Knight Frank

PARIS / ÎLE-DE-FRANCE

OFFICE PROPERTY MARKET

Q4 2018

OCCUPIER TRENDS | INVESTMENT TRENDS | MARKET OUTLOOK

OCCUPIER MARKET

KEY FINDINGS

Take-up amounted to 629,000 m² in the 4th quarter, a decrease of 19% compared to the same period in 2017.

Over the whole of 2018, take-up volumes totalled almost 2.54 million m². They are almost equal to the very good results of 2017, and are more than 14% higher than the ten-year average.

Take-up volumes in Paris exceeded one million m² for the third consecutive year.

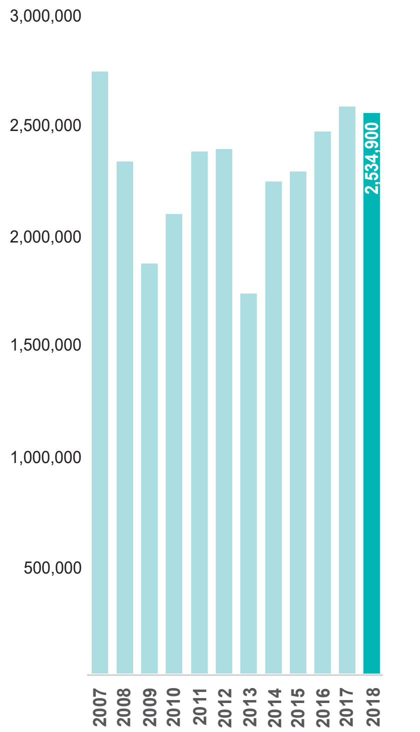
Down 12% year-on-year, the volume of available supply in the Greater Paris Region stabilised below the 3 million m² threshold. The vacancy rate now stands at 5.4%.

18.4 billion euros were invested in the Greater Paris Region office market (+10% year-on-year). 8.8 billion euros were invested in inner Paris.

Prime yields remain unchanged, between 3.00 and 3.25% in Paris CBD.

Île-de-France take-up

In m²



Source: Knight Frank

MAINTAINED MOMENTUM

Prolonging the slowdown observed since the beginning of the second half of the year, the Greater Paris Region office market experienced a robust end to 2018, although it did not reach peak levels. Take-up amounted to 629,000 m² in the 4th quarter, a decrease of 19% compared to the same period in 2017. Over the whole of 2018, take-up volumes totalled almost 2.54 million m², compared to 2.56 million m² a year earlier. The overall trend remains positive: 2018 results are almost equal to the very good results of 2017, and are more than 14% higher than the ten-year average.

The strength of the Greater Paris Region market is particularly noticeable with areas of less than 5,000 m², which traditionally form the basis of lettings activity. Areas comprised between 1,000 and 5,000 m² are the most active, with volumes up 16% year-on-year. Lettings of areas over 5,000 m² totalled 916,000 m², a decrease of 24% year-on-year. While their number is also decreasing (79 transactions compared to 93 in 2017, but 68 on average over the past ten years), it is mainly the size of large transactions that is behind the slowdown in the office market. Only six company movements of more than 20,000 m² were recorded in 2018, of which five were signed in the first half of the year. There were ten such deals in 2017, including two for more than 50,000 m² which totalled almost 150,000 m².

The shift in activity towards new/redeveloped premises remains a constant in the Greater Paris Region market, accounting for 73% of take-up over 5,000 m² in 2018, close to the 72% recorded one year earlier. The share of pre-lettings of new/redeveloped large areas also remains high (77% in number, compared to 73% in 2017 and 51% in 2016), another indication of occupiers' preference for the most qualitative properties whose immediate supply has further decreased significantly.

CONTRASTING RESULTS

The Western Crescent experienced a subdued second half of the year which explains the 9% decrease in take-up in 2018. Two office sectors were particularly hard hit: the Southern Loop, whose results were somewhat improved by Nestlé's leasing of "Shift" in Issy-les-Moulineaux, and Neuilly-Levallois, where just one deal over 5,000 m² was recorded. Following a sluggish start to the year, La Défense made up some of its lost ground in the second half of the year with the take-up of a few large, second-hand office premises. Take-up in La Défense over the whole of the year reached almost 145,000 m². This volume is down 21% compared to 2017 and 22% below the average of the last five years.

