Knight Frank

PARIS VISION

Offices

Hurry Up, We're Dreaming

♫ 2018 ♫

EDITO

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Dear friends,

I am pleased to present *Paris Vision 2018*.

This is a very special edition since we are celebrating the 10th anniversary of the publication, which was first produced in 2008 in a quite different market environment – in fact, almost another era.

The original aim was simple: to produce a different kind of study, a vibrant report that reflected the real experiences of the Knight Frank teams, as well as of our clients, who each year have been keen to share their vision with us and to tell us more about their strategy. I would like to sincerely thank them all.

The second aim of *Paris Vision* was to provide a forward-looking analysis over the long term. This has not always been easy in the last decade, particularly as the global economy faltered in the wake of the 2008 financial crisis, followed by the Eurozone crisis. At that time, uncertainty and a lack of visibility were at their peak, yet what stands out above all is the resilience and depth of the Paris region market.

Ten years on, in a new era, *Paris Vision 2018* describes a corporate real-estate market boasting excellent results and exceptional strength.

In 2017 the investment market recorded its second-best year ever. This performance was boosted by the proliferation of large transactions, the domination of French investors and record property investment inflows. The Chairman of Swiss Life REIM (France) and ASPIM[1], Frédéric Bôl, one of the key commentators in *Paris Vision 2018*, gives us some clues to understanding the coming months.

As the digital economy grows, stores have an important role to play in web business models. The retail market is benefiting from a sharp upturn in consumer confidence, the return of tourists and the arrival in France of new foreign retailers. One of the most dynamic of these is Five Guys, operating in the very buoyant restaurant sector. In this issue, its Development Director, Philippe Cebral, sets out the real-estate strategy adopted by the new king of burgers and its ambitions for the coming years.

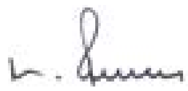
The office rental market in the Paris region is also buoyant, with take-up at its highest level since 2007 and particularly intense activity in the large-transactions segment. The acceleration in economic activity has no doubt played a role. French growth is now in line with the European average, the business world has regained confidence and Paris has been chosen to host the Olympic Games in 2024 against the backdrop of completion of the Grand Paris Express. This “French moment” is examined by Daniel Cohen in greater depth at the start of this new issue of *Paris Vision*.

Finally, never has corporate real estate experienced such transformation, as investors, developers and occupiers constantly innovate to create working spaces tailored to new habits. The development of Spaces is an excellent illustration of this and, in a third section of the report, Paulo Dias, the CEO of Southern Europe, Africa and Brazil at Regus, sets out the vision of this pioneer in coworking spaces.

We are without doubt seeing a French moment and certainly a new era – which looks set to be an exciting one for corporate real estate.

I would like to take the opportunity of this 10th anniversary to thank you for your confidence and loyalty, in the hope that *Paris Vision 2018* will help you to make your plans a reality, this year and beyond.

I hope you enjoy reading this issue.



[1] Association des Sociétés de Placement Immobilier (French Association of Real Estate Investment Companies).

OPINION

DANIEL COHEN

Professor and Director of the Economics Department of École normale supérieure de Paris
Founding member of the École d'Économie de Paris
Director of CEPREMAP (Centre pour la recherche Économique et des Applications).

Philippe Perello: Dear Daniel, you've worked with us for 10 great years on Paris Vision, enlightening us on the general economic climate. Last year, for the first time, your analyses of the French economy were cautiously optimistic. I imagine that this optimism is now confirmed, with the pace of the French economy now aligned with that of the other OECD countries?

Daniel Cohen: Confidence is certainly high and we can now say that the decade lost as a result of the financial crisis is coming to an end. All indicators are good, and in all countries, which is rare. The OECD is forecasting global growth of 4%, growth in global trade of 5% and Eurozone growth of almost 2%. The latest indicators from Insee show that France is also predicted to comfortably achieve growth of around 2%, for 2018. Investment by companies and households is robust and employment and salaries are picking up. There may be a slight slowdown in the growth of consumer purchasing power in France in the first half of the year, due in part to the short-term increase in inflation and partly as a result of taxation, but this shouldn't have a long-term impact. I am therefore optimistic for 2018, as are most observers.

THE DECISION TO AWARD THE 2024 OLYMPIC GAMES TO PARIS ALSO REFLECTS FRANCE'S ASCENDANCE TO THE INTERNATIONAL STAGE

PP: Without wishing to give way to excessive optimism, aren't we experiencing a "French moment", as our country gains special influence and appeal due to the current geopolitical context? The organisation of the Olympic Games in 2024 is part of this movement. Do you expect a significant impact from the Games on investment in the city or its appeal?

DC: France is undoubtedly finding its feet on the international stage. After an annus horribilis in 2016, during which Brexit and Trump's election appeared to indicate an unstoppable rise in populism around the world, the election of Macron, on an explicitly pro-European ticket, elicited surprise. Many factors obviously came together to make his election possible, particularly the collapse of the traditional parties, but he successfully seized the opportunity, and there have also been comments showing admiration for his personal achievements in the international press. Macron may embody the new face of a more ambitious Europe, although at the end of the day, everything will depend on the quality of the Franco-German relationship. The good news is that Germany's grand coalition, if confirmed, gives him a fantastic opportunity to advance his European agenda.

The decision to award the 2024 Olympic Games to Paris also reflects France's ascendance to the international stage... What is most interesting is that the Games will come at the same time as the expected completion of the Grand Paris projects. Paris and its suburbs may emerge totally reinvented from this dual stimulus.

PP: In your opinion, what are the main challenges our country must tackle to support vigorous and sustainable growth? Do you think that the reforms that have been implemented or announced are heading in the right direction?

DC: All developed countries have faced the same dilemma in the last 30 years – how to revive their economies' structural growth. We have entered an upswing in the cycle, which will unblock all sorts of initiatives. For French growth to be sustainable, it needs to be inclusive, which means that young people looking for their first job and a career, the long-term unemployed and those who have lost out to new technologies must benefit from this upswing to become firmly rooted in economic life. It's not just about finding a job, but about contributing to overall economic productivity, improving quality, making the best use of new technologies to include as many people as possible in the growth cycle. The government is backing radical reform of vocational training, which is indeed vital, but universities and career paths need to be completely overhauled if we want France to fully embrace the 21st century digital economy.

PP: Brexit, which has entered the second phase of negotiations, appears more as an opportunity for Europe to reinvent and strengthen itself. Do you agree? What impact do you think it will have on the French economy? We are seeing the first effects of Brexit on our corporate real-estate markets with the announcement of relocations to Paris, which appear to me to show Paris clearly becoming more appealing to large international companies, compared with other global cities. What do you think are the levers to continue along this path and take advantage of this success?

DC: Overall, I found that Europe's reaction to Brexit was weak. No momentous idea has yet emerged, apart from a promise to do better. From an institutional perspective, everyone knows what they need to do: complete the banking union, overhaul the European Stability Mechanism and, as proposed by President Macron, give the Eurozone its own budget, approved by a parliamentary vote in which only Eurozone MEPs are eligible to take part. But, if we look in greater detail, we see that everything is very complex. Will the ESM be reformed according to the German idea of, in practice, strengthening its inter-governmental dimension? Will the budget be a minor gadget or will it actually have macroeconomic importance, capable of withstanding crises as severe as the one we have just been through?

In terms of the City's role, it will obviously be reduced after Brexit. But I don't think that one city in particular will take over the leadership it held. Frankfurt is in a good position, but Paris, Dublin and even New York will also benefit, while London will also long continue to host part of the global financial activity.

PP: Since spring 2016, the Haut Conseil de Stabilité Financière (HCSF - High Council for Financial Stability) has issued several warnings about the level of prices for commercial property. From our perspective the market fundamentals remain healthy, with controlled supply and a positive trend in demand from both occupiers and investors. What is your analysis in this respect?

DC: Real estate in general, and commercial property in particular, remains very dependent on the question of future interest rate movements. For several years, as a result of the crisis and incredibly weak inflation, we have benefited from a very loose economic policy in both the United States and Europe. Mario Draghi will hand over to a new head of the ECB in 2019. If a moderate successor is appointed, like Mr Powell in the United States, I think we can avoid major disruption to asset values. One parameter I think it is vital to monitor – which could prove a fly in the ointment – is movements in the euro. Europe has immense trade surpluses and, from the point of view of the rest of the world, the euro generally appears undervalued. Avoiding excess strengthening will be one of the ECB's (implicit but important) targets post-Draghi…

HURRY UP, WE'RE DREAMING

THE OFFICE LETTINGS MARKET

Fonçons, nous rêvons! That was the name of the first double album from M83, the French electronic music group, which achieved global success. This visionary title could now be appropriated by players and observers in the office letting market to describe 2017. The year certainly provided plenty of reasons to dream and become carried away by the rhythms of the Paris region market, with results far exceeding expectations.

