

# Development of a financialized rental investment product: private serviced residences in the Paris region (Ile-de-France)

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## **Abstract**

Most research on the financialization of the real-estate sector tends to focus on commercial property, although such a trend also affects the rental housing market. In France, *private serviced residences* (namely student residences, business-tourist residences, senior residences and retirement homes) represent the rental investment product closest to standard financial securities. Despite the very limited presence of institutional investors, this paper argues that serviced residences can still be considered “financialized” as they share two striking similarities with products offered on the tertiary property market: the search for maximum intermediation between the investor and the acquired property; geographic patterns which are increasingly shaped by the potential investments' rates of return. In this paper, I analyse the serviced residence sector in the Paris region (Ile-de-France). A geo-localized database, established at the level of postal address, was built for four main types of private residences. The dataset is based on information provided by the actors of the sector.

**Keywords:** serviced residences; Paris region (Ile-de-France); financialization; housing

## Introduction

In France, serviced residences (*“résidences avec services”*) first emerged in the late 1960s and early 1970s, mainly in the form of tourist residences offered by real-estate developers in winter and seaside resorts. From the 1980s, this model gradually spread to other types of residential properties but the real boom of the sector dates from the mid-1990s. As a result, the share of serviced residences in total new-build housing units has increased in France from 1.9% in the period 1990-1994 to 4.7% in the period 2005-2009. This trend is even more pronounced in the Paris region (*Ile-de-France*), where this share has gone up from 1.4% to 8.3% in the same period. The label “private serviced residence” now encompasses four main types of rental properties, designed for different types of populations, namely: student residences; tourist-business residences, also known as “apart-hotel” or “self-catering” apartments; senior residences, for independent elderly people; and retirement homes, also called EHPAD (or “nursing homes for dependent elderly people”). Due to their apparent heterogeneity – at least from a tenant point of view –, these various properties are usually studied separately. However, from an investor point of view, they all belong to the same family of rental investment products aimed at private individual investors.

Significantly, the take-off of the serviced residential sector started at the same time as the financialization process that began to affect the French property market at the turn of the 1990s. However, in the French context, it is generally assumed that financialization has above all impacted on the tertiary property market of great metropolises (business, commercial properties, urban infrastructures). Indeed, in France, financialization has led to a global withdrawal of institutional investors (e.g. banks, insurance companies, pension funds) from the national rental housing market (Nappi-Choulet, 2009), whereas this process is generally considered as going hand in hand with a growing involvement of such financial actors. But despite the very limited presence of institutional investors in the serviced residence sector in favor of private individual investors, this paper argues that these residential products can still be considered “financialized” as they share two striking similarities with those offered to institutional investors on the tertiary property market. First, there is in both cases the search for maximum intermediation between the investor and the acquired property

(Theurillat, 2011). A second common feature is their geographic patterns, which are in both cases increasingly shaped by the potential rates of return on investments (Crouzet, 2001; Harvey, 1985). The growth of the serviced residence sector has also been possible because of advantageous tax relief attached to this type of housing product (Pollard, 2010; Vergriete & Guerrini, 2012).

Although the particular form and scope of the serviced residence model are specific to the French context, the role played by investors in the development of similar “purpose-built” properties has been researched in several other countries, within various theoretical frameworks. For instance, the growth of private student residences has been analyzed as a consequence of new flows of international student populations (Tsutsumi & O'Connor, 2011). This phenomenon is also often regarded as symptomatic of a specific type of gentrification: “studentification” (Hubbard, 2009; Smith, 2009). Senior residences are often studied by looking at their most extreme form: gated communities intended for elderly people (“sun cities”, “retirement communities”) (Pihet, 1999; Stroud, 1995). In the field of the geography of tourism, tourist-business residences are analyzed as a specific sort of secondary residence or a new branch of the hospitality sector (Johns & Lynch, 2007; Nicod *et al.*, 2007), while retirement homes are mainly a research subject within the geography of health and aging (Joseph & Chalmers, 1996; Ford & Smith, 2008)

