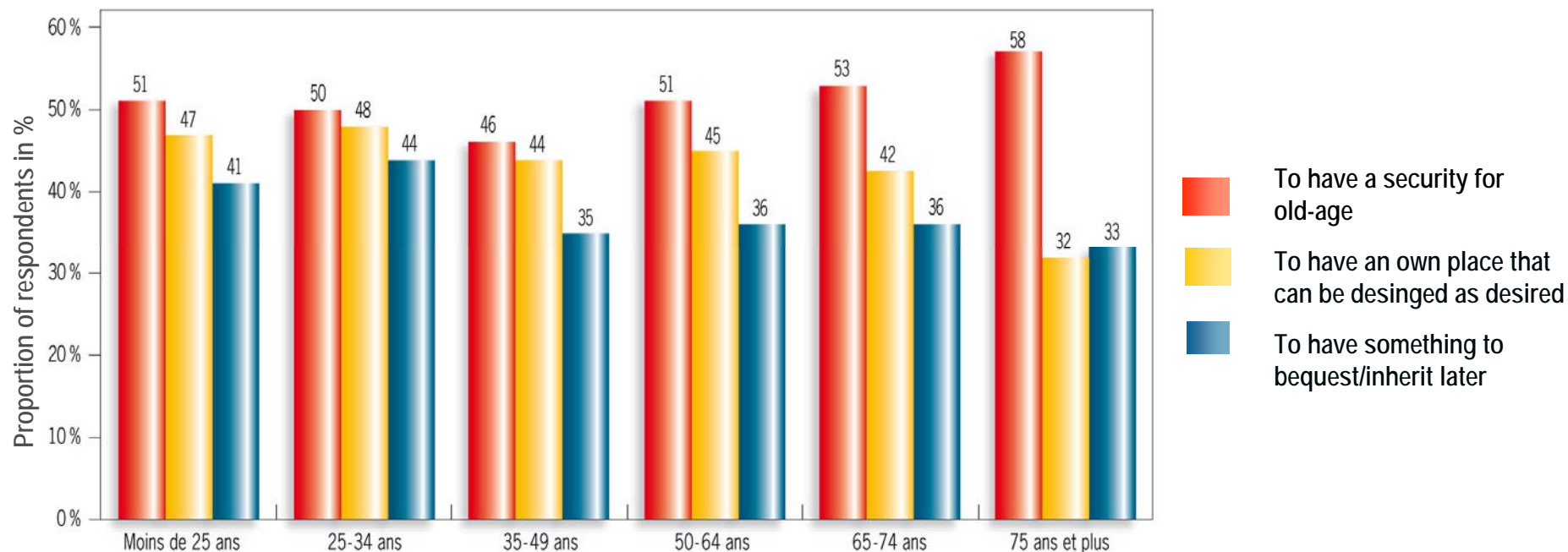
- Surplus
- Slight surplus
- Low deficit or balanced
- Medium deficit
- High deficit

The structural factors of stability: the desire for an own house remains strong



- The desire for an own house is traditionally strong in France
- The need to provide for old-age strengthens this effort
 - Old-age provisions, only 4th reason for acquisition in 2001, is first reason in 2007
 - Real estate property is considered a security for the future: it limits future expenses and is a good capital reserve in a «worst case scenario»