The title contains a sense of wonder, but also fear that it may not be sustainable and one day it will be necessary to wake up. This reflects questions over the capacity of the Paris region market to sustain its impressive performance. The outlook for 2018 is far from clear. Some awakenings are gentle, however, and some dreams do last.

OVERVIEW OF 2017

- ♫ Take-up in the Paris region increased by 5% in 2017, approaching 2.6 million sq m. The Paris region market therefore achieved its best performance in 10 years.
- ♫ The foundations for this success lie in the segment of surface areas between 5,000 sq m and 20,000 sq m, which grew by 59% in a year.
- ♫ A lack of supply meant that 2017 was less favourable than previous years in inner-city Paris and La Défense. Activity picked up, however, in the Western Crescent and the Inner Rim.
- ♫ Available supply continued to contract, reaching 6.1% in the Paris region by the end of 2017. In addition, the proportion of Grade A surface areas fell further, to 13%.
- ♫ For the first time in five years, prime values in the CBD broke through the €800 mark (to €810/sq m/year).
- ♫ The outlook for 2018 looks favourable, with transactional activity likely to remain dynamic and potentially matching the level seen in 2017.
- ♫ Prime rents are set to continue to increase in the first half of 2018, before gradually stabilising towards the end of the year.

TRENDS

Stamina

What was the main characteristic of the Paris region letting market at the end of 2017? Above all, loops. Enthralling and exhilarating sound loops – in transactional activity – worthy of arrangements by the very best electronic artists. Vibrating loops, overflowing with energy and endurance, demonstrating what is called stamina in English-speaking countries. The same stamina that creates the best club nights around the world. It was the inspiration for an album by Vitalic. Another Frenchie who established himself as a leading artist in electro, a music movement marked from the outset by its "French touch", from its founding fathers, Pierre Schaeffer and Pierre Henry, to contemporary stars Daft Punk. A French touch which was also a distinguishing feature of 2017. This was true on the European and international political stage and appears to be increasingly the case economically. And the letting market was no exception, with the Paris region firmly taking first place in Europe.

#01 - DEMAND FOR OFFICES

Heaven 17

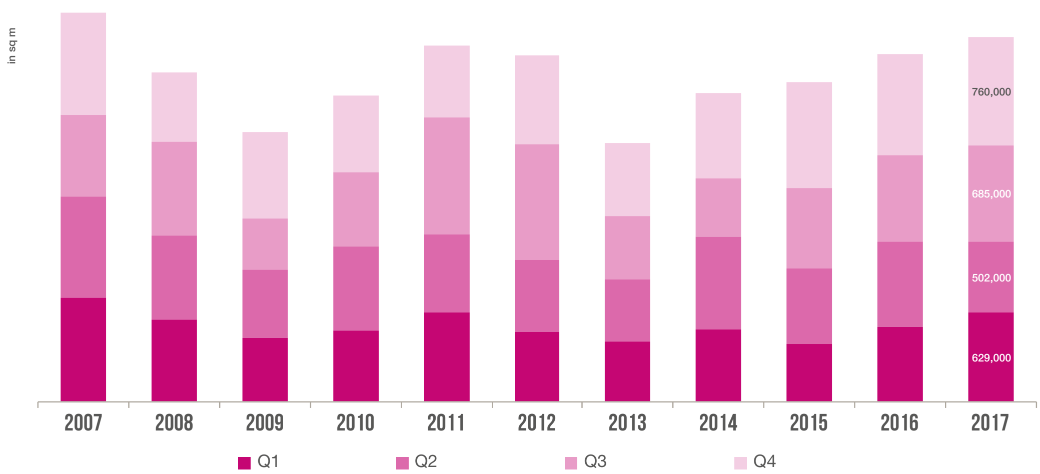
Transactional activity certainly led some real-estate players to feel they were in heaven in 2017, like ravers carried away in an electro trance. But without any illegal substances! Heaven 17[1]...

The Paris region once again demonstrated its power and unrivalled influence on the French letting market. Almost 2.6 million sq m of offices were let or sold to occupiers in 2017, a year sure to be seen as a great success. The increase in transactional activity may not have appeared remarkable, at a modest +5%. Nothing, on the face of it, to trip out about! The increase was significant, however, given that it was achieved based on 2016 results which were themselves very good. It wasn't going to be easy to equal those previous results – yet they were exceeded.

> Office take-up reached almost 2.6 million sq m in the Paris region in 2017, up by 5% in a year – the region's best result in 10 years.

The Paris region ended 2017 well above the 10-year average (2.27 million sq m of take-up), recording a surplus of almost 15%. It has only done better three times since 1974[2]: in 2000, 2006 and 2007.

Changes in take-up in the Paris region
Source: Knight Frank



[1] Heaven 17: name of a British synth-pop group.

[2] Knight Frank began monitoring transactional activity in the Paris region in 1974, when it was founded in France.

TYPES OF OCCUPIERS

What are the reasons for this success in 2017? It is based on transactions by large companies, looking for offices between 5,000 sq m and 20,000 sq m. This segment accounted for almost 825,000 sq m of take-up, an increase of 59% compared with the previous year. This rise is even more impressive given that volumes had already increased significantly the previous year. In all, 32% of transactional activity in 2017 was carried out through 87 transactions for between 5,000 sq m and 20,000 sq m. There were "only" 61 in 2016.

825,000 sq m of take-up resulted from transactions for between 5,000 sq m and 20,000 sq m, up by 59%. At the other end of the spectrum, take-up of small surface areas fell by 29%.

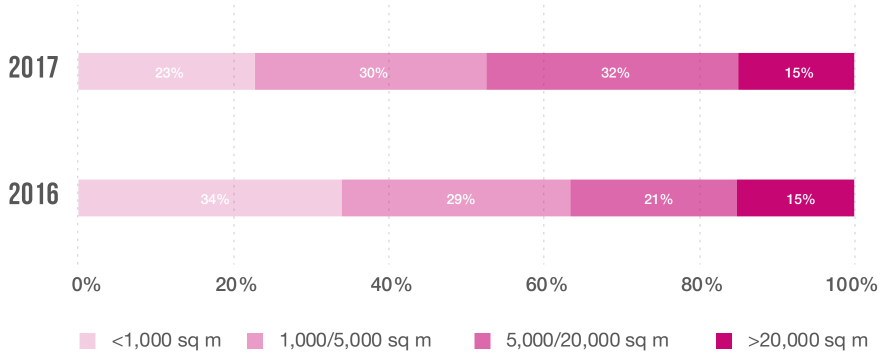
At the other end of the spectrum, activity from occupiers of small surface areas (less than 1,000 sq m) recorded a significant fall in the Paris region (- 29%). The scale of this decline may appear surprising given the more favourable economic environment, which looks likely to continue to improve. These occupiers represent just 23% of office take-up, down from 34% the previous year.

Between these two extremes, with their completely contradictory movements, other segments of surface area appeared very tame, with moderate increases of 6% for medium-sized transactions (between 1,000 and 5,000 sq m) and 3% for mega-deals of 20,000 sq m or more.

The change observed in the largest user segment (20,000 sq m or more) is not particularly surprising. It would have been difficult to do much better, given the strong growth recorded in this segment in 2016. The 3% increase seen in 2017 therefore confirms the dynamism of this segment and its maintenance at historically high transaction volumes, despite a slight contraction in the number of transactions (10 compared with 12 in 2016). The year featured the letting by Natixis of 88,500 sq m in the Duo towers (Paris 13) and the letting of 57,000 sq m, in the Bridge building in Issy-les Moulineaux, by Orange.

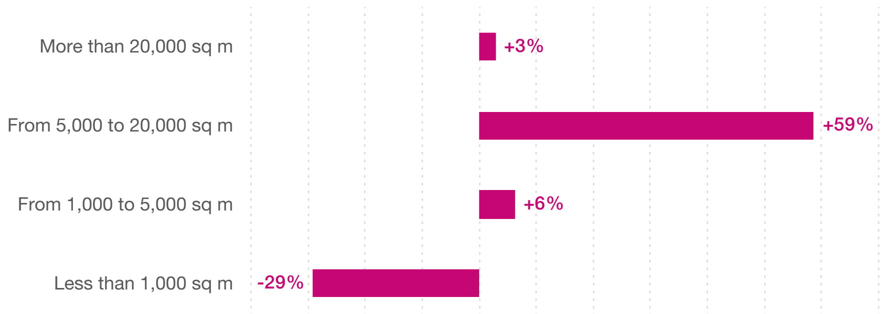
Breakdown of take-up by surface area

Source: Knight Frank



Evolution of take-up by surface area between 2016 and 2017

Source: Knight Frank



The most interesting changes are in other segments of surface area. What lies behind the contrasts observed in 2017?

The momentum among large occupiers largely reflects their search for real-estate consolidation and efficiency. There is an undeniable need among companies, many of which are based in ageing offices. In fact, just 13 million sq m (new and redeveloped) have been delivered in the last 15 years. This is just over 24% of the 54 million sq m in the huge Paris region office stock. Considering that in the last decade, design and construction techniques have made it possible to improve buildings' efficiency by 30% and reduce charges and operating costs by a similar amount, the ageing office stock is becoming a disadvantage for occupiers.