The results of the other Greater Paris Region office sectors are just as diverse. In the Inner Suburbs, the South stood out with a strong 45% increase in take-up as a result of the signing of 8 deals over 5,000 m². This sector benefits from a relatively large supply of new or recent premises; properties offered at competitive prices, which have notably attracted Parisian occupiers who have been hindered by the lack of real estate solutions in the capital. The success of the South could well continue due to the shortage of supply in Paris, but also because it will be one of the first markets to benefit from the commissioning of one of the future Grand Paris Express metro lines. This will also be the case in the North, where take-up fell sharply in 2018 (-50%), in contrast to the South. Finally, the good results of the Outer Suburbs (+30%) are mainly due to large-scale endogenous movements: several companies in the sector have chosen new developments to streamline their real estate assets, as illustrated by the 15,000 m² leased by Orange in Saint-Quentin-en-Yvelines.

PARIS, STILL ON TOP

Examples of office lettings > 5 000 m² in Q4 2018

Building/Address	Tenant	Area (m²)
Floresco / Saint-Mandé (94)	Ubisoft	16,500
Native / Montigny-le-Bretonneux (78)	Orange	15,000
3-5 bd de la Madeleine / Paris 8th	Chanel	12,500
Be Issy / Issy-les-Moulineaux (92)	Seqens	10,400
IBOX / Paris 12th	ESMA	8,000
UFO / Paris 2th	Le Bon Coin	7,800
Osmose / Arcueil (94)	Atlantic	7,600
255 boulevard Pereire / Paris 17th	WeWork	7,300
Canopy / Le Pré Saint-Gervais (93)	Hermès	6,400
94-96 rue Lauriston / Paris 16th	Adobe	5,800
Tour Europlaza / Courbevoie-La Défense (92)	Autorité Bancaire Européenne	5,300

Source: Knight Frank

Take-up volumes were stable in Paris in 2018 and exceeded one million m² for the third consecutive year. The driving force behind this success? The excellent results of the CBD and Paris Centre West, whose cumulative volumes increased by 11% in 2018 due to lettings activity in the intermediate and over 5,000 m² area categories. Murex, for example, leased the 16,600 m² "Freedom" building in the 17th district. This transaction – the largest signed in 2018 in western Paris – is symbolic of the increase in pre-lettings, a trend also illustrated by Lazard's very early positioning on the 10,900 m² in "173 Haussmann" in the 8th district. While take-up also increased in Paris North East, activity in Paris South stalled. Despite some notable transactions, such as ESMA's recent letting of 8,000 m² in "Ibox" in the 12th district, it was difficult for this sector to live up to 2017 which was notable for Natixis' lease on almost 90,000 m² in "Duo".

The rate of lettings has generally remained steady in Paris, which benefits from demand from a wide variety of companies, concerned about centrality and surroundings that are conducive to retaining or attracting talent. The capital's best supply is thus coveted by traditional occupiers, in fields such as consultancy, luxury or finance, but also by more recent and fast-growing players such as New Tech and Coworking. The latter accounted for 25% of the volume of large transactions signed in Paris in 2018, a significant proportion related to the strong increase in the number of transactions and the increase in the average size of movements, from 1,500 m² in 2015 to more than 4,000 m² in 2018 due to the greater share of leases of more than 5,000 m².

INCREASED MOVES TO THE SUBURBS?

