



Q2 2009

PARIS DIGEST

Commercial Real Estate Markets in Ile-de-France

Knight Frank

HIGHLIGHTS

- Take up for office space in the Ile-de-France region was 860,000 sq m in the 1st half of 2009.
- By the end of 2009, take-up is forecast to be close to 1.7 to 1.8 million sq m. This would make 2009 an average year for the Ile-de-France occupational market.
- Transactions of over 5,000 sq m slowed in Q2 2009 as compared to previous quarters and represented only 30% of total transactions in the Ile de France. This is a result of the increase in time taken to complete major transactions.
- Available space is continuing to increase, with the vacancy rate standing at 6.4% in the Ile-de-France at the end of June 2009. However, the region has an uneven profile in terms of vacancy, and the probability of there being widespread oversupply remains remote.
- The days of astronomical rents have passed. The downward correction has clearly begun for high-end rents, particularly in the Paris Central Business District. Mid-range rents are continuing to drop at a moderate rate.
- 780 million euros were invested in commercial property in the Ile-de-France during the 2nd quarter 2009. This is a relatively poor result but is an improvement on the 1st quarter.
- Yield decompression was clearly subdued in the 2nd quarter 2009. Yield profiles remain at levels comparable to those at the end of 2004.

LETTING MARKET: A STABLE OUTLOOK

Office take-up: momentary slowdown in major transactions

The number of transactions has once again decreased. The take up of office space in the Ile de France region was just under 415,000 sq m, compared to 445,000 sq m in the previous three months. The slowdown is therefore continuing, albeit to a lesser rate than at the beginning of the year (-7% compared with 10% recorded between the 4th quarter 2008 and the 1st quarter 2009).

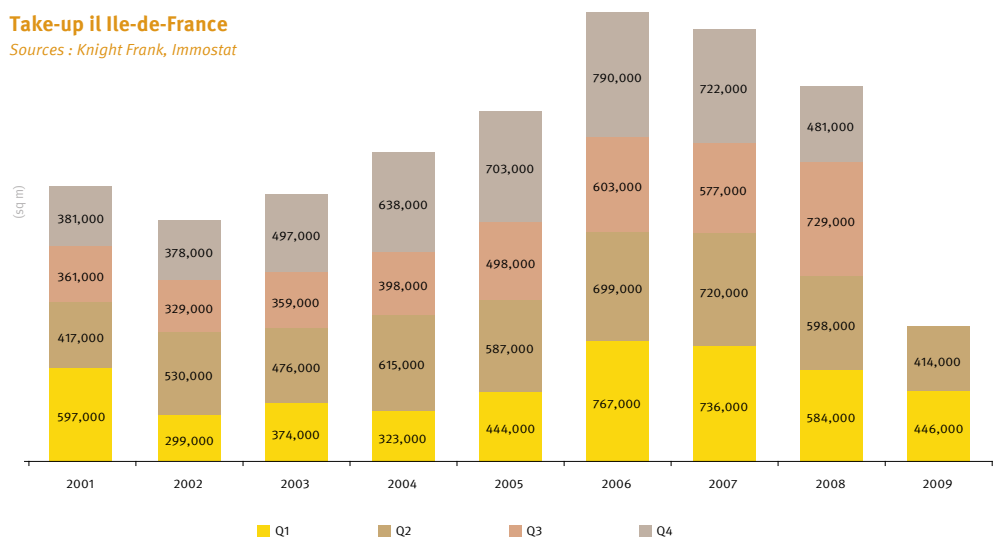
The cause of this fall is something new. In the months preceding the second quarter, business was underpinned by major transactions; when these transactions slowed in the second quarter, the entire office sector suffered. Only ten transactions of more than 5,000 sq m were recorded, totalling 123,000 sq m. This represents 30% of the transactions completed, down from 46% observed in the 1st quarter 2009, and down from the more usual Ile de France figures of 35% to 40%.