Expectations for office space have changed radically, with a major increase in occupier needs in terms of property suitability.

The address, quality and layout of a building are also increasingly perceived by companies as HR management tools, due to their significant contribution to employee fulfilment, particularly employees from Generation Y. When asked whether the offices were a factor in their decision to join their company, 30% of employees responded in the affirmative, increasing to 56% in French tech companies[3].

Indeed, expectations in terms of office space have evolved considerably in the last few years, leading to a profound change in how it is designed and how work is organised. Gone is the anonymity which often afflicted corporate real estate out of fear of narrowing its commercial appeal, gone

[3] SFL, Paris Workplace 2017.

Transactions for more than 20,000 sq m in 2017
Source: Knight Frank

Surface area	Tenant	Building	Submarket	Date
88,500 sq m	Natixis	Duo towers	Paris 12/13	Q1 2017
57,000 sq m	Orange	Bridge	Southern Bend	Q3 2017
43,000 sq m	SNCF	SFR Campus	Northern Inner Rim	Q4 2017
33,400 sq m	Conseil Régional	Influence 1.0	Northern Inner Rim	Q1 2017
33,200 sq m	Cap Gemini	Aquarel	Southern Bend	Q2 2017
27,900 sq m	Lagardère	Octant & Sextant	Neuilly-Levallois	Q3 2017
26,300 sq m	Altarea Cogedim	85-89 Richelieu	Paris QCA	Q3 2017
26,100 sq m	Crédit Agricole Assurances	44 Vaugirard	Paris 14/15	Q2 2017
25,000 sq m	Parfums Christian Dior	Kosmo	Neuilly-Levallois	Q4 2017
23,000 sq m	Axa	Java	Paris Peri-CBD	Q4 2017

now aims to be a tool to enable talent and individuality to flourish, while enabling everyone to assert their role and place in the community (i.e. the company).

Real estate is now perceived as a tool to enable talent and individuality to flourish while enabling everyone to assert their role and place in the community.

The focus is now on the spirit of the premises and their identity. Buildings with personality and alternative districts are increasingly in demand, sometimes to the detriment of more established tertiary locations. Halls and passageways are being magnified and showcased to become meeting spaces. Emphasis is shifting to relaxation and leisure areas, with the introduction of table football and table tennis, while lounges, kitchens and cafeterias are becoming more important. Service areas are becoming more common and emerging from their dark corners. The largest companies, meanwhile, are creating terraces and

One of the archetypes of this new generation of buildings was designed by and for Google in Mountain View, near San Francisco. The Googleplex offices are almost hidden from sight. Employees there can swim, play beach volleyball, bring their dogs and work on personal projects – to the extent that work becomes invisible. This reflects the blurring of work and the increasing porosity between work and leisure time, professional and private life. As Alain d'Iribarne, chair of the scientific board Actinéo, notes: "We are in a state of transition... Whenever and wherever you happen to be, you are always potentially at work"[4].

Employees are mobile, including while they are at work. They may change location each day and even several times in the same day, depending on who they need to work with and the tasks they have to complete. This is the "dynamic open-plan", in which the allocated workstation no longer necessarily exists. This design of space is enabled by the paperless culture, leading to the disappearance of cabinets and files, as well as seemingly innocuous details, such as the disappearance of the individual waste bin in favour of a collective bin on each floor for recycling. It is now winning over numerous large groups, which see it as an opportunity to adapt to new technologies and attract young talent. The adoption of these cross-functional, open, fluid and egalitarian spaces must be accompanied by a profound managerial change. They are the polar opposite of a strict, vertical hierarchical structure.

This paradigm shift in the perception of work and office spaces is pushing companies to relocate in order to keep up with the trend. The market particularly encouraged them to do this in 2017, since it offered a broader choice of locations due to the increase in the number of new and restructured premises delivered, despite a higher pre-letting rate. Since they offer large surface areas, these buildings were mainly available to large companies.

Those companies were particularly encouraged to make real-estate decisions since their economic environment has improved and their future has become clearer. In January 2018, the Banque de France upgraded its latest growth forecasts for the French economy in 2017, predicting a GDP increase of 1.9%. Most economic commentators also made similar upward adjustments, leading to an average consensus of +1.8% for France. This represents a significant improvement compared with the results previously recorded. If confirmed, 2017's results will be the best since 2011.

Yet France remains below the Eurozone average (+2.2%), which has also increased considerably since 2017, and well below the growth rates recorded in some Asian countries and in the United States. The large companies based in the Paris region are often very international, however, and their turnover is boosted by overall global growth. This improvement, combined with less uncertainty in Europe, is helping companies to plan positively for the future and implement real-estate decisions committing them for several years.

[4] France Inter, *Secrets d'Info*, 10 February 2017.

Consolidation is therefore one of the key drivers of the letting market in the Paris region – a driver which should, in theory, have a big impact regardless of the surface area in question. So what explains the fall in transactional activity among small occupiers (-29%) and the mediocre growth (+6%) among occupiers of medium-sized surface areas?

Apart from the fact that their economic outlook is often more limited to France, they also have more difficulty accessing new and redeveloped surface areas than large occupiers, which enjoy a big advantage in winning over landlords, since they offer the potential to secure buildings under development via major lettings and pre-lettings. Only rarely is a deliberate division strategy adopted when marketing new and redeveloped buildings, offering an opportunity to occupiers seeking smaller surface areas.

A new trend is playing a key role in the decline of the small surface areas segment: the exponential growth of coworking in Paris.

Does that mean that a lot of small and medium-sized occupiers, realising they are excluded from the Grade A office market, have abandoned their plans due to a lack of satisfactory real-estate solutions? Possibly not, since a new trend is playing a role – potentially just as important – in the weakness observed in these segments of surface areas: the growth in coworking. This opens the door for many occupiers to top-quality serviced premises, even if they only need a small number of workstations. Although, in theory, large companies are not excluded from coworking, the movement mainly concerns occupiers of small and medium-sized surface areas.

This access is also based on service agreements, whose flexibility is in line with modern needs. There is no need for a three-year commitment, as with a traditional lease. The flip-side is that these occupiers are disappearing from the traditional letting market, accentuating the decline in transactional activity.

Coworking is experiencing exponential growth on the Parisian market. The trend amplified in 2017, with an increase in the number of lettings by specialists in this new sector, as well as in the size of the properties let. During 2017, for instance, they generated eight transactions for more than 5,000 sq m, for a total of almost 100,000 sq m of take-up across all sizes of transactions. These surface areas are in addition to those let in 2015 and especially in 2016, which are now being let with maximum divisibility and flexibility.

The arrival of coworking specialists currently mainly affects the CBD and, to a lesser extent, the rest of inner-city Paris and La Défense. It is interesting in this respect to note that a market such as the CBD, which has traditionally specialised in small and medium-sized surface areas, saw a sharp fall in those segments' market share in 2017, along with a significant increase in the proportion of large transactions. The coworking phenomenon is boosting the large transactions segment, while at the same time reducing transactions for smaller surface areas.

Coworking is boosting the large transactions segment and reducing transactions for smaller surface areas.

However, coworking is in the process of breaking out of more established markets to take on more peripheral areas. For instance, while Morning Coworking, the specialist subsidiary of Bureaux à Partager, was preparing to open its new 3,000 sq m space on Rue Treilhard, a stone's throw from Parc Monceau (Paris 8) at the start of the 2018, it was also finalising the letting of 8,000 sq m in the Gate One building in Clichy.

The new techno beats of the letting market will keep the Paris market dancing for some time to come!