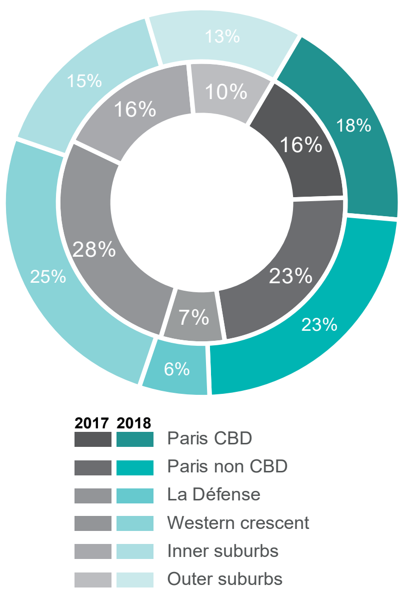
Down 12% year-on-year, the volume of available supply in the Greater Paris Region stabilised below the 3 million m² threshold. The vacancy rate now stands at 5.4%, well below the previous high of 2014 (7.7%). The shortage situation observed in several office sectors is unlikely to change in the short term. As such, 45% of the 2.13 million m² of offices currently under construction in the Paris region for delivery by the end of 2020 are already pre-let. The remaining future space is by far insufficient to satisfy the appetite of large occupiers and competition for the highest quality assets will remain strong.

Due to centrality and HR concerns, the effects of this shortage should be felt mainly in inner Paris, where the limited number of opportunities and the strength of occupier demand have already pushed rental values up in 2018. In the new premises market sector, the prime rent thus increased to €840/m²/year in the CBD (+4% over one year), while the average rent rose by 2%.

The increase in rental values, combined with the long-term shortage in supply, could increase the number of Parisian companies moving to offices in the suburbs, and to quality assets that are well connected by public transport in particular. The extent of this phenomenon could affect the level of take-up of supply in some Inner Suburb markets. This is one of the challenges for this new year, even though the deteriorating business climate raises greater questions about the performance of lettings activity in the Greater Paris Region. However, activity drivers remain numerous, whether this be economic factors with the possible completion of new leases related to Brexit or, above all, structural factors with the need for occupiers to adapt their real estate to the digitalisation of working methods, the need for productivity and the new aspirations of employees.

Geographical breakdown of take-up in Île-de-France

Source: Knight Frank



INVESTMENT MARKET

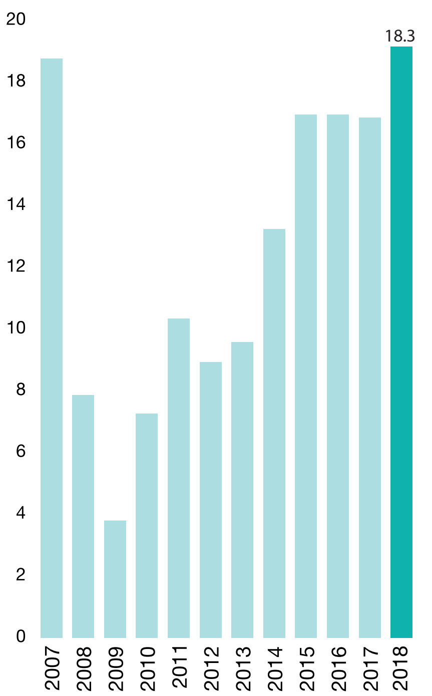
RECORD YEAR

Totalling more than 21 billion euros, volumes invested in the French office market exceed the peak level of 2007. These amounts are 87% concentrated in the Greater Paris Region, a share fairly close to that of 2017 but whose stable level masks significant disparities between the various office sectors.

The change is most spectacular in inner Paris. The amount invested in offices reached a record level of 8.8 billion euros, partly due to the increase in large deals. Of these, 6 were for investment volumes over 400 million euros, including the sale of "Capital 8" to Invesco, the sale of Altarea-Cogedim's new headquarters to CNP Assurances and the sale of "Neo" to Covea in the CBD. While the CBD has achieved a historic performance, the other Parisian sub-sectors are not to be outdone: in addition to two transactions totalling nearly €1 billion, there were many large deals and investment activity was fairly evenly distributed. Various districts and asset types were targeted, highlighting the advantages of a Parisian market whose rental activity, based on a geographical expansion of occupier demand, appears structurally sound and allows investors to anticipate further rent increases.

Île-de-France office investment volumes

€ billion



Source: Knight Frank

Although they still account for a significant share of investment activity, the results of the western Greater Paris Region office sectors are more mixed. In 2018, investment volumes fell by 27% year-on-year in the Western Crescent and by 30% in La Défense. Boosted in 2017 by an exceptional deal – the sale of Cœur Défense for €1.8 billion – the business district is not struggling: €2.4 billion was invested there in 2018, a 81% increase compared to the average of the last ten years.