■ Major motivations for the acquisition of property

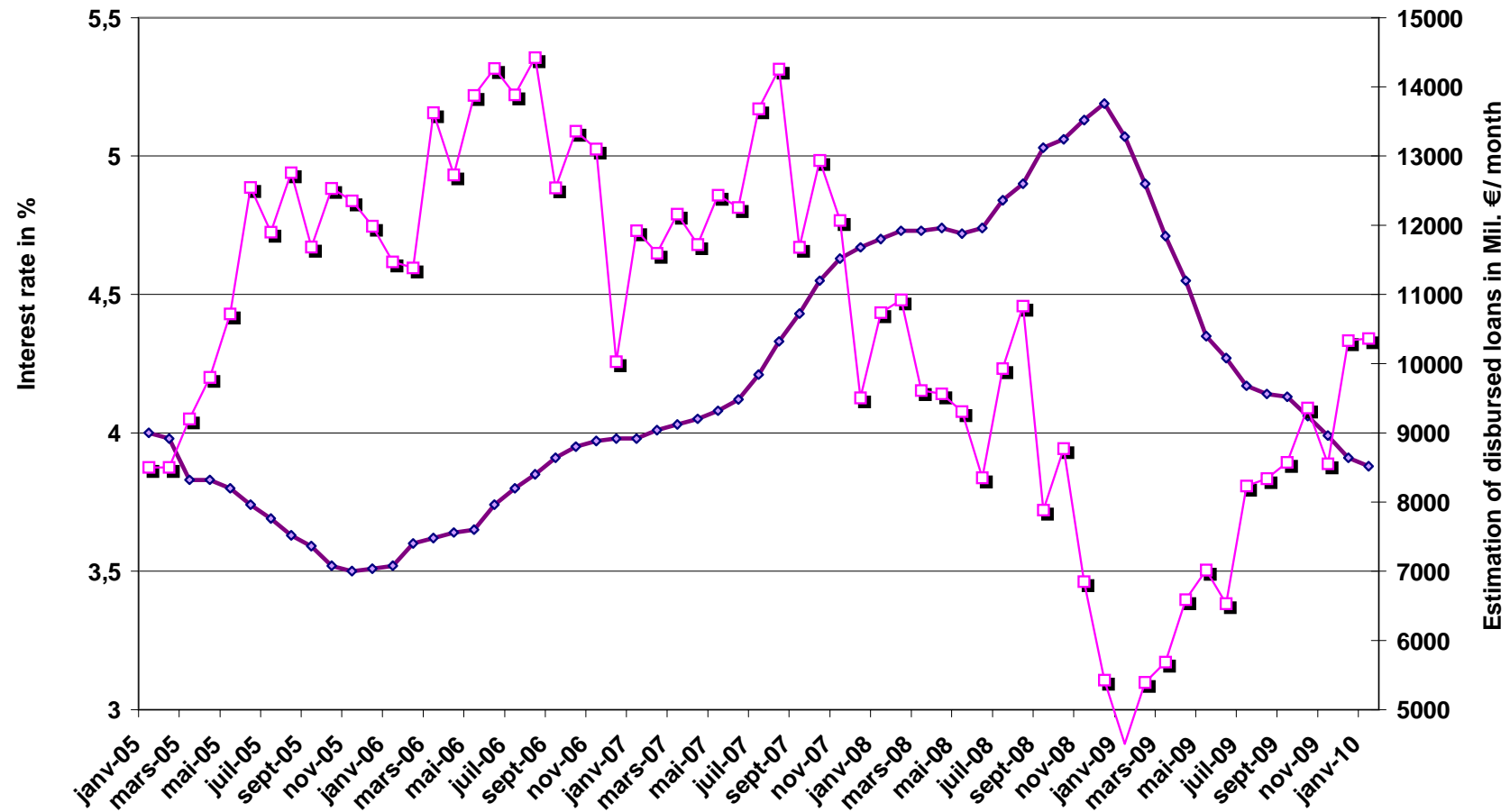


Economic factors of support: a significant decline in interest rates and a rapid recovery of credit supply



- A decline of 140 base points in one year
- Rapid recovery of credit supply

Interest rate for housing loans and disbursed housing loans from 2005 to 2010
(estimations: BPCE, after Banque de France)