Transactions of over 5,000 sq m were supported by big companies wishing to rationalise their property costs. Several occupiers have decided to vacate their older premises for

cheaper space offering equivalent or better facilities, the benefit outweighing the renegotiation of their previous lease. It is possible that a rebalancing took place during the second quarter 2009 with landlords having a clear indication of the incentives required to retain tenants. The slowdown of transactions over 5,000 sq m may also be due to the increase in the time taken to complete negotiations for these transactions. Occupiers are increasingly aware that market conditions are in their favour, with their demands reflecting this and consequently prolonging discussions with landlords.

Requirements relating specifically to very large spaces may face another problem, as it is becoming increasingly difficult or even impossible for landlords of these spaces to match tenants' demands.

Take-up il Ile-de-France
Sources : Knight Frank, Immostat



Examples of leasing transactions (Q2 2009)

Adress	Sub-market	Tenant	Size (sq m)	Rent (€/sq m/annum)
Le Pointe Métro - Gennevilliers	Northern Bend	Prisma Presse	23,800	325
Le Newton	La Défense	Total	14,700	400
Avenue de Tocqueville - Antony	Southern Inner Rim	Stallergènes	10,000	NC
Terra Nova - Montreuil	Eastern Inner Rim	Pôle Emploi	5,200	270
7 place de Valois - Paris 1 ^{er}	Paris CBD	Cabinet d'avocats	1,050	476



As shown by the expected leases to the SNCF, the Banque de France and one other major institution in Paris's Central Business District, protracted negotiations seems to be the main explanation for the increasing delays in major transactions. However, it is still too early to be certain.

As far as net absorption is concerned, the deceleration witnessed over the last few quarters shows no sign of abating (net absorption Q2 2009 is estimated to be around 21,000 sq m). It is, however, worth pointing out that the market is still growing, albeit at a slower rate. This performance is explained by the fact that availability is continuing to increase at a faster rate than take-up of office stock. The decrease in take up is expected to continue, becoming slightly negative by the end of the year, as companies that have concluded major pre-contractual agreements over the last few months will vacate their current premises.

Office supply: increasing lack of uniformity in the Ile-de-France submarkets

For nearly a year now, the availability of office space has been increasing. The trend continued in Q2 2009, at the same rate as that observed at the beginning

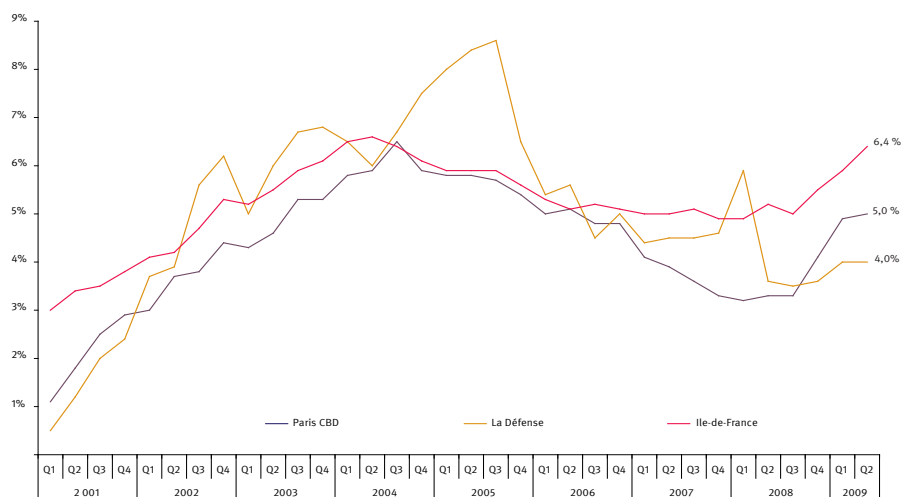
of the year. The regional vacancy rate now stands at 6.4%, compared with 5.9% three months ago. At the beginning of the summer of 2008, the vacancy rate was only 5.2% in the Ile-de-France region.