TOPS & FLOPS

Changes in take-up by submarket between 2016 and 2017

Source: Knight Frank

1 - Northern Inner Rim **+163%**

2 - Southern Bend **+63%**

3 - Neuilly - Levallois **+61%**

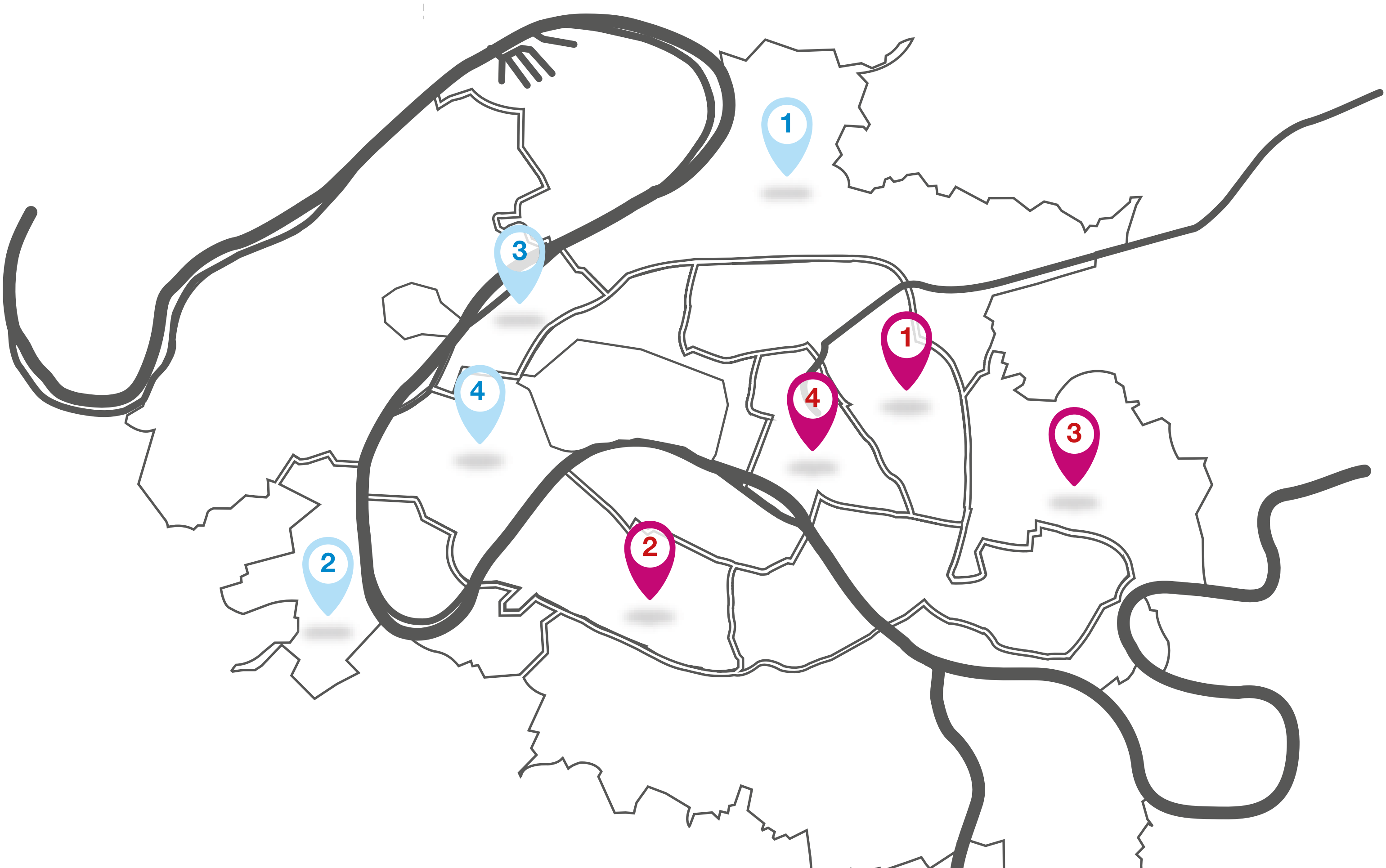
4 - Paris Centre West (excl. CBD) **+36%**

1 - Paris 18/19/20 **-60%**

2 - Paris 14/15 **-31%**

3 - Eastern Inner Rim **-25%**

4 - Paris 3/4/10/11 **-22%**



GEOGRAPHICAL DISTRIBUTION OF TRANSACTIONAL ACTIVITY

The contrasting changes in the various segments of surface area therefore reveal some radical new movements. The same movements shaking the world of work and our economy. And the same movements seen in the Paris region, since the way this transactional activity is structured also explains its geographical breakdown. The areas most attractive to large and very large occupiers, with quality supply, saw the greatest growth in 2017.

It was not a typical year for Paris in 2017 – the city centre saw its share of transactional activity fall from 44% to 39% over the year.

The year was clearly not very typical for Paris. The city centre saw a fall in its relative market share of regional take-up, from 44% in 2016 to 39% in 2017. This was due to the scarcity of its available supply, limiting real-estate development possibilities and pushing up rents, combined with a weak performance by its usual core market of small and medium-sized surface areas (see above).

Does this indicate a reversal of the main trend in recent years, i.e. the recentralisation of activity and the return of companies to central Paris? Not really. Inner-city Paris experienced an unusual level of activity in large surface areas during 2017, driven in particular by banks and insurance companies (Natixis for 88,500 sq m in the Duo towers, Crédit Agricole Assurances for 26,100 sq m in the former La Poste head office, Axa for 23,000 sq m in Java and Bank of America for 9,300 sq m at 49-51 Rue la Boétie), as well as by industrial and services companies (e.g. Canon, Altice/SFR and Europcar) relocating from the outskirts and others, confirming their choice of Paris, including Pernod Ricard, Free and Eramet. They joined traditional clients who remained active in 2017, represented by luxury companies and law firms, particularly in the CBD. These lettings and user sales confirm companies' appetite for the Paris region's most central markets. These large companies took advantage of the opportunities offered to satisfy that appetite, under financial conditions deemed to be reasonable given their standards.

The long-standing centralist view of Paris – with its leading core surrounded by incrementally less prestigious concentric circles – is in the process of changing.

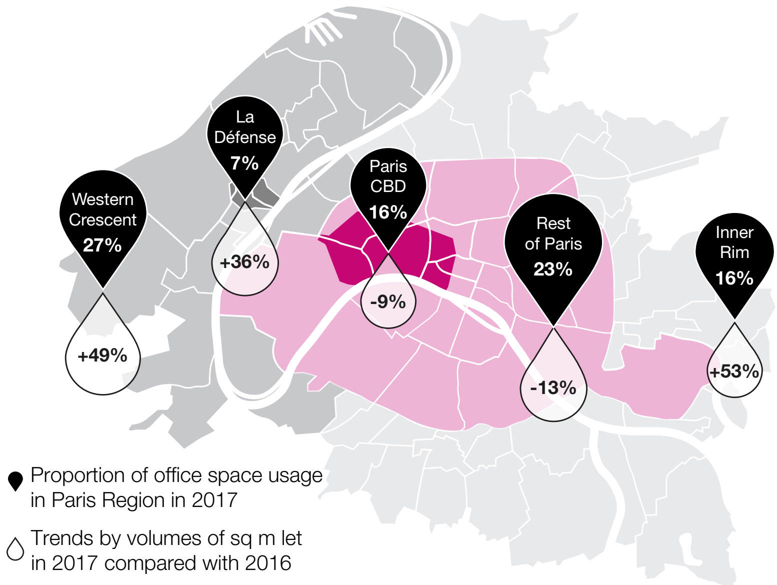
Not all companies had this option, however, and 2017 saw a geographical shift in transactional activity. But this phenomenon no doubt also reflects a change in attitudes and perception of the Paris region. Is the heart of Paris really becoming limited to the city centre and a few acres of the CBD? The long-standing centralist view of Paris – with its leading core surrounded by incrementally less prestigious concentric circles – is in the process of changing as a result of the Grand Paris redevelopment project and, to a lesser extent, events such as the Olympic Games. There is a realisation that the city centre is squeezed into an extremely small and dense area, five times smaller than that of London. This configuration means that concepts of centre and suburbs need to be reassessed. Paris needs to expand it horizons if it is to compete with most other large global metropolises.
This expansion will be particularly encouraged in the future since the Grand Paris project is largely based on the completion of a new modern and efficient transport network – the Grand Paris Express. Although the exact conditions for achieving this remain subject to changes, due to be announced in 2018, its principle and scale have been confirmed by successive governments, irrespective of their political hue. This network will radically change the way the Paris region operates, giving new areas a direct connection to existing major business hubs and enabling the emergence of new development areas. This project will only be completed gradually, with a vital stage coming in 2024 with the Olympic Games, and it would no doubt be excessive to attribute to it the geographical shifts in transactional activity observed last year. Some of the winners of 2017 are nevertheless due to benefit directly from the Grand Paris Express in the medium term (e.g. Saint-Denis, Clichy/Saint-Ouen, Nanterre, Issy-les-Moulineaux and Boulogne-Billancourt).

Companies continue to want well-connected, central premises. It is simply the perception of this centrality that is changing.

Unlike the previous year, the main winners in 2017 were the “peripheral” markets of the Western Crescent and Inner Rim. Some of these areas saw a spectacular increase in transactional activity. This was true of the Northern Inner Rim (+163%), the Southern Bend (+63%) and Neuilly-Levallois (+ 61%). Conversely, the CBD, along with many markets in inner-city Paris and La Défense which recorded an impressive year in 2016, saw their take-up fall, sometimes significantly. These markets were victims of their past success, which resulted in reducing the range of premises available to companies looking for real-estate solutions.

These adaptations to market constraints and changes in their perception of the territory do not detract from companies' requirement for well-connected, central premises. It is simply the perception of this centrality that is changing.