This paper puts emphasis on the intrinsic quality of serviced residences as rental investment products, as they are the closest to the ideal of dematerialized property assets equivalent to standard financial securities on the French housing market. This paper also aims to provide a picture of the serviced residence market which has remained unexplored by using information provided (notably online) by major actors of the sector: private real-estate developers, property managers, real-estate agencies, specialized advertisement websites. A geo-localized database, established at the level of postal address and intended to be as exhaustive as possible, was built for the purpose of this study by collecting data on the four main types of private residences above-mentioned. I chose to focus on the Paris region (*Île-de-France*) as this area provides a good case to explore the dynamics of the sector and the activities of its actors. The first French metropolitan area is the oldest and biggest French urban market for serviced residences. It

represented 18% of the new-build serviced residence housing units in the country in the period 2005 to 2009. Furthermore, the four main types of serviced residences are well represented in this area. The database includes data on 564 residences in operation at the time of this research (first quarter of 2012), which represent more than 50,000 housing units. In addition, detailed information (including advertised rates of return) was compiled on about thirty serviced residences commercialized in the same period.

First, through a description of the main characteristics of the serviced residence model, I will shed light on practical ways sectoral actors use to achieve intermediation. Then, I will analyze the dynamics of construction and location patterns of these financialized products in the Paris region, with a specific emphasis on the influence of investors rates of return. Finally, as the serviced residence sector remains segmented, each type of residence following its own logic, I will show how these subsectoral dynamics are reflected in the profiles of the players involved in each branch.

## **The serviced residence model: definition and delimitation**

The French General Tax Code provides a unifying definition of serviced residence accommodation : 'a furnished apartment (...) including, in addition to accommodation, at least three of the following services delivered in similar conditions to those offered in professionally-run hotels : breakfast, regular cleaning of the premises, providing of the household linen and reception of customers, even not individualized.' (Article 261 D 4° b of the General Tax Code (CGI)). This type of accommodation is a mix between a furnished rental apartment and a hotel room, but it differs from both on several aspects. On the one hand, it differs from a furnished rental apartment with regard to the hotel-like services provided, the fact that it is intended for special categories of tenants and that it is located in specifically designed housing complexes (and never in standard residential buildings). On the other hand, it differs from an hotel room as stress is put on the autonomy of each apartment; theoretically, a tenant should be able to live in a serviced residence without having recourse to the collective hotel-like services offered. This requirement implies in particular the presence of a kitchen –

hence the term of “self-catering residence” mainly used in the business-tourist sector. It also differs in terms of ownership structure: in most cases, the apartments of a serviced residence are sold on a lot-by-lot basis to private individual investors and are not owned by a single owner, like most hotels.

***Serviced residence as a rental investment product: the benefits of intermediation***

The serviced residence model is mainly based on the idea of intermediation between investors and real physical properties pushed to its maximum. But what does this intermediation concretely consist in? Serviced residences are generally designed from the very beginning in close cooperation between a real-estate developer and a property manager. It is quite usual for these two actors to be part of the same real-estate group. Prior to the property purchase, the developer offers investors a financial package rather than a tangible apartment (sold most often 'off plan'); this package already takes account of tax reliefs corresponding to this kind of product and includes an advantageous loan pre-negotiated with a financial partner of the operation. This financial package is made even more attractive through the systematic involvement, after the purchase, of the property manager who relieves the investors from any rental management tasks: he will attend to tenant search, lease management, rent collection and provision of services attached to the property. The involvement of a single manager for the whole residence plays the role of an insurance mechanism for the investor, as it ensures steady rental income flows guaranteed by contract at a pre-negotiated rate, irrespective of whether his particular apartment is actually rented or not; it secures at the same time the tax breaks linked to this kind of investment product. In return, the investor just has to sign a compulsory long-term commercial lease (at least nine years duration) in favor of the appointed manager. As a result, the investor bears no rental risk at all and the only variables he has to consider are the amount of capital to provide and the expected rates of return. Due to this far-reaching system of intermediation, serviced residence apartments can be sold as dematerialized financial assets, very close to bonds, and are often referred to as 'packaged products'.

### *Serviced residence as a tax exemption tool*

The development of the serviced residence sector was and is also largely driven by tax considerations. Since the mid-1990s, the French governments implemented a series of tax deductions aimed at boosting the new rental housing sector through investment from private individuals. Even though those tax deductions were above all targeted at the conventional rental sector, investors in certain types of residences (notably student residences and retirement homes) could also benefit from them. Until recently, owners of serviced residence lodgings could also be granted an advantageous fiscal status called LMP (for 'Professional Furnished Accommodation Renter') under a simple condition of minimum rental income in this type of rental housing, even when they were not actual 'professionals'. But this LMP status was eventually denounced as a tax-evasion tool and was drastically restricted in 2009.