However, figures vary across the region. In the city of Paris, the vacancy rate is only 4.6%, and drops as low as 4% in La Défense. Conversely, it can be as high as 15% in other areas, such as the Northern Bend (Gennevilliers, Colombes and Clichy). Pockets of oversupply are forming but they are a long way from affecting the whole Ile-de-France region. The most prestigious sectors in the letting market seem to be the most immune to the risk of high vacancy even though they have experienced a considerable reduction in rental activity.

It is important to put the increase in vacancy rates in context by taking into account the quality of the available office space. New or refurbished buildings, the only space really capable of satisfying current occupier requirements, are few and far between and represent only a quarter of the office space available in the Ile-de-France region. The only geographic sectors where a variety of choice is available to companies are those where the asking rents are high in relation to the rental value expectations of the major occupiers. This is the case, for example, in the 15th arrondissement, where several buildings that have undergone or are undergoing major refurbishment are available at rents of more than € 500/sq m.

Vacancy rate in Ile-de-France

Sources : Knight Frank, Orié



Office rents: controlled downward adjustment

The fall in headline rents, already experienced in the previous quarter, has continued into Q2 2009. This is most obvious in the most expensive submarkets, where prime office buildings are suffering because occupiers do not consider that the rents charged offer value for money and this is particularly true for buildings offering large areas. In the 2nd quarter 2009, no transaction of more than 5,000 sq m was completed for more than € 400/sq m.

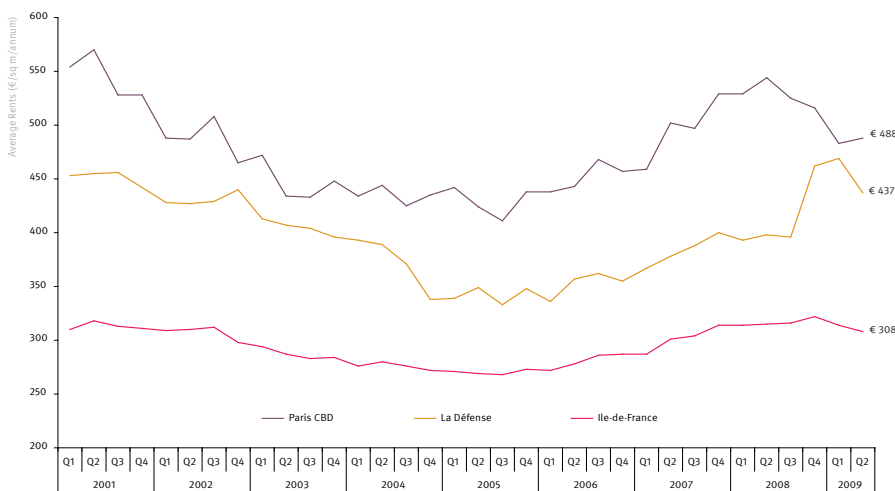
In this context, it is now extremely rare for landlords to charge rates more than € 800/sq m for several thousand square metres of office space. In the CBD, prime headline rents now range from € 750 to € 790/sq m/year (excluding tax and charges). Outside the CBD, the other established markets (La Défense, the 7th, the 12th or the 15th arrondissements, etc.) have

not experienced any significant adjustment. In these areas, incentives act as the area of negotiation and result in a net effective rent of 12% to 17% less than the headline rent agreed.

Mid-range rents throughout the Ile de France continue to fall, with average figures dropping from € 313 to € 308/sq m/year (excluding taxes and utility rates) between the 1st and the 2nd quarter 2009. At the beginning of the year, this drop was attributed to the poor rents achieved in the CBD. However, the situation has improved in the last quarter, with average CBD rents increasing from € 483 to € 488/sq m/year. This improvement, combined with the drop recorded in La Défense during the same period (the latter being unable to benefit from "major high-price transactions") means that the historical rental levels in the Ile-de-France are beginning to align themselves.

