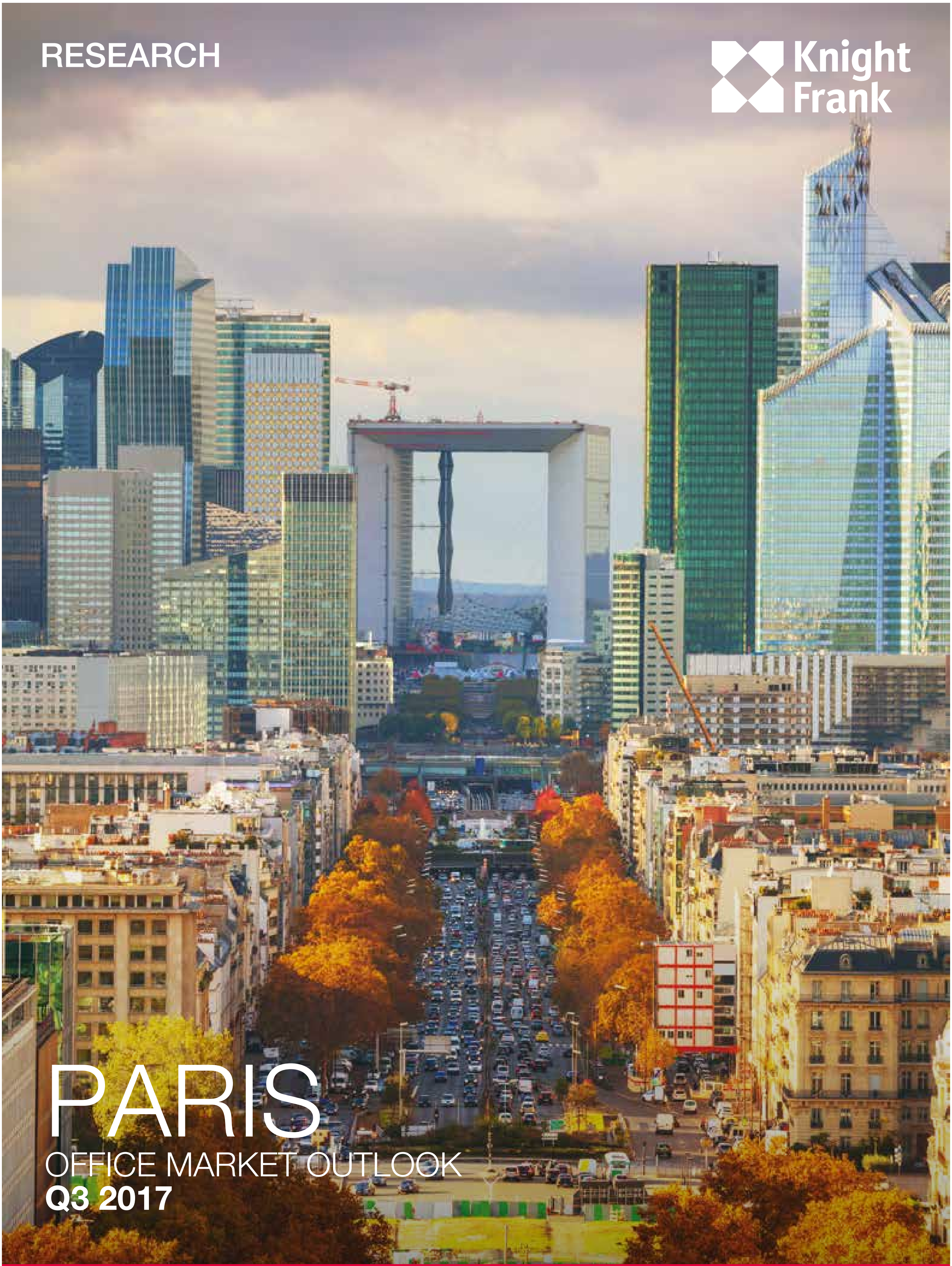
RESEARCH



PARIS

OFFICE MARKET OUTLOOK
Q3 2017

OCCUPIER TRENDS | INVESTMENT TRENDS | MARKET OUTLOOK

KEY FINDINGS

The French economy is forecast to grow at 1.6% in 2017, driven by a strong business services sector.

Office take-up was 1.1 million sq m in H1 2017, with corporates the most active occupiers.

Vacancy levels have continued to come under downward pressure in the CBD and La Défense due to low completion volumes.

Prime rents in the CBD increased to €772 per sq m per annum during H1 due to shortages in Grade A supply.

Office investment volumes in Île-de-France totalled €5.0 billion in H1 2017, falling by 31% year-on-year.