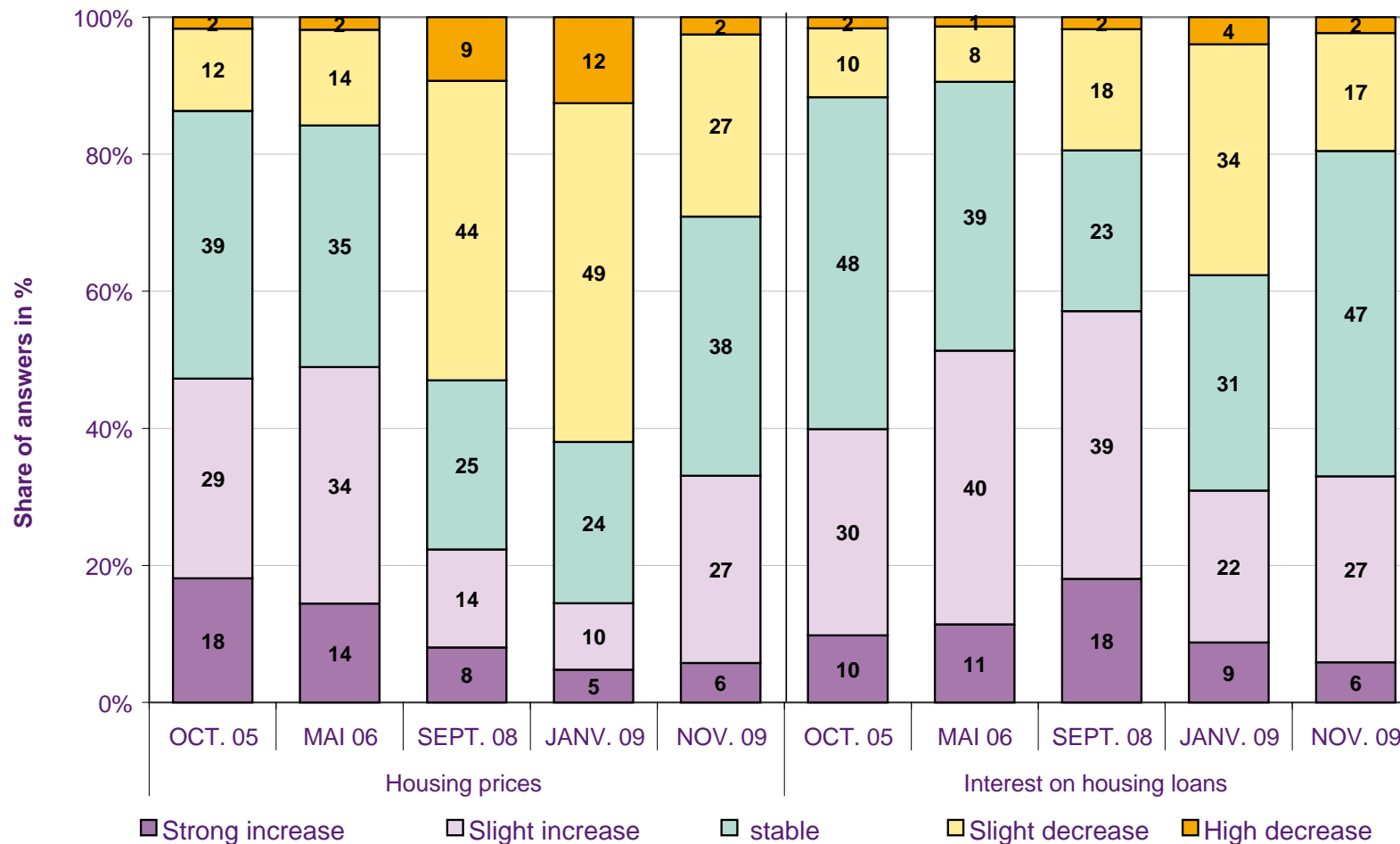


Economic factors of support: convictions and expectations of households back the market



- The French do not believe in a housing crash: Their memory of volatile real estate markets has been cleared by a 12-year bull market period and the comparison with the stock market that saw two crises in 10 years is flattering

Perception of the development of future housing prices and interest on housing loans



Economic factors of support: the government policy supports the real estate market aggressively