Average rents in Ile-de-France

Sources : Knight Frank, Immostat





OUTLOOK

With 860,000 sq m of office space leased in six months, performance in the first half of 2009 is as expected. Q3 2009 is looking fairly promising, with the expected completion of several major transactions including deals involving Atos Origin, SNCF and Banque Postale. The next quarter should witness two major deals in the Paris CBD, the first being the Banque de France's occupation of 9,400 sq m in the Paris Victoire Business Centre, and the second being the expected take up of a further 5,000 sq m in the area. Both these deals are evidence that major transactions are once again being completed in the CBD. In total, take up for 2009 should reach around 1.7 to 1.8 million sq m in the Ile-de-France. Results like this would make 2009 an average year, similar in terms of volume to 2003 or 2004.

Net absorption, which measures the evolution in the overall demand for office space, currently remains positive but is contracting. Transactions are linked to the optimisation of office space occupied and not to the requirement to increase the area of accommodation. Over 2009, net absorption is expected to stagnate or even drop slightly.

This decrease in net absorption obviously encourages an increase in available office space. At mid 2009, the vacancy rate stood at 6.4% for the entire Ile-de-France region. This increase shows no sign of abating in the coming months, with vacancy rates in the region expected to move towards 7% by the end of the year. Most of the

available office space reflected in this increase will be 'second hand', i.e. office space vacated by previous occupiers. Companies seeking prime modern office space are therefore not likely to benefit from this higher vacancy rate in the short term. Supply of new office space may risk being more and more limited to the most expensive markets or in areas that are very poorly served by public transport. In order to search for a sustainable alternative, occupiers may be forced to explore the option of occupying new buildings built specifically to their requirements.

As a result of this disparity between occupier demand and new or renovated property on offer, the downward adjustment of headline prime rents should be essentially limited to the most expensive markets and to areas that are too remote to be attractive, where values seem too expensive in the current economic situation. This phenomenon has been witnessed in the CBD in the Q2 2009. It could extend to other established areas, especially if the CBD continues to become more attractive to the occupational market. In total, the downward adjustment of prime rents should be approximately 10%. This adjustment will, however, be more significant for "second-hand" floor space, due to the increase of availability in this sector.

INVESTMENT MARKET : A SLIGHT THAW

Invested volumes: summary of the first major acquisitions of the year

Following a poor performance at the start of the year, the investment market has shown signs of improvement during the second quarter of 2009. While figures remain relatively low, investment volumes in the Ile de France region in Q2 increased to € 780 million compared to € 440 million in Q1 2009. Another encouraging sign is that investment activity accelerated strongly towards the end of the quarter, which bodes well for the coming months. It would appear that the economic turmoil that the investment market has experienced since September 2008 is starting to show signs of improvement.

The Ile-de-France investment market has not changed significantly in nature and is still dominated by transactions of lot sizes below 25 million euros. A slight revival can also be seen in the market for larger assets. The acquisition of 21 boulevard de la Madeleine for € 210 million saw the first transaction of over € 100 million this year while other major transactions have been or are about to be completed, although not all will be logged in the results for the second quarter 2009. Such transactions include the € 98 million sale of over 90,000 sq m of office space in Elancourt to a major manufacturing group, and the acquisition of 17,000 sq m of