Breakdown of take-up by submarket and year-on-year comparison
Source: Knight Frank



#02 - OFFICE SUPPLY

Waiting for the Stars

Waiting for the stars… Another electro title which sums up one of the trends recorded in 2017 in the Paris region letting market. Occupiers have very specific expectations in terms of real estate, leading them to favour new or restructured buildings. In other words "Grade A" properties – a category of keen interest to the public and comprising the real stars of the market. This obviously means that not everyone will have access to them…

A few figures are sufficient to give an insight into occupiers' appetite for new and restructured surface areas and the situation in terms of supply: in 2017, just over one million sq m of Grade A offices were delivered in the Paris region. This volume is up considerably (+46%) compared with the previous year. By the end of 2017, however, 86% of those surface areas had already been let.

> One million sq m were delivered in 2017, up 46% in a year, and 86% of these surface areas have already been let.

This indicates that a large supply of Grade A surface areas generates transactional activity, while their shortage is the reason for some decreases. This explains the mixed fortunes encountered in 2017 by La Défense and the Western Crescent, for example. Although some feared that the jump in construction activity would lead to an increase in the vacancy rate, it simply boosted take-up. Hopeful occupiers wait for the stars.

This has led to a continued reduction in available supply. At the end of 2017, the average vacancy rate stood at 6.1% in the Paris region, down from 6.6% a year earlier. The Paris region has confirmed its position among the markets with the lowest level of available supply in Europe. The rate in London, for example, is now higher, at 7.3% (compared with 4.4% at the end of 2015).

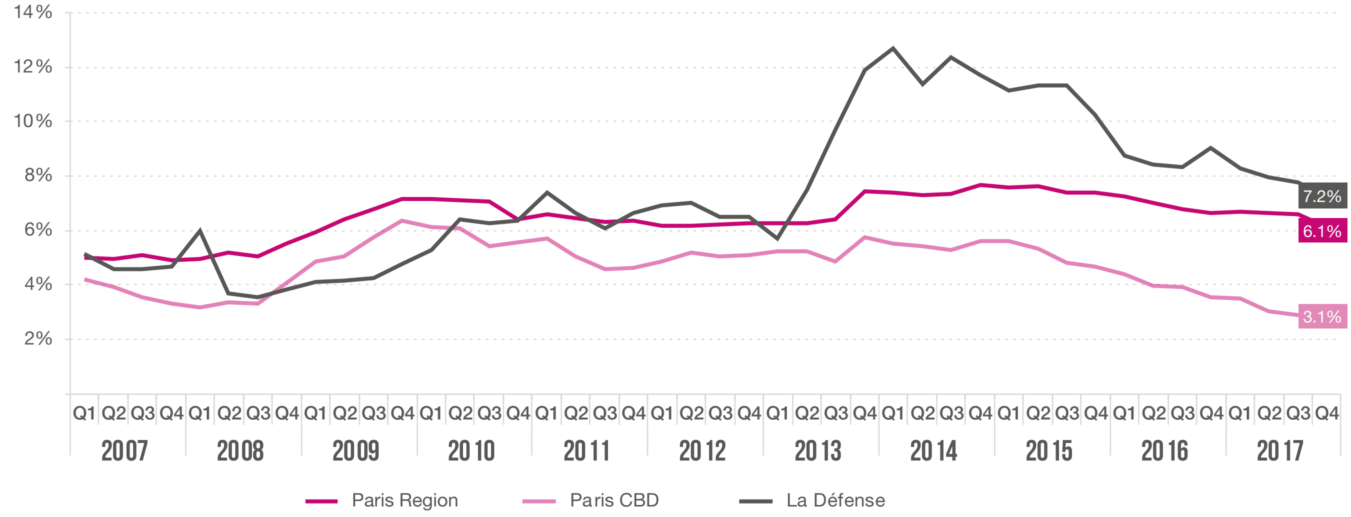
Strong take-up of Grade A premises and "good opportunities" also boosted this performance in another way, by encouraging owners of ageing offices to redevelop them or sell them to allow their updating, thereby delaying their return to the market.

> At the end of 2017, the vacancy rate stood at 6.1% in the Paris region, down from 6.6% a year earlier.

The Paris region market presents situations of under-supply in some areas, particularly those most popular with companies. The vacancy rate in the CBD, for example, had fallen to 3.1% at the end of 2017 and is even lower in the rest of inner-city Paris (2.7%). The phenomenon is now becoming apparent in La Défense, a market dedicated to large occupiers, which is experiencing

Changes in vacancy rates in the Paris region

Source: Knight Frank



a bottleneck since available supply now stands at just 7.2%. The cases of under-supply and even shortages, observed as early as 2016, worsened in 2017.

At the other end of the spectrum, the vacancy rate is much higher in the Western Crescent (11.2%) and, to a lesser extent, the Inner Rim (8.3%), although those figures do not indicate a situation of over-supply reflecting any reticence on the part of occupiers – as demonstrated by the success of the letting markets in those areas in 2017.

Although the Paris region market is occasionally pushed up by the lack of available premises, the main obstacle is their quality.

Grade A supply represents just 13% of immediately available supply available to companies. This figure is too low to meet demand. Transactional activity recorded in 2017 very clearly reveals occupiers' preference for this type of surface area: 93% of surface areas let via large transactions in the CBD in 2017 were Grade A. The same is true of the Paris region as a whole, since new and restructured surface areas account for 73% of take-up of properties larger than 5,000 sq m. This dominance is certainly not a fleeting trend, since these proportions were more or less the same in previous years.

This demonstrates the structural imbalance in the Paris region market, with obvious market disparities in areas such as La Défense as well as in the CBD and the rest of inner-city Paris.

The shortfall may be less obvious than it was a year previously, but the correction appears weak given the considerable acceleration in construction activity witnessed in 2017, which led to hopes of a bigger market stimulus.

Total supply and Grade A supply

Source: Knight Frank

Each window corresponds to 100,000 m² of office space

- Occupied office space
- Availability of Grade A
- Other availability

	Paris CBD	Rest of Paris	La Défense	Western Crescent	Inner Rim
Office stock	6.8M m²	10.4M m²	3.6M m²	7.7M m²	8.0M m²
Grade A availability	20,700 m²	43,400 m²	12,100 m²	158,400 m²	62,000 m²
Vacancy rates	3.1%	2.7%	7.2%	11.2%	8.3%

#03 - OFFICE RENTS

Kometen-melodie

Long before Rosetta and Philae, the legendary electro group Kraftwerk came up with the "comet melody". A strange melody, composed of overlaid soft and high-pitch sounds against the slower, deeper background of the universe. A melody which could have been that of office rents if they had been set to music in the Paris region in 2017. The comets in that case would certainly be Grade A buildings.

For the first time in many years, office rents in the Paris region have clearly begun to rise. This was particularly true in the CBD, in terms of both high-end and average rents.

The letting of 8,700 sq m at 52 Champs-Elysées to Chanel for a headline rent of €830/sq m/year is a perfect example. The building's location and quality are certainly exceptional, justifying values rarely seen on the market. Yet higher rents have been recorded for smaller surface areas.

> Rents are clearly rising for the first time in years.

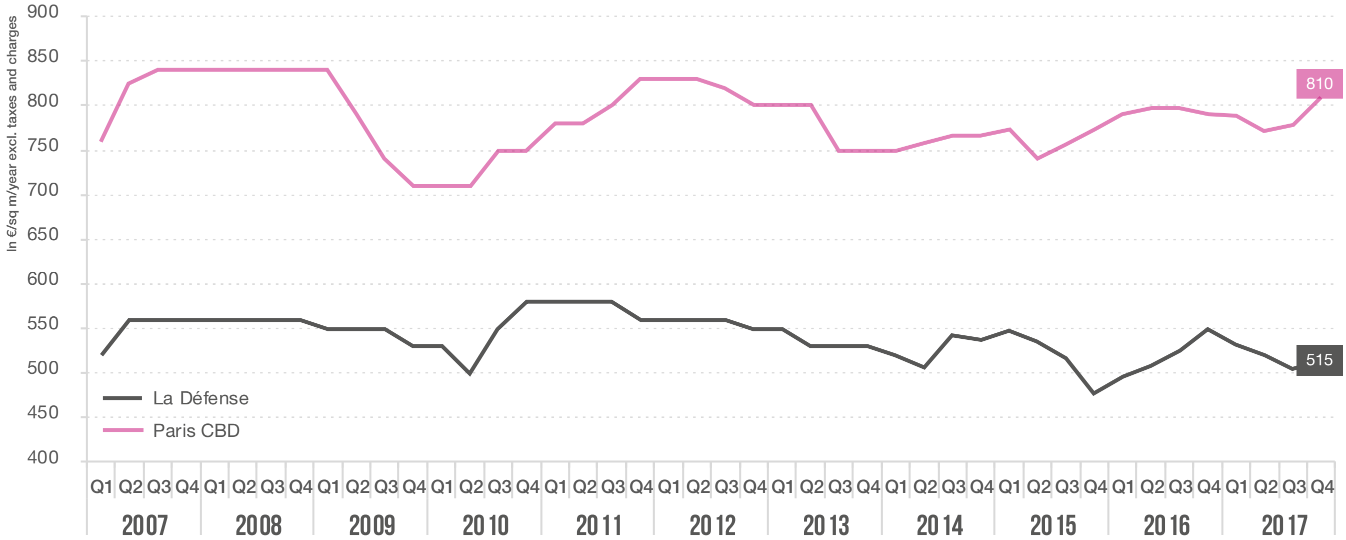
Prime rent[1] in the CBD, for instance, stood at €810/sq m/year at the end of Q4 2017. Its annual rise was modest (+3%), but it represents the first time in five years that the €800/sq m/year mark has been broken.