Prime yields remain at a record low 3.0% in the CBD.

OCCUPIER MARKET

Pre-leasing activity has increased against the backdrop of limited Grade A supply.

Since President Macron's election in May, France's economy has been showing signs of improvement. Business sentiment has lifted and the private sector has seen its fastest rate of growth in six years.

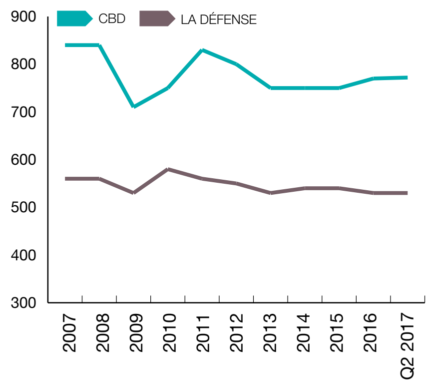
Despite improvements to the economy, the occupational market witnessed a subdued first half year. Office take-up in Île-de-France was 1.1 million sq m (Figure 1), slightly below take-up for the same period last year (-3.3%). Corporates were once again the most dynamic occupiers, accounting for 37% of the transactional activity, led by the Banking and Finance sector.

Due to improved demand and limited new supply, the vacancy rate for Île-de-France has continued its downward spiral falling to 6.6%. Despite reaching a five-year low, disparities are evident across the Paris Region. La Défense is a structurally volatile market and highly dependent on large occupiers. It has witnessed a downward trend in completions over recent years. This contraction in supply has led to a fall in vacancy rates (8.1%) and although above the regional average (6.6%), the gap is narrowing from the peak observed in recent years. Aside from Window – fully pre-let by RTE in 2016 – no speculative developments will be delivered before the end of the year, with Grade A supply therefore continuing to diminish. Subsequently, pre-lettings, which were not a feature prior to 2014, now account for nearly half of the leases for future deliveries before the end of 2019.

The CBD is also facing a dearth of available supply, with vacancy rates falling to 3.1%. This has hampered occupier activity, forcing some occupiers to consider alternative solutions, such as deferring future location decisions, geographical relocation or making stronger use of co-working environments. However, improvements to the development pipeline beyond 2017 will be welcome and will assist in rebalancing the demand-supply dynamics.

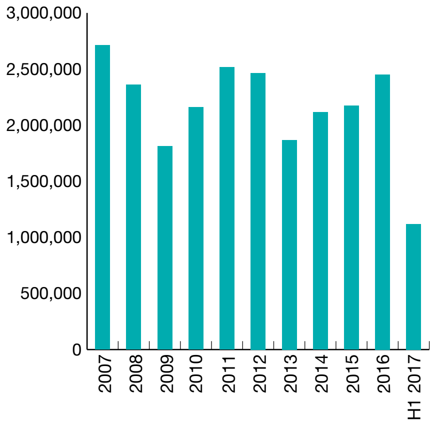
Prime CBD rents increased to €772 per sq m per annum, with incentives continuing to contract. Rents in La Défense are in the region of €520 per sq m per annum, with incentives remaining very high at between 25% to 30% of headline rents (Figure 2).

FIGURE 2
Prime office rents
€ per sq m per annum



Source: Knight Frank Research

FIGURE 1
Île-de-France office take-up
sq m



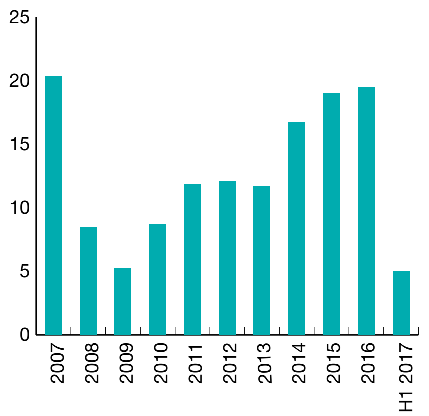
Source: Knight Frank Research

Key office leasing transactions in 2017

Quarter	Address	Tenant	Size (sq m)
Q1	Duo, Paris 13	Natixis	88,500
Q2	Aquarel, Issy-les-Moulineaux	Cap Gémini	30,000
Q2	Kosmo, Neuilly-sur-Seine	Parfums Christian Dior	25,000
Q2	Centre Marine Pépinière, Paris 8	Gide	18,500
Q1	138 Avenue de Stalingrad, Villejuif	Orange	18,000
Q1	Cœur Défense, Courbevoie	Orange (Orange Business Services)	17,545
Q1	Green Office Opale Issy-les-Moulineaux	La Poste Immo	16,700