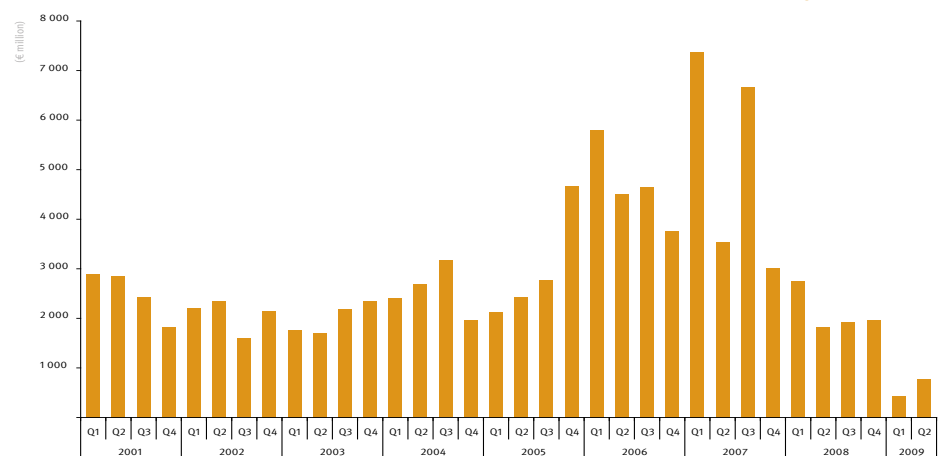
office space at rue Henri Barbusse in Clichy for € 80 million.

Purchasers are continuing to focus on secure assets and placing even more emphasis on location. As a result, central Paris locations are the most highly sought after and account for € 777 million (or 64%) of the total investment volume in Ile-de-France for the first half of 2009. Almost € 580 million of this figure was invested in the Central Business District alone.

At the start of the year, domestic investors dominated the Ile-de-France market with French investors holding a 70% share of the total investment volume in the first quarter of 2009. However, the mid year results suggest that the investor profile is starting to diversify as foreign investors regain confidence and the heavy repricing which has taken place

Investment volumes in Ile-de-France

Sources : Knight Frank, Immostat



Examples of investment transactions (Q2 2009)

Asset	Sub-market	Purchaser	Size (sq m)	Price (€M)
21 boulevard de la Madeleine - Paris 8 ^{ème}	Paris CBD	Macquarie	35,800	240
Rue Henri Barbusse - Clichy	Northern Bend	STAM	17,000	80
3 rue la Boétie - Paris 8 ^{ème}	Paris CBD	Swiss Life	6,265	46
37/39 rue d'Anjou - Paris 8 ^{ème}	Paris CBD	Corpus Sireo	4,500	40
11 rue de Prony - Paris 8 ^{ème}	Paris CBD	CARMF	2,595	27



encourages them to take a renewed interest in the Paris market. A good example of this is Macquarie who have acquired 21 boulevard de la Madeleine for € 210 million. This deal alone represents 27% of the investment volume this quarter.

Prices and yields: pricing expectations of buyers and sellers

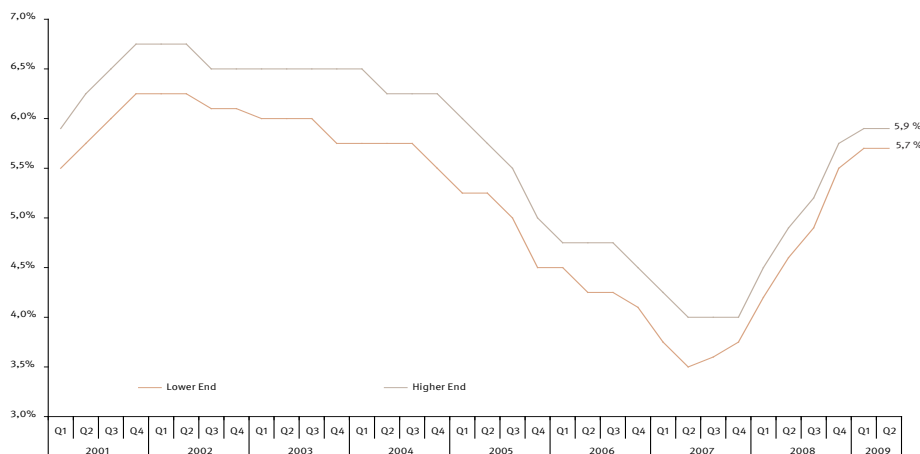
The correction that has taken place since mid 2007 is severe, reaching almost 200 basis points in the Paris CBD although it would appear that the rate of yield decompression is slowing and the gap between the pricing expectations of vendors and those of purchasers is closing. Concerns are now turning towards the stability of the rental market as investors look to avoid assets that are significantly over rented.