This increase in marketing values for the best surface areas automatically pushes up average rent. Across all types of surface area, average rent therefore stood at €615/sq m/year in the CBD at the end of 2017, up by 9% year-on-year. This increase reflects the significant market focus on large surface

[1] Weighted average by surface area for the top five highest-value transactions concluded for individual surface areas larger than 500 sq m, on a year-on-year basis.

Changes in prime rents in Paris CBD and La Défense

Source: Knight Frank



areas, mainly let in new and restructured buildings, and the weakness recorded in the segment of small and medium-size surface areas, which comprises more second-hand offices.

Although it has narrowed year-on-year, the difference between prime and average rent remains significant in the CBD (€195), clearly indicating the difference in values between the best buildings and more standard offices.

The increase in prime rents has not spread to all marketing values, although there is also an upward trend, to a lesser extent, for the Paris region as a whole. Average rent stands at €408/sq m/year, up slightly year-on-year.

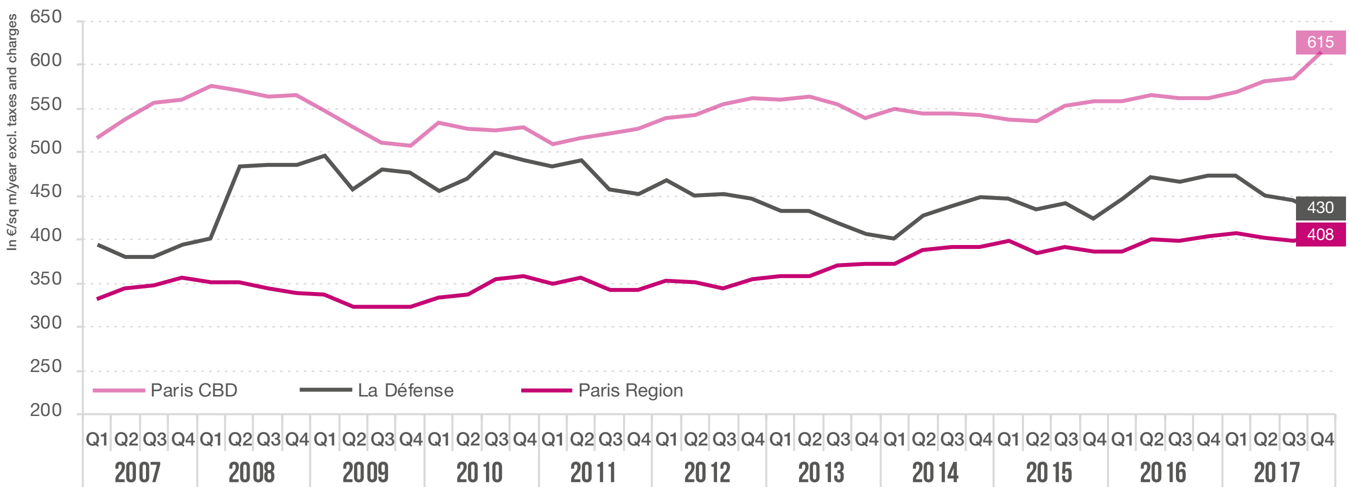
> Although smaller, the difference between prime and average rent remains significant in the CBD (€195), indicating the disparity between values.

La Défense was an outlier in 2017, recording a fall in its prime and average rents. The reason for this exception lies in the structure of supply available to occupiers, which is now almost exclusively made up of second-hand surface areas, meaning that transactions for the most expensive premises have all but disappeared. It is a safe bet, however, that the results for La Défense would have been different at the end of 2017 if more Grade A surface areas had been let. The coming months will no doubt provide a correction, with the arrival on the market of high-quality offers, at values higher than €550/sq m/year.

The comets have not finished playing their melody.

Changes in average rents in the Paris region

Source: Knight Frank



Stay Tuned

Restez à l'écoute ! This instruction from Le Peuple de l'Herbe, a French electro group, expresses the state of mind as we enter 2018. After its performance in 2017, does the letting market risk running out of steam or could it repeat its impressive performance?

Feeling is divided between optimists and doubters – although optimism looks as if it may be winning the day. Whether or not it manages to return to previous levels, the Paris region market is likely to remain dynamic.

OFFICE DEMAND

The fundamentals which dictated movements in the letting market in 2017 remain and some could be even more influential in 2018.

That is true of the improvement in the economic environment, which is expected to have a bigger impact on employment than in recent months. Office transactions have not so far been boosted by job creation. While the number of unemployed (in category A) finally appears to be falling in the Paris region (-2% in the three months to the end of November 2017), it rose slightly year-on-year (+0.9%)[1]. The latest data available gives reason to hope for a further improvement, with figures for December 2017 set to record a new fall year-on-year. If the trend for net job creations is confirmed, it is likely to lead to increased demand for office space, with a knock-on effect on transactional activity.

> Net job creation is likely to increase companies' demand for office space – it's been a long time since the Paris region market was driven by an increased need for surface areas in absolute terms.

This therefore represents a new market driver, indicating a positive outlook in terms of take-up. It's been a long time since the Paris region market was driven by an increased need for surface areas in absolute terms. This driver could also be reinforced by another phenomenon – relocation to Paris (or expansion) by foreign companies attracted by France's new image. This is typically the case for technology companies. In January 2018, for example, Google announced the forthcoming creation in Paris of its second European centre for fundamental research in artificial intelligence. This move will mean a 6,000 sq m extension to the internet giant's French headquarters. The same applies to companies based in London, which are being forced to consider the relocation of some of their teams as a result of Brexit. HSBC, Bank of America and the insurer Chubb chose Paris in 2017. They could be joined by others, particularly in the financial sector, following the decision by the European Banking Authority to move to the banks of the Seine.

[1] Direccte Ile-de-France, based on data from Pôle Emploi, 27 December 2017.

Companies' need to streamline and modernise their premises – the main driver for the Paris region letting market in recent years – remains as strong as ever and will continue to influence the market. An immense need exists among the many occupiers that currently have employees working in ageing offices, whose operating costs are becoming less and less competitive, as well as those bogged down in real-estate arrangements which have become unsuited to their organisation. We are still waiting, for instance, for finalisation of the lease for the 74,000 sq m to be built above the future Gare des Groues station in Nanterre, due to house Vinci's new head office. Many other projects are under discussion in relation to smaller surface areas.

However although these factors are grounds for optimism as we enter 2018, none are entirely certain.

The main unknown is the impact of the increase in rents on companies' decisions.

The main unknown is the impact of the increase in marketing values seen for Grade A surface areas, which are the most sought-after by companies. This increase could prove problematic for some occupiers, which may then be tempted to postpone relocating for the time-being, choosing instead to renegotiate financial conditions for their current premises. If they are unable to find the ideal building (either because it doesn't exist or is too expensive), they could choose instead to reduce the cost of their existing building and remain in it for longer. If this strategy becomes widespread, it could act as a dampener on transactional activity.

Changes to interest rates and the value of the euro could also disrupt the economic outlook for some companies, leading to transactions being deferred.

Transactional activity is likely to remain dynamic in 2018, at around 2.5 million sq m.

Overall, transactional activity is likely to remain dynamic in the Paris region, although it will not be easy to match 2017's results. It would therefore appear reasonable to expect take-up of around 2.5 million sq m. That is not to say there may not be some pleasant surprises along the way…

OFFICE SUPPLY

One of the keys to the future of the letting market, insofar as it will dictate changes to rents and therefore the level of demand, is how the supply of office space will change and develop over the coming months.

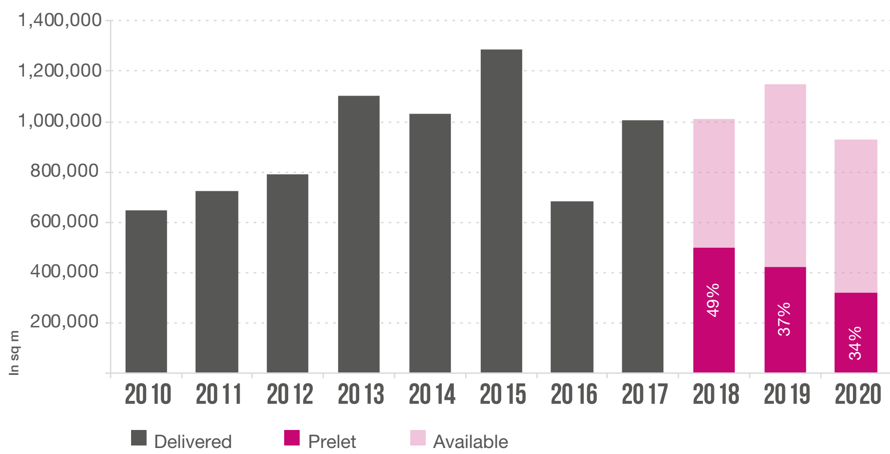
The level of construction activity (production of new and restructured surface areas) will remain stable in 2018 compared with 2017, at just over 1 million sq m expected to be delivered. The Paris region market demonstrated an excellent capacity to absorb surface areas in 2017, confirming the scarcity of Grade A supply and creating upward pressure on marketing values.