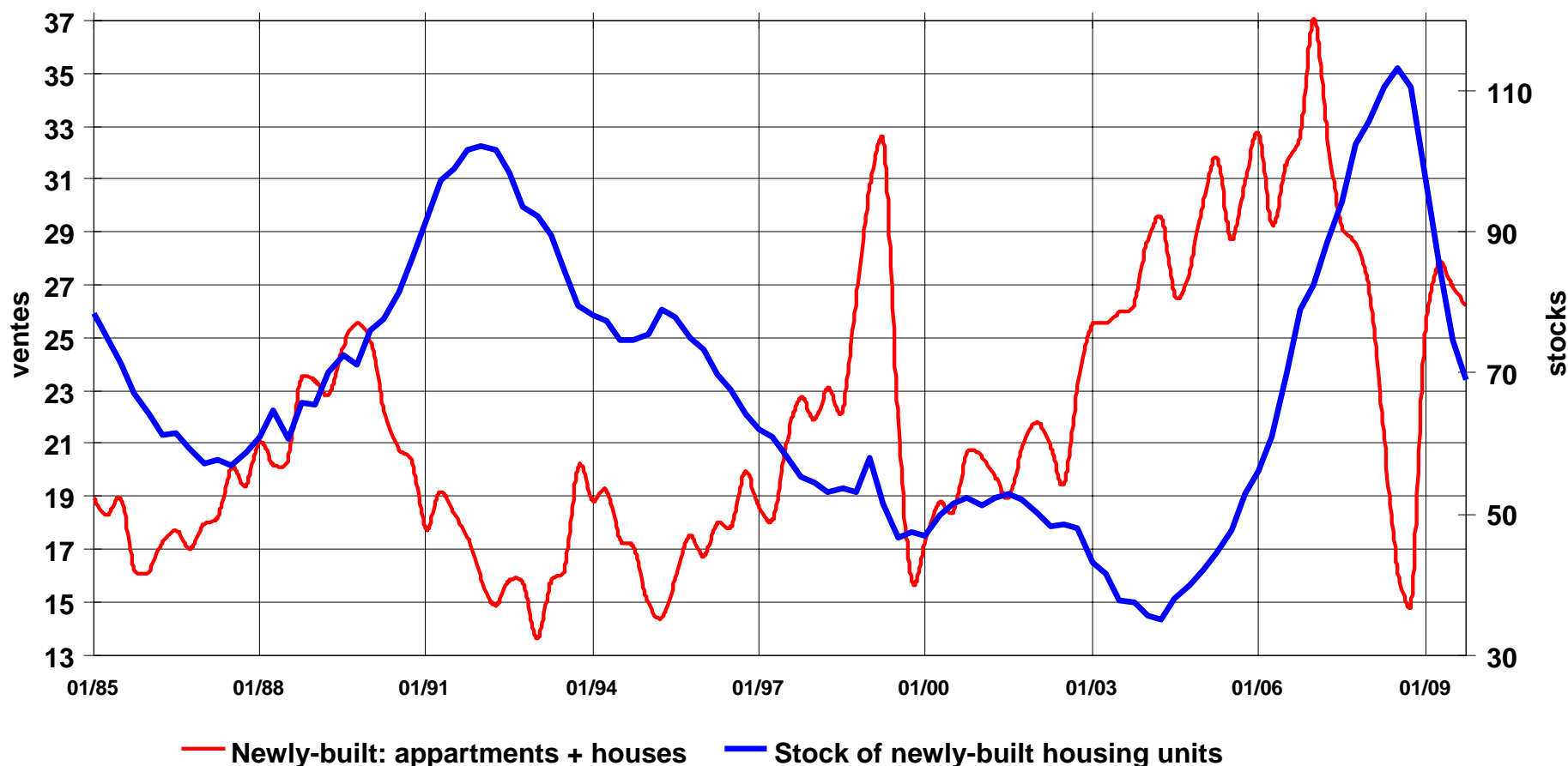
- **Doubling of the zero-interest loan (ZIL)** (A long-term, supplementary, interest free loan which is available for first-time buyers as long as they do not exceed certain income limits)
 - Increase of the income limit (ca. 60,000 € / year for Ile de France and 45,000 € / year in the province for a family of four)
 - Doubling of ZIL for owner-occupied houses, that have been bought in 2009 or have been or will be purchased in the first half of 2010
 - Furthermore an increase of 50% for purchases of newly constructed houses from the second half of 2010 to 2011 (transition period)
 - An additional increase of 15,000-20,000 € can be expected if the house satisfies the latest energy saving standards (BBC 2005)
 - In tense regions ((«sensitive») urban areas) the duration of the loan is increased to 25 to 30 years and a deferred repayment is allotted
 - On average, the ZIL increased from 18,000 € to 36,000 € ; its share on the transaction amount rose from 20% to 30%
- **Extension of «Pass-Foncier»** (it can be combined with the ZIL and allows the purchase of a simple house in two steps: first the construction costs are repaid within 18 to 25 years and after that, the land is repaid within 10 to 15 years. Moreover, buyers profit also from a reduced VAT and support of the community)
 - Also the construction of multi-family houses is eligible to «Pass-Foncier»
- **Introduction of an eco-zero-interest loan (eco-ZIL)**
 - It was introduced in April 2009 and serves as an incentive for homeowners in order to improve the energy balance of their houses. The eco-ZIL allows for the financing of works up to 30,000 € and has to be paid back within 10 years.