Partly in order to offset this restriction and prevent investors from abandoning the sector, a tax abatement specifically designed for serviced residences and called 'Censi-Bouvard' (or 'Scellier LMNP') was set up the same year (Article 199 of the General Tax Code (CGI)). This measure concerns all the before-mentioned types of serviced residences, except senior ones. This decision was politically justified by the social functions these products are supposed to fulfill, especially on tight property markets: they target growing populations that face difficulties finding suitable accommodation for economic and/or comfort reasons. Serviced residences are usually presented to private investors as “socially responsible investments” (SRI), once again mirroring an emerging trend on financial markets. Yet this assertion is very questionable as the tax reductions provided by the Censi-Bouvard law do not depend on social conditions – e.g. protected rents or conditions as to tenants' income –, nor on any spatial constraints regarding the location of the apartment.

## The dynamics of the private serviced residence market: a geography of return rates

### *A high-growth sector since the mid-1990s*

The number of new serviced residence lodgings built per year in the Paris region has steadily increased from the mid-1990s (Figure 1).

**Figure 1.** Construction of serviced residence apartments in the Paris region (1985-2009). *Source:* SIT@DEL2 (data) / Trouillard E. (treatments)

The timing of this expansion is closely connected to the development of the tax measures promoting investments in new rental housing. The major trend has been a progressive spatial deconcentration, first in favor of the inner suburbs (60% of the constructions in 1995-1999), and eventually in favor of the outer suburbs where most of the constructions took place over the last period (49% in 2005-2009) (Table 1). This shift in the construction of serviced residences towards the outskirts of the Paris region has to be connected with the important increase of land and real-estate prices on this market, mainly since the late 1990s (Friggit, 2011). The development of the serviced residence sector took place at the national level, but the Paris metropolis is particularly attractive and safe for investors as its real-estate market remains tight and potential demand for such products is high. Indeed,

quite an important part of the populations targeted by these rental products (students, tourists, businessmen, seniors) is concentrated in the area.

*A production concentrated along a north-south axis...*

Data available at a communal level for the 2000-2009 period (Figure 2) show that construction in the serviced residence sector is highly concentrated along a central north-south axis that crosses most of the inner suburbs of the Paris region. This distribution can be explained by an underlying axis of high rates of return, as evidenced by the map representing the private serviced residences under development in the Paris region by their advertised rate of return (Figure 3): this connection is particularly clear in the case of the north-east of the inner suburbs (in the department of Seine-Saint-Denis) as well as in the south of the inner city of Paris, where most of the highest rates (superior to 4%) are located.

**Figure 2.** Construction activity of the serviced residence sector in the Paris region between 2000 and 2009. *Source:* SIT@DEL2 (data) / Trouillard E. (treatments)

**Figure 3.** Projects of private serviced residences in Ile-de-France according to their advertised rate of return. Source: Author's database

Rates of return result from a trade-off between new housing prices in the Paris region and the level of rents a location is likely to generate for a certain category of tenants. The lower the housing prices and the higher the collected rents (two conditions rather contradictory in practice), the higher the final rate of return for an operation. Given these conditions, it is no surprise to observe that both the axes of construction and rates of return actually follow and reflect a dividing line in terms of housing prices: this dividing line separates the Paris agglomeration into a wealthier western part, more attractive but also more expensive, and a cheaper eastern part, with more people from lower social classes. In most cases, it is along this dividing line that the chances of maximizing the rates of return will be the highest.

***...But a sector that remains segmented: variety of residences, variety of trade-offs***

Substantial differences can be observed when examining the distribution of the different types of existing private residences in the Paris region (Figure 4). First, it appears that the different branches are not equally developed from a quantitative point of view. Second, the maps show distinct location patterns.