The pre-letting rate for those surface areas is high, accounting for 40% of volumes expected to be delivered by the end of 2020. It stands at 49% for those in 2018, leaving only just over 510,000 sq m available at regional level. This level is grounds for some optimism regarding the maintenance of a strong absorption capacity. For now at least, since this absorption capacity could fall if occupiers do indeed choose to renegotiate in order to avoid paying rents they see as too high for Grade A surface areas. Competition between high-quality surface areas would then increase, particularly looking to 2019, when the volume of deliveries is due to rise.

The level of pre-letting of deliveries is high, generating optimism regarding a continuing strong level of absorption – for now at least.

Deliveries of new or redeveloped surface areas in the Greater Paris region

Source: Knight Frank



That competition, combined with even a slight fall in transactional activity, could make some owners more wary of launching projects to redevelop existing surface areas. Those projects, which have the immediate effect of removing surface areas from the market while the work is carried out, have contributed to a decline in the vacancy rate. Their increased scarcity could have the opposite effect.

> It is possible there could be a slight increase in available supply by the end of 2018 and into 2019.

It is therefore possible there could be a slight increase in available supply by the end of 2018 and into 2019 (due to the expected increase in deliveries in that year). Nothing too spectacular should be expected, at least nothing that will reverse the balance between landlords and occupiers, but perhaps a stimulus nonetheless. That will be very welcome in some markets, which are suffering from a debilitating lack of supply.

OFFICE RENTS

A highlight of 2017 is the revival in prime rents. Mainly confirmed in the CBD, which serves as a barometer for the market, could this phenomenon continue and spread to other areas or will it peter out?

> During the first half of 2018, prime rents in the CBD are likely to continue to increase to between €850/sq m/year and €900/sq m/year.

It all depends on the time-frame. In the short term, at least during the first half of 2018, marketing of the best buildings will continue to be guided by the current climate, with ambitious owners and sufficient competition for the best buildings for eager occupiers to accept concessions. Values should therefore continue to increase.

This could mean seeing several lettings in the CBD of between €850/sq m/year and €900/sq m/year in the prime segment (Grade A buildings offering a sought-after address) – a record level for the Paris region market. This competition would have a knock-on effect on less prestigious areas of the CBD and beyond, meaning that unprecedented values are likely to be recorded for some addresses in inner-city Paris for new and redeveloped buildings.

La Défense should also benefit from the marketing of Grade A surface areas, which have been cruelly lacking in 2017, and should see its prime rent increase rapidly to around €550/sq m/year.

In the longer term, from the second half of 2018, the increase in prime rents could concurrently stabilise and, paradoxically, become more widespread. It all depends on the degree of occupiers' acceptance of the increases recorded and the real-estate decisions they make. If some choose to renegotiate their existing leases, while others choose to expand their geographical search area, then the upward movement will have been limited to the most sought-after areas of the Paris region. However, some peripheral markets will be able to take advantage of their increased appeal to edge up their values. Although only by a limited amount, otherwise occupiers will soon put them back in their place. Stay tuned…

QUESTIONS FOR

PAULO DIAS

Paulo Dias, CEO Southern Europe, Africa and Brazil, Regus

THE AMBITION BEHIND SPACES HAS ALWAYS BEEN TO REINTERPRET THE APPROACH TO WORKING BY CULTIVATING A COMMUNITY OF VISIONARY MEMBERS – BUILDERS AND CREATORS – IN THE RAPIDLY CHANGING WORLD OF WORK.

Knight Frank: Can you tell us briefly about the history of *Spaces*?

Paulo Dias: ***Spaces*** is the pioneer in community coworking spaces, created in Amsterdam in 2006. It's a concept offering stimulating working environments in which to create and innovate. The ambition behind ***Spaces*** has always been to reinterpret the approach to working by cultivating a community of visionary members – builders and creators – in the rapidly changing world of work, creating synergies between them to drive their business growth.

This community was destined to expand internationally. The merger with the *IWG Group* in 2015 was a natural next step, enabling a spectacular expansion in our geographical coverage. The first sites were opened simultaneously in London, New Jersey, Melbourne and Sydney. By 2017, the network already had a presence on every continent and offered an extraordinary variety of additional sites including Oslo, Geneva, Tel Aviv, Mexico, São Paulo, Nagoya and, of course, Paris!

KF: After leasing 18,000 sq m in the Le Belvédère building in La Défense at the end of 2017, at what stage is your development in France, and what are your ultimate goals here?

PD: France has become an ideal playing field for entrepreneurs. Paris is becoming the flagship city for Europe in the field of innovative startups, overtaking London in terms of company creations and, soon, fund-raising. The development of the Parisian *Spaces* network is therefore very ambitious. We officially launched in April 2017 with the opening, in barely six months, of four sites in the Paris region: three in “Silicon Sentier” (Opéra, Réaumur and Bonne Nouvelle) and one in Boulogne-Billancourt. Spaces Saint Lazare will open on Rue de Londres this summer, followed at the end of 2018 by the inauguration of the emblematic Le Belvédère site (Spaces Arena), the largest coworking space in France.

This is only the beginning obviously. Other French cities are very dynamic and support innovation, including Bordeaux, Lille and Lyon, for example. Our teams are therefore continuing to work on a large number of new sites in the Paris region, as well as elsewhere in France, in order to create the dense network expected of the *IWG Group.* We're not setting any unrealistic quantitative objectives for the coming months however. The choice of sites must be right for the short, medium and long term in a rising property market. We shouldn't confuse rapid development with haste.

KF: Some coworking players began their development in France before *Spaces* and now have a wider network. What is your strategy for standing out from the competition?

PD: When it was founded in 1989, ***Regus*** was already the pioneer in coworking and facility management. At that time, working methods were less collaborative and mobile than they are today, but we did a lot of work to educate people about pooled workplaces and their flexibility of use, while building an international network. Our sites gradually evolved and have offered relaxation areas to the members of our community for many years. We laid the foundations of coworking and our network continues to grow to support our clients.

The takeover of ***Spaces*** in 2015 enabled our group to expand its range of services by offering our clients a new international network of collaborative and scalable working spaces. ***Spaces*** sites are unique, in terms of location, design quality as well as the intrinsic quality of the buildings selected! These high standards and the quality of execution by our teams differentiate us in themselves.

Belonging to the *IWG Group* brings something extra: each member of the ***Spaces*** community obviously has access to numerous Spaces sites on all continents, as well as all 3,200 centres in the IWG network in over 110 countries, in city centres, on the periphery, in airports and in train stations. It's a unique and very relevant offering since 60% of our members travel and like having access to working spaces, wherever they may be.

KF: *Spaces* and *Regus* – how do you see the articulation between these two brands?

PD: *Spaces* and *Regus* are subsidiaries of the *IWG Group (International Workplace Group)*, which has also included the *Regus Express* and *Stop & Work* trademarks in France since 2014. IWG also has other brands abroad, including ***Signature***, ***Open Office***, *Base Point* and *N°18*, which will soon be coming to France to bring even greater product segmentation to our network, which is already the densest in the country. Our multi-brand offer is therefore clearly a competitive advantage. Each brand has its own unique characteristics in terms of design and range of services. Every customer should be able to “feel at home”. Our strategy is clearly to offer our members choice, while perfectly tailoring the product offering to the building, the neighbourhood and its client base. Startups, large groups and independent professions come to us with different needs.

KF: *Spaces* has opened sites in the main business districts of Paris and its region (Paris CBD, La Défense, Boulogne-Billancourt). What are your location criteria?

PD: Our knowledge and experience of the flexible working spaces market naturally help us to identify target locations for ***Spaces***. Buildings must be fully accessible, be part of a lively environment (shops and restaurants), be large and, if possible, independent in order to offer a wide range of services. We like buildings with character. Our site on Rue Réaumur, in the 2nd ***arrondissement***, is a very good example, with its Eiffel-style architecture, which is very popular with our French and international clients. A very good site without all of those characteristics is still interesting, however, since we have a sufficiently large brand portfolio to offer the right product for the building, the district and its client base.

KF: Regulatory environment, state of the real-estate market, etc. – what are the main constraints likely to hinder the development of *Spaces* in France?