- **«Scellier»: a support for investments into rental housing**
 - This instrument replaces older subsidies for investments into rental housing and offers the possibility to deduct 25% to 37% of the total amount invested in 9 to 15 years from taxes
 - The tax reduction amounts to 25% in 2010 for an investment not exceeding 300,000 € and falls to 15% in 2011 and 10% in 2012
 - For an investment in a building that conforms to the "BBC 2005 standards", the tax reduction amounts to 25% in 2011 and falls to 20% in 2012.
- **These measures, aimed at newly constructed houses, had a clear impact**
 - ZIL-payments increased by 35%, and loans for newly constructed houses fell only by 7% although the total fell by 16%
 - The sales campaign of the private residential construction sector led to a sales increase of 34% and made it possible to reduce (excess) supply without jeopardizing the financial stability of the industry
 - The development is more muted for existing buildings – in contrast to the sales at newly-built houses
 - The eco-ZIL have reached their goal: 75,000 disbursed loans between April and December 2009

Newly-built houses have shown a strong recovery since spring 2009



- The upturn in sales has led to a rapid decline in stocks (compared to 1991-1993)

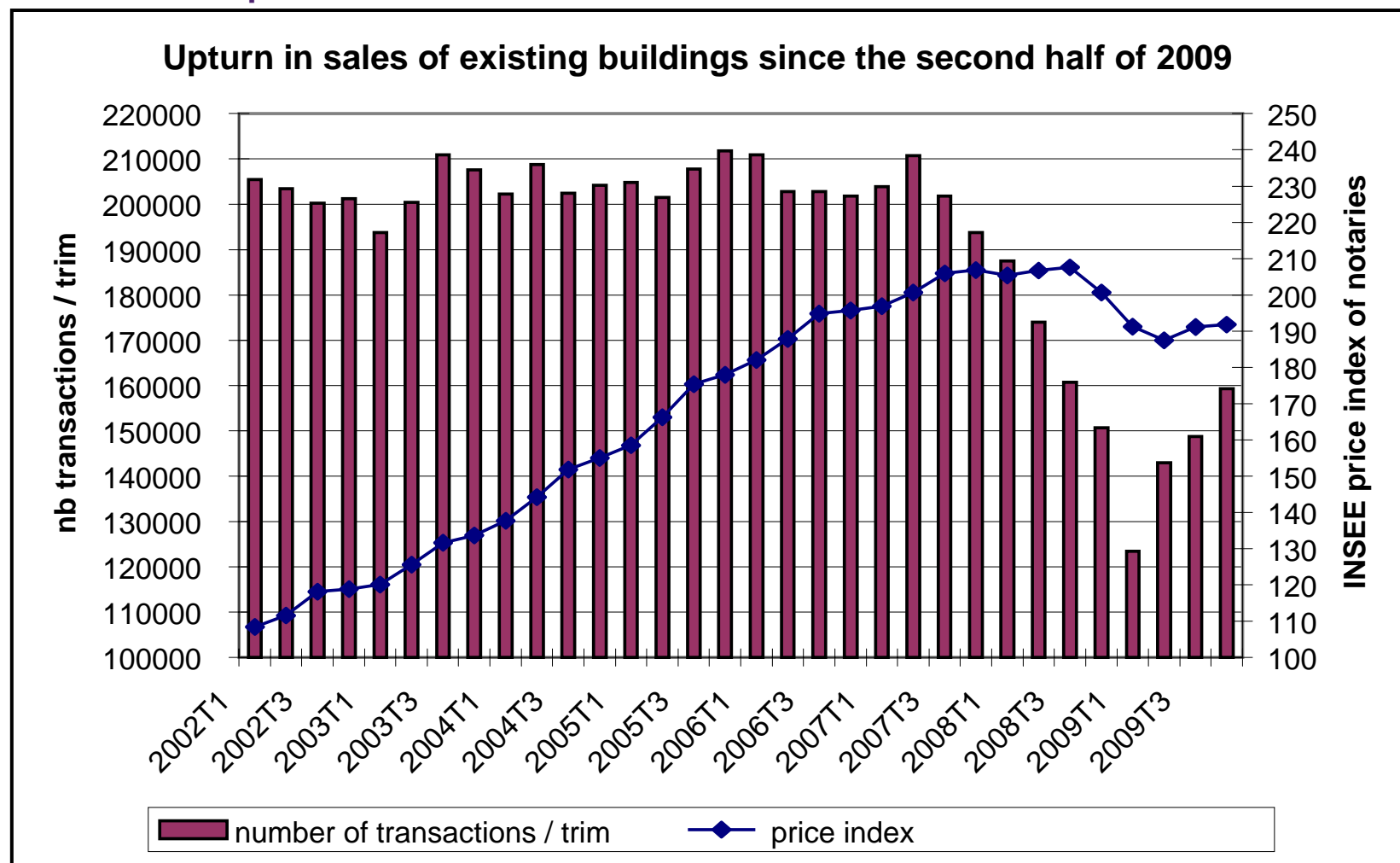


- But of 107,000 sales in 2009, only 35,000 were for ownership and only 50,000 investments (whereof 23,000 were social housing objects)

Newly-built houses have shown a strong recovery since spring 2009



- For existing buildings – and in general acquisitions for achieving home ownership – the revival was slower and less pronounced: transactions and prices remained under the pre-crisis level