**Figure 4.** Locations of private serviced residences in the Paris region according to their type. *Source:* Author's database

Those results indicate that each type of residence still has its own specificity and constraints. Each is characterized by specific trade-offs to maximize the profits generated. For instance, students' financial capacities are not comparable to those of the elderly, and their requirements when moving into a residence are not the same either. For student residences, central locations are generally sought, as the proximity of educational establishments (high schools, colleges and other establishments of higher education) as well as that of the city center and its amenities are regarded as key variables. The price of the centrality will be balanced out with a provision of services limited to the minimum required by law to obtain the tax abatement, so as to limit rent levels. Conversely, retirement homes are characterized by heavy expenses in mandatory medical services, which necessarily have a significant impact on the financial equilibrium of the residence. In addition, potential tenants are advanced in age, dependent and much less mobile. As a result, the centrality of the residence is often less decisive for the tenants than its immediate surroundings, its liveliness and the comfort of the apartments. Marketers also emphasize security aspects such as restricted access, fences and presence of a security guard. The additional costs generated by these services can be offset by choosing a less central location with lower land prices.

It appears that the key activity in the conception of products like student residences is development, as the services provided are of secondary importance in comparison with the location of the residence. On the contrary, the crucial activity in the case of retirement homes is management, as the quality and quantity of services provided are more important for the success of the residence than its centrality. By contrast, senior residences and tourist residences are situated in an intermediate position, with a less clear-cut trade-off between location and services.

## **The players of the financialization process in the serviced residence sector**

Who are the “anchoring actors” (Theurillat, 2011) of serviced residences in the Paris region, concretely responsible for the production (the anchoring) of these financialized products on the real property market? The existence of specific constraints and trade-offs for each type of residence clearly results in specialization: despite the standardization of the sector, the serviced residence market remains segmented as property groups with strong positions in several branches are still the exception rather than the rule. Moreover, activities in each branch are concentrated in the hands of a limited number of big players along with many small participants operating only a few residences (often only one). It is possible to distinguish between three main categories of players currently operating residences in the Paris area. Two of these categories comprise players who combine property development and management activities. The first category corresponds to specialized subsidiaries of big generalist property developers (e.g. Nexity, Kaufman & Broad, BNP Paribas real-estate). The second category is 'tax-exempting developers' (Vergriete, 2012) specialized in rental investment properties (e.g. Pierre & Vacances, the Réside Études group). Lastly, there are also pure property managers – i.e. without a property development division –, coming mainly from the hotel business (e.g. Accor group, The Ascott Limited) or from the medical sector (e.g. Korian, Medica, Orpea).

The historical development of each branch determines to a large extent its system of actors as well as the weight of private individual investors in its functioning. Private student and senior residences have developed according

to the serviced residence paradigm – which was originally designed by and for groups with development activities and directed towards individual investors. Conversely, the private retirement home sector already existed before the development of the serviced residence model and is thus mainly structured around pure managers from the medical field. Likewise, the proximity between urban tourist residences and conventional hotels explains the strong presence of pure managers in this branch. Institutional investors also play a greater role in these two sectors. More generally, there is a trend towards the integration within a single property group of a set of functions as large as possible, ranging from property development and management to marketing, via provision of services and construction activities. The integration of various activities is beneficial to the group as it ensures the capture of a greater part of the income flows generated at each step of the “lifespan” of the investment products. It facilitates the creation and the promotion of a brand image as the serviced residence sector is largely structured around great brands (chains) of residences in the same way as the hotel sector.

## **Conclusion**

The current developments of the Parisian serviced residence sector are characteristic of two interconnected trends linked to the global process of financialization of the property sector:

1. the development of a system of intermediation that tends to disconnect more and more individual landlords from physical properties and final users (tenants).
2. the generalization of a purely financial approach to owner-investors, where urban spaces are mainly regarded as investment supports and the geography of new residences is governed by the logics of rates of return.

With regard to these trends, it is not an exaggeration to talk of financialized rental investment tools to describe these housing products, even though the market is primarily dominated by private individual investors. These conclusions can be further generalized as the conventional

rental housing sector has also been impacted in the same ways through the growing supply, politically encouraged, of rental investment products (Vergriete, 2012). Nevertheless, this trend is not as strong as in the serviced residence sector, which has become a “pure” investment market where the possibility of home ownership is hardly conceivable, neither in the middle nor the long term. This raises the question of the long-term future of this opportunistic housing stock, beyond the short-sighted perspective of the tax reduction it makes possible. Is it really compatible with the project of a sustainable Parisian urban space? Will the landlords agree to make the necessary investments to avoid the deterioration of properties initially sold as dematerialized products? Can a viable second-hand market of serviced residence emerge without public financial support? These questions provide a challenging agenda for future research.

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