It was the North that stood out in the Inner Suburbs, with volumes up 105% year-on-year and 55% concentrated in Saint-Denis alone. Ivanhoe Cambridge notably purchased the 90,000 m² Cap Ampère building there: a symbolic deal because it is the largest office property sold in 2018 in France, but also because it perfectly illustrates investors' appetite for the major Greater Paris Region development areas. The Pleyel development area is benefiting from both the future commissioning of the Grand Paris Express and the organisation of the 2024 Olympic Games; others have been targeted in Saint-Denis, Saint-Ouen, Clichy or outside of the Northern Inner Suburbs, in the South and East in particular.

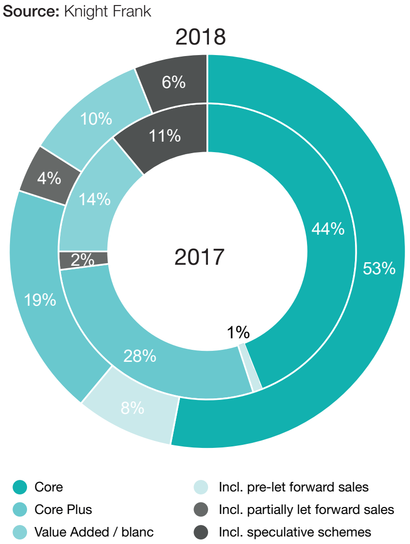
Interest in assets located in areas undergoing major redevelopment was accompanied by a sharp increase in forward funding sales: a total of €3.1 billion was invested in 2018 in the Paris region in this type of deal (+44% year-on-year). This increase is not necessarily a sign of greater risk taking by investors, as 60% of this volume was for partially or fully pre-let assets. Within the context of a shortage of prime offices and yield compression, the search for returns remains an important driver of investment activity. Many investors have thus focused on office assets that need to be restructured and are located in established markets or are well connected by public transport, particularly near to the future Grand Paris Express stations.

The increase in risks prevents us from betting with certainty on another year of rising investment volumes. Political risk is undoubtedly one of the risks to be most feared: the rise of protectionism could thus derail an international economic situation that has so far been quite robust. In France, social tensions will undoubtedly remain high: they are likely to thwart the pace and scale of reforms, exacerbate the deterioration in the business climate and could weigh on the appeal of France and activity in the lettings markets. However, the French investment market is not lacking in advantages. Despite the tightening of monetary policies, interest rates will probably remain fairly low, allowing the spread to remain favourable to the real estate sector within the context of higher stock market volatility. As with last year, investors' risk aversion will benefit the safest investments, such as Greater Paris Region offices. Assets that need redevelopment will not be overlooked, allowing certain players to overcome the shortage of prime supply and seek returns by targeting in particular properties offering the potential for transformation or adaptation to new uses.

Breakdown by risk profile

Transactions > €20 million in Île-de-France

Source: Knight Frank



Examples of investment transactions in Q4 2018

Source: Knight Frank

Building / Address	Seller	Purchaser	Area (m²)
Capital 8 / Paris 8th	Unibail-Rodamco-Westfield	Invesco	45,000
85-89 rue Richelieu / Paris 2th	Altarea-Cogedim	CNP Assurances	31,800
Window / Puteaux-La Défense (92)	Groupama	Oxford Properties	44,000
Ariane Tower / Puteaux-La Défense (92)	Unibail-Rodamco-Westfield	GIC	63,800
Pacific Tower / Puteaux-La Défense (92)	Tishman Speyer	Sogecap	55,800
Icade business parks* (92 / 93)	Icade	SMABTP	242,100
54-56 rue La Boétie / Paris 8th	IGIS Asset Management	NBIM	21,000
Cap Ampère / Saint-Denis (93)	AEW	Ivanhoé-Cambridge	90,000
Blanche Tower / Courbevoie-La Défense (92)	LIM / Quantum Global	DWS	25,800
Prisma Tower / Courbevoie-La Défense (92)	Invesco	AEW Ciloger	23,200
Passy Kennedy / Paris 16th	AG2R La Mondiale	Cegereal	23,600
Iro / Châtillon (92)	AXA	Covivio	25,600