This, combined with the tentative revival of investment volumes, largely explains why yields have remained relatively stable in the primary markets of Ile-de-France. The rise in yields has had a larger impact on the peripheral and emerging markets.

The latest transactions and ongoing negotiations show that the "prime" yields are holding at levels between 5.70% and 5.90% in Paris CBD. In La Défense, this range has narrowed slightly and is currently between 6.00 and 6.50%. The two primary markets of Ile-de-France are therefore now reflecting yield profiles that were recorded at the end of 2004.

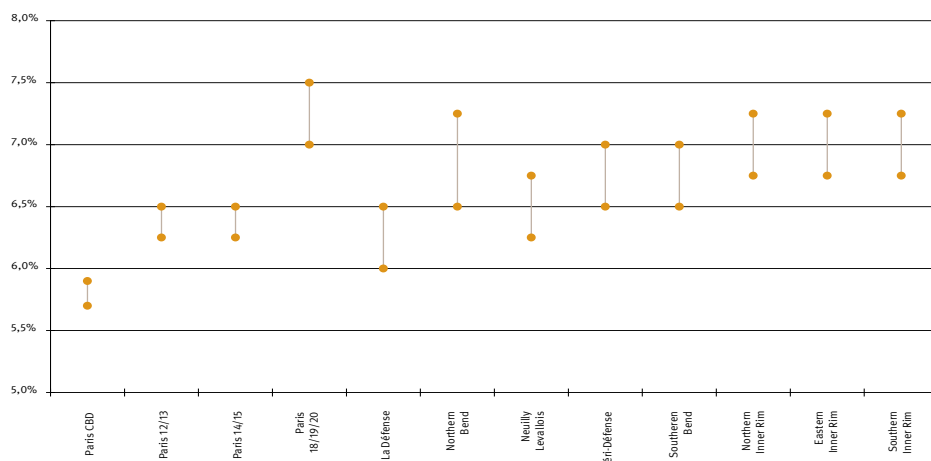
Prime yields band in Paris CBD

Source : Knight Frank



Prime yields in Ile-de-France

Source : Knight Frank



The difference between these two markets and the peripheral geographic sectors remains relatively small at around 100 basis points although it is possible that the coming months may see a widening of this gap.

OUTLOOK

The 2nd quarter 2009, although not outstanding by any means, confirms that the stagnation of the investment market observed in the first quarter was only temporary. The Ile-de-France region is progressively returning to the levels it has seen for several quarters previously, investment volumes close to € 1.8 - € 2 billion. However, the shortfall of investment volume recorded over the first half of 2009 is too significant to hope to achieve by year end 2009, the same level of investment volumes achieved in 2008 (€ 8.45 billion). The total investment volume for 2009 will most likely be in the region of € 5 billion which would be the lowest level recorded this decade.

However, increasing investor confidence witnessed over the last four months remains positive. Many potential buyers are looking closer at the market and beginning to source good deals. Foreign investors are now taking a greater interest in the Paris market and consider the spread between returns and financing costs more and more acceptable in their cash flows. As a result, several negotiations that were initiated at the beginning of 2009 are set to be finalised in the coming months. Similarly the renegotiations of leases that are underway combined with the June valuations should help to pave the way for future transactions and lift pressures that have been imposed on certain negotiations by reducing levels of over rent in the market and permitting institutional investors to sell at more realistic market levels.

Investment activity this year may also be guided by distressed sales. The investment market is likely to benefit from companies looking to dispose of property in order to improve liquidity. For investors, particularly those facing financial difficulties, the current environment is facilitating their decisions to sell major property assets.