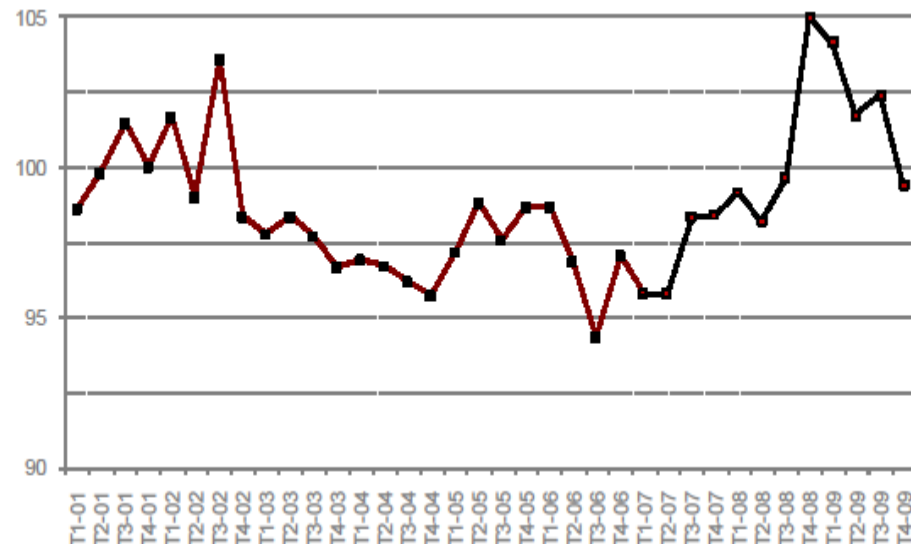


Only a short-term upswing or a resilient recovery? The question of solvency, employment and interest rates

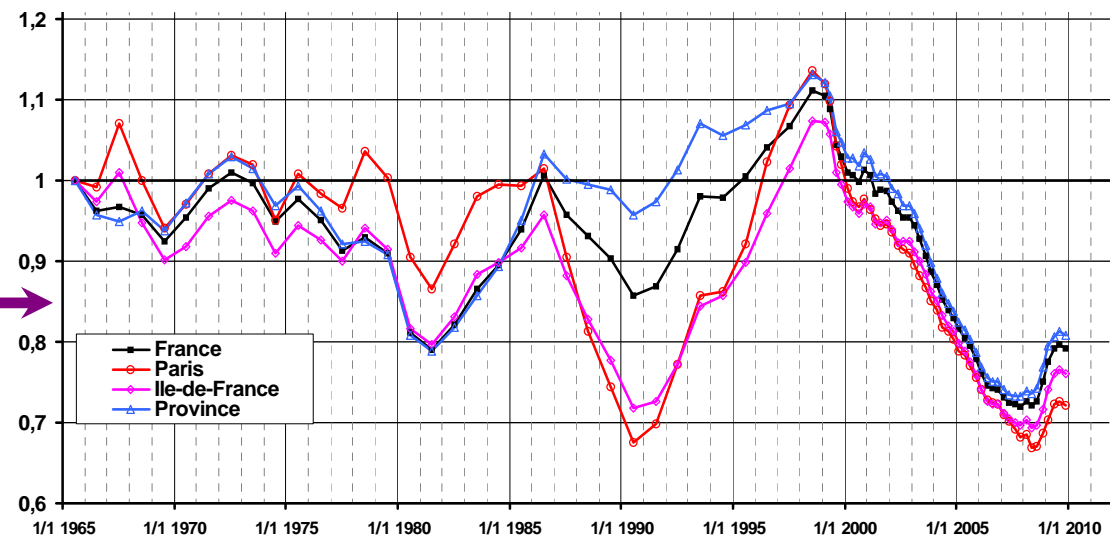


■ Economists are divided about the solvency of households

■ The solvency indicator of Mr Mouillart and Crédit Logement / CSA point to a level that equals the one in the year 2001



■ The solvency indicator of Mr Friggit and analysis Analysen of the Caisse d'Épargne show a clearly worsened solvency for 2008



Only a short-term upswing or a resilient recovery? The question of solvency, employment and interest rates



- **A deteriorating economic and financial situation of private households**
 - A weakening of purchasing power which is mitigated by social transfers and a low inflation rate: 2.2% in 2009, 0.5% in 2010
 - A continued rise in unemployment to over 10% in 2010
- **A gradual tightening of monetary policy**
 - There are signals for a cautious and gradual change in the general monetary policy, to prevent later on a sudden correction
 - From the second half of 2010 there may come a period of gradual and careful raising of interest rates ... to 1,25% or 1,5% by the end of 2010?
- **The long-term interest rates are on the rise**
 - The exit of central banks from quantitative easing will lead to a reduced demand for government bonds from credit institutions
 - The reversal of inflation expectations and tightening of monetary policy ... should diffuse and let long-term interest rates rise to 4%
- **The rise in housing prices and the deteriorating financial situation of households may hinder a timely recovery and delay it to 2012**