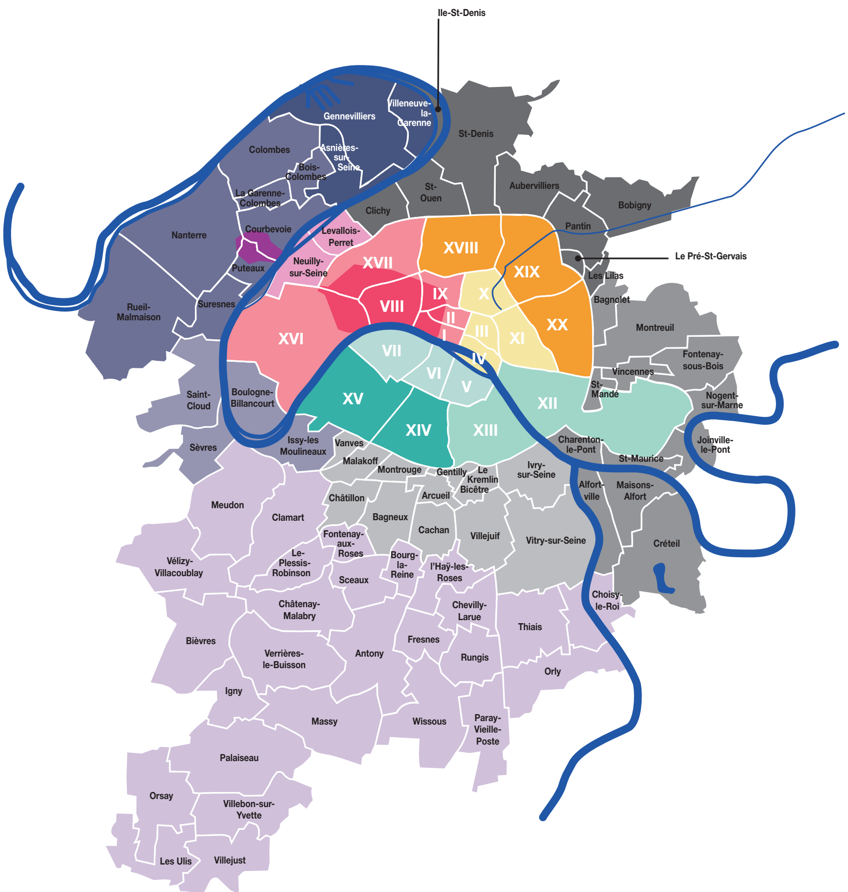
*Three assets in Colombes, Nanterre and Villepinte (Paris Nord 2).

Office market indicators in Île-de-France

Source: Knight Frank

	Île-de-France 2018	Île-de-France 2017	Annual growth
Take-up	**2,534,921 m²**	2,557,877 m²	-1%
Take-up > 5,000 m²	**915,748 m²**	1,198,063 m²	-24%
Available supply	**2,890,000 m²**	3,301,265 m²	-12%
Vacancy rate	**5.4%**	6.1%	-0.7pt
Prime rent*	**€840/m²/year**	€810/m²/year	+4%
Investment volume	**€18.4 billion**	€16.7 billion	+10%
Transactions > €100 million | Share	**70%**	69%	+1pt

*Prime rent: weighted average of 5 transactions> 500 m² with the highest rents of the past 12 months, all asset characteristics include.



Paris CBD	Northern Loop
Paris Centre West (excl. CBD)	Péri-Défense
Paris $3^{th}/4^{th}/10^{th}/11^{th}$	Southern Loop
Paris $18^{th}/19^{th}/20^{th}$	Southern Outer Suburbs
Paris $5^{th}/6^{th}/7^{th}$	Neuilly/Levallois
Paris $12^{th}/13^{th}$	Northern Inner Suburbs
Paris $14^{th}/15^{th}$	Eastern Inner Suburbs
La Défense	Southern Inner Suburbs

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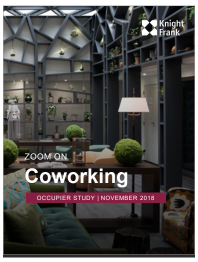

Coworking 2018

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