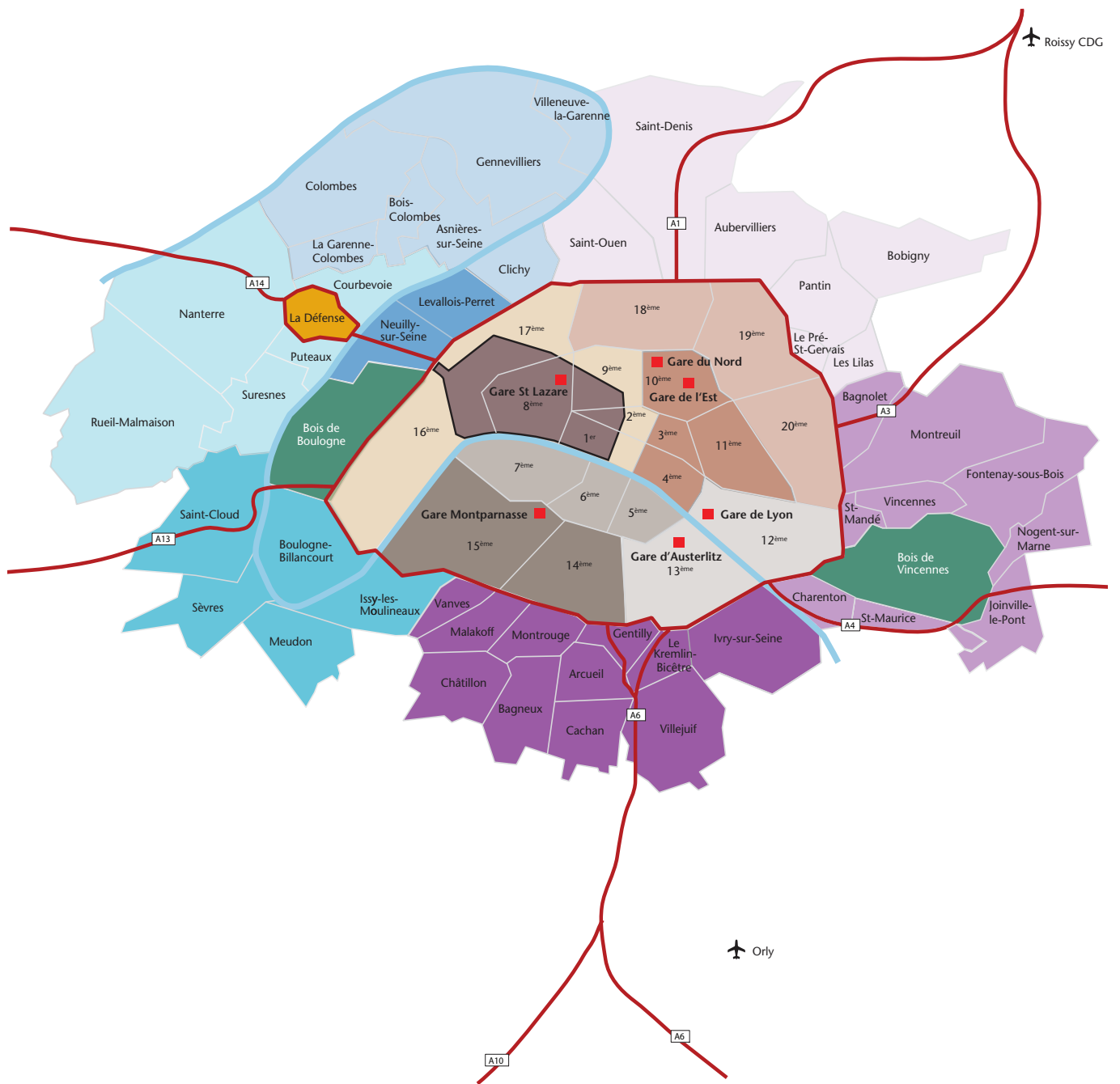
We must not, however, exaggerate the prospects for increased investment activity. For many landlords, the cash flow generated by their property assets remains greater and more secure than that of other asset classes. This means that, unless the prospects on financial or other products improve considerably, it is unlikely that we will see a dramatic increase in sales by the major investors. As such, we will no doubt have to wait until autumn 2009 as the last two summers have been devastating for world finance.