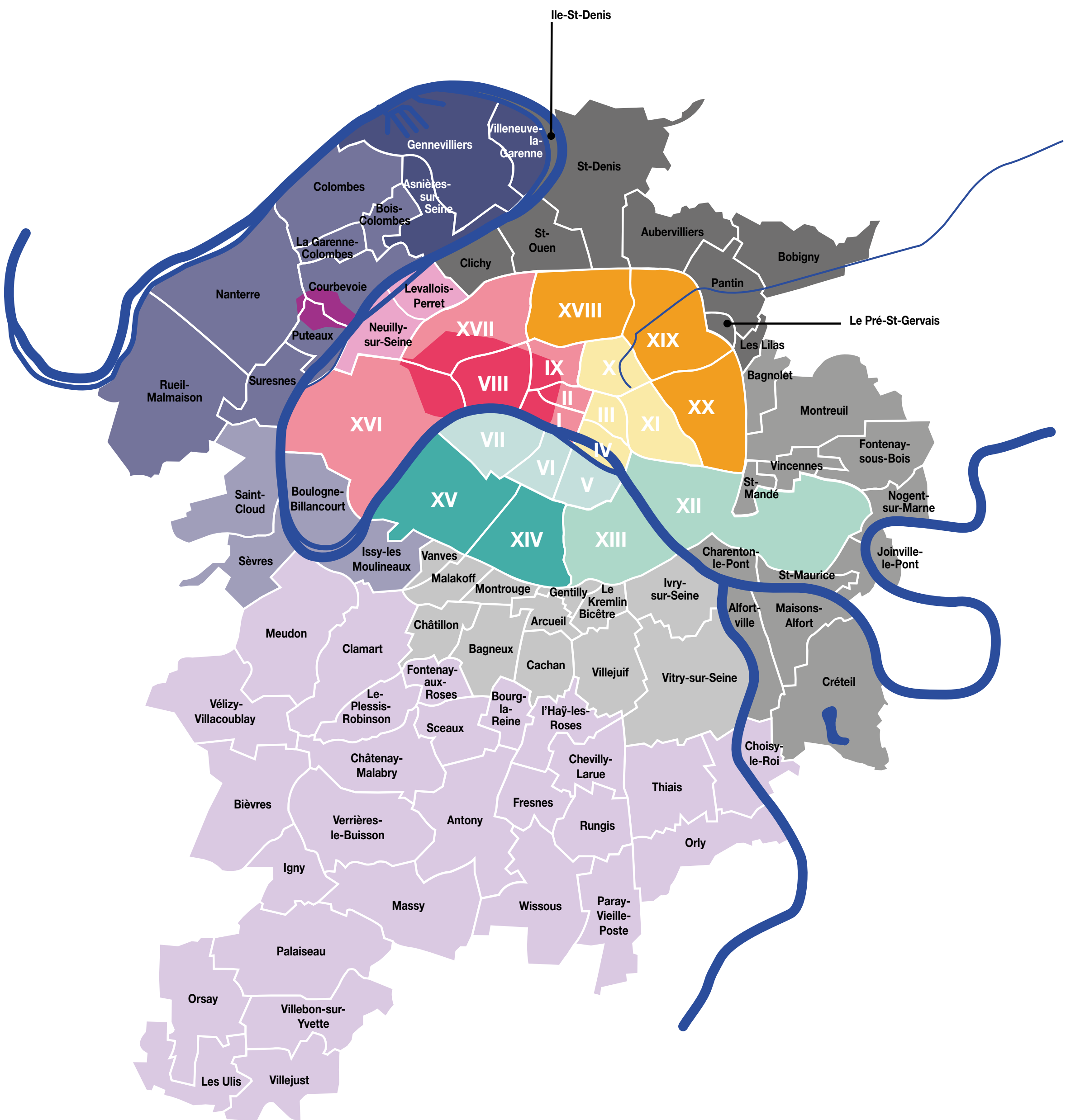
PD: We have always been able to work with various constraints specific to each region. The reduction in available supply, particularly buildings of a sufficient size and with character, is one of them. However, our market knowledge and permanent interaction with all its key players allow us to unearth “rare gems”, as in the case of the Le Belvédère building in La Défense. Its location, easy access by public transport and private vehicles, as well as its range of services, make it a unique site. And despite its large surface area it retains a human touch.

KF: Having existed for several years now, and after a few months in France, how have your clients changed and how are you adapting Spaces to the increasing diversification of user profiles in the coworking sector?

PD: We offer a wide range of working spaces corresponding to our members' profiles and their growth stage, from collaborative spaces to private offices. The spectrum ranges from individual entrepreneurs refining their startup concept to CAC 40 key accounts setting up standalone task-forces to improve efficiency. As you can tell, that's a wide spectrum! Our greatest source of pride is supporting entrepreneurs just starting a business, then seeing their company grow. In almost 30 years, our network has seen several million companies grow around the world. Very well-known brands like Google and Facebook started out with us and we're proud of having been travelling companions on their road to success.

Spaces Arena, Le Belvédère, La Défense

2017 KEY FIGURES



Paris CBD
Paris Centre West (excl. CBD)
Paris III/IV/X/XI
Paris XVIII/XIX/XX
Paris V/VI/VII
Paris XII/XIII
Paris XIV/XV
La Défense
Northern Bend
Péri-Défense
Southern Bend
Southern Outer Rim
Neuilly/Levallois
Northern Inner Rim
Eastern Inner Rim
Southern Inner Rim

Submarket	Prime rents	Take-up	Trend 2016/2017	Stock	Vacancy rate	Trend 2016 - 2017
	(€/sq m/year)	Volume (sq m)		(sq m)	(%)	
Paris CBD	**810**	**412,379**	↘	**6,549,700**	**3.1**	↘
Paris Centre West (excl. CBD)	**611**	**164,232**	↗	**1,967,100**	**3.6**	↘
Southern Paris						
Southern Paris / Paris V/VI/VII	645	28,018	↗	1,263,200	1.7	↘
Southern Paris / Paris XII/XIII	530	156,287	↗	2,090,700	2.6	↘
Southern Paris / Paris XIV/XV	537	119,389	↘	2,038,900	2.6	↘
Total Southern Paris	-	**303,694**	↘	**5,392,800**	**2.4**	↘
North Eastern Paris						
North Eastern Paris / Paris III/IV/X/XI	561	76,308	↘	1,498,800	2.5	↘
North Eastern Paris / Paris XVIII/XIX/XX	373	43,505	↘	1,306,900	3.2	↘
Total North Eastern Paris	-	**119,813**	↘	**2,805,700**	**2.8**	↘
Total inner Paris		**1,000,118**	↘	**16,715,300**	**2.9**	↘
La Défense	**515**	**180,476**	↘	**3,551,000**	**7.2**	↘
Western Crescent						
Western Crescent / Northern Bend	240	34,089	↗	809,300	14.2	↗
Western Crescent / Neuilly Levallois	600	176,595	↗	1,516,500	6.9	↘
Western Crescent / Péri-Défense	360	203,371	↗	2,651,600	15.8	↗
Western Crescent / Southern Bend	480	290,985	↗	2,613,800	8.8	↘
Total Western Crescent	-	**705,040**	↗	**7,591,200**	**11.5**	↘
Inner Rim						
Inner RIm / Northern Inner Rim	365	229,860	↗	3,165,900	10.2	↗
Inner RIm / Eastern Inner Rim	295	69,996	↘	2,321,500	4.4	↗
Inner RIm / Southern Inner Rim	335	117,656	↗	2,473,700	9.6	↘
Total Inner Rim	-	**417,512**	↗	**7,961,100**	**8.3**	↗
Outer Rim	-	**272,567**	↘	**17,881,800**	**5.8**	↘
Total Île-de-France		**2,575,713**	↗	**53,700,400**	**6.1**	↘

Source: Knight Frank

KNIGHT FRANK

Knight Frank is an international real estate advisor.

In France, the company operates in the corporate real estate market, mainly comprising offices, retail premises and industrial or logistics buildings.

Knight Frank France serves two separate groups of clients: owner investors and tenant companies.

Knight Frank France was founded over 40 years ago and is organised into six business lines: Offices, Retail, Capital Markets, Property Management, Knight Frank Valuation and L'Atelier Knight Frank (a spatial design consultancy).

The Knight Frank France team includes 80 professionals working from Paris. Historically specialising in the real estate market in the centre of the capital, the company has gradually widened its field of expertise and is now a recognised consultant in areas including La Défense and the Western Suburbs of Paris. The Capital Markets department, along with the independent subsidiary Knight Frank Valuation, also support their clients throughout France.

Knight Frank France is the French branch of Knight Frank LLP, a British company founded more than 120 years ago and now operating in 60 countries. It offers its clients the skills of its 15,020 professionals, working from 418 offices worldwide.

A global platform and an independent partnership, specialising in tertiary and residential real estate and employing professionals dedicated to their clients, Knight Frank enjoys a unique position in the world of real estate consultancy.

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