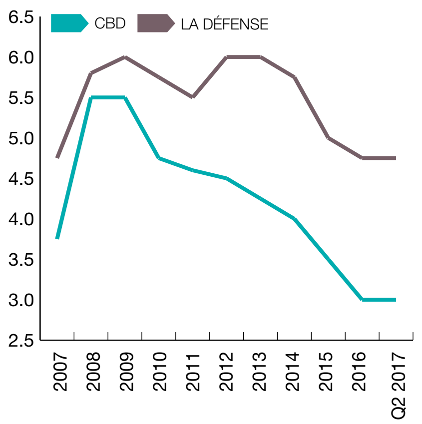
Source: Knight Frank Research

FIGURE 3
Île-de-France office investment volumes € billion



Source: Knight Frank Research

FIGURE 4
Prime office yields
%



Source: Knight Frank Research


Vivacity (under construction) sold by Knight Frank

INVESTMENT MARKET

Office investment volumes in Île-de-France were subdued in H1 2017. A total of €5 billion was invested into the region's office assets marking a significant drop of 31% compared to H1 2016 (Figure 3). After a positive start to the year, the CBD saw the pace of investment fall in Q2, with its regional share falling from 33% in 2016 to 19% in H1 2017 – the lowest recorded since the start of the decade. Despite the fall in transactional activity, H2 is likely to see the finalisation of several large deals, indicating an encouraging outlook for H2.

The investment market has witnessed a proliferation of foreign buyers from the Eurozone. Domestic investors however continue to dominate (63%). Generally, the appetite has been toward mid-sized assets (€50 million to €200 million) but more recently, there has been a notable increase in the €50 million to €100 million segment. Value-added properties have been less affected by the scarcity of saleable assets, leading to a proportional increase in their share of transactions.

At a range of between 3% and 3.25% since mid-2016, prime yields remain at a record low in the CBD. As the spread between prime office yields and bond yields continues to widen, increasing from 238 bps at the end of 2016 to 247 bps at Q2 2017, real estate continues to offer a better value proposition to investors and will result in strong capital flows.

Key office investment transactions in 2017

Quarter	Property	Seller	Buyer	Approximate price (€ million)
Q2	Vivacity	Blackstone	Amundi	365
Q1	Grand Central Saint-Lazare	The Carlyle Group	Union Investment	345
Q2	West Park	LBO France	AXA IM	170
Q1	112-122 Avenue Emilie Zola	SMABTP	Société Foncière Lyonnaise	165
Q1	102 Avenue des Champs-Élysées	Thor Equities	AEW Europe	115
Q1	Nework	Eiffage Immobilier & Altarea Cogedim	Générale Continentale Investissements	100

Source: Knight Frank Research

KNIGHT FRANK VIEW

The outlook for the French economy and the occupational market is strengthening. Negotiations are underway concerning several potential lettings and point to strong absorption capacity over the remainder of the year. The second half of the year is also likely to see the completion of several major office investment transactions, some of which will exceed €200 million, allowing the market to make up for the shortfall in the first half of the year.

Against the backdrop of booming investments by venture capital funds, the city's corporate start-up scene is burgeoning and tech sector employment is rising. Oxford Economics forecasts that the tech sector may account for 13% of total employment in Paris, overtaking the retail sector. Therefore, while tech occupiers have typically accounted for a relatively small share of take-up, demand from this sector is expected to increase significantly over coming years.

EUROPEAN RESEARCH

Matthew Colbourne, Associate
International Research
+44 20 7629 8171
matthew.colbourne@knightfrank.com

Vivienne Bolla, Senior Analyst
International Research
+44 20 7629 8171
vivienne.bolla@knightfrank.com

PARIS

Vincent Bollaert
Head of Capital Markets
+33 1 4316 8890
vincent.bollaert@fr.knightfrank.com

Cyril Robert, Director
Head of Research
+33 1 4316 5596
cyril.robert@fr.knightfrank.com

Nadège Pieczynski, Analyst
Research
+33 1 4316 8884
nadege.pieczynski@fr.knightfrank.com

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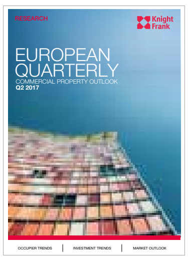
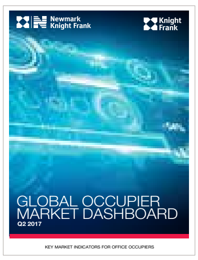
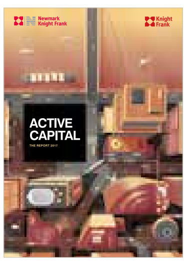


European Quarterly - Q2 2017



Global Occupier Dashboard - Q2 2017

Central London Quarterly - Q2 2017



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