As stated last quarter, vendors and purchasers look set to reach a consensus soon on what is to be considered a "fair price". This trend was confirmed in the 2nd quarter, with yields having barely moved. It must be said that the adjustment has reflected a yield decompression of ca. 200 basis points since mid 2007 and has been required in order to gradually bring back into line a level of acceptable returns relative to the cost of financing. So, unless the financial situation deteriorates further, we are unlikely to see a significant additional adjustment in the coming months.











Market breakdown as at Q2 2009

Area	Prime rents (€/sq m/annum)	Average rents (€/sq m/annum)	Take-up in 2009 (sq m)	Estimated stock (sq m)	Vacancy rate (%)	Prime yields bands
Paris CBD	790	488	103,800	6,685,000	5.0 %	5.70 % - 5.90 %
Paris Centre West (excl. CBD)	530	364	28,500	1,811,000	4.6 %	-
Southern Paris	-	381	72,400	4,957,000	4.1 %	-
Paris 5/6/7	700	405	26,600	1,215,000	3.9%	5.90 % - 6.20 %
Paris 12/13	475	389	27,000	1,833,000	2.6 %	6.25 % - 6.50 %
Paris 14/15	550	363	18,800	1,909,000	5.7 %	6.25 % - 6.50 %
North Eastern Paris	-	266	43,300	2,788,000	4.3 %	-
Paris 3/4/10/11	390	296	21,300	1,620,000	3.3 %	6.25 % - 6.75 %
Paris 18/19/20	310	2218	22,000	1,168,000	5.7 %	7.00 % - 7.50 %
Total Paris	-	-	248,000	16,241,000	4.6 %	-
La Défense	550	437	115,300	3,187,000	4.0%	6.00 % - 6.50 %
Western Crescent	-	294	212,700	7,375,000	9.8 %	-
Northern Bend	330	193	66,000	1,539,000	14.8 %	6.50 % - 7.25 %
Neuilly Levallois	530	359	26,600	1,375,000	7.2%	6.25 % - 6.75 %
Péri-Défense	430	242	63,000	2,122,000	10.7 %	6.50 % - 7.00 %
Southern Bend	495	334	57,100	2,339,000	7.1 %	6.50 % - 7.00 %
Inner Rim	-	205	112,300	5,577,000	9.3 %	-
Northern Inner Rim	315	193	34,500	2,314,000	10.0 %	6.75 % - 7.25 %
Eastern Inner Rim	270	208	35,700	1,205,000	6.7 %	6.75 % - 7.25 %
Southern Inner Rim	360	213	42,100	2,058,000	10.0 %	6.75 % - 7.25 %
Outer Rim	-	139	171,800	18,266,000	6.1 %	-
Ile-de-France	-	308	860,100	50,646,000	6.4 %	-



Paris CBD	
Paris Centre West (excl. CBD)	
Southern Paris	
<i>Paris 5/6/7</i>	
<i>Paris 12/13</i>	
<i>Paris 14/15</i>	
North Eastern Paris	
<i>Paris 3/4/10/11</i>	
<i>Paris 18/19/20</i>	

La Défense	
Western Crescent	
<i>Northern Bend</i>	
<i>Neuilly/Levallois</i>	
<i>Péri-Défense</i>	
<i>Southern Bend</i>	
Inner Rim	
<i>Northern Inner Rim</i>	
<i>Eastern Inner Rim</i>	
<i>Southern Inner Rim</i>	

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