PARIS / ÎLE-DE-FRANCE

OFFICE PROPERTY MARKET
Q2 2018

OCCUPIER TRENDS | INVESTMENT TRENDS | MARKET OUTLOOK

KEY FINDINGS

French economic activity slowed down during the 1st half of 2018. Growth should return to its cruising speed during the 2nd half of the year.

Over the 1st half of the year, areas that were let or sold to occupiers in the Greater Paris region already totalled 1,360,000 m², an increase of 15% year-on-year and a level that hasn't been seen since 2007.

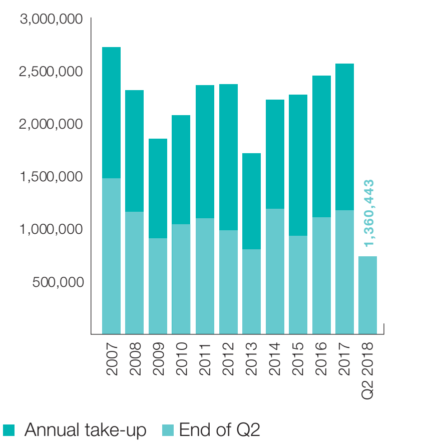
With take-up of 543,500 m², the city of Paris saw take-up activity increase by 4% year-on-year, related to the dynamism of Western areas.

Decreasing by 3% in one quarter and 14% year-on-year, the volume of available space in the Greater Paris Region totalled 3.05 million m² as the end of the 1st half of 2018. The vacancy rate stands at 5.7%, its lowest level since 2009.

The city of Paris concentrated 56% of investment volumes in offices in the Greater Paris Region.

The geographical readjustment in the investment market mainly benefitted the Western Crescent and the Northern Inner Suburbs which concentrated between them 38% of office investment volumes in the Greater Paris Region.

Île-de-France take-up
In m²



Source: Knight Frank

OCCUPIER MARKET

ECONOMY: A FEW CLOUDS

After the strong acceleration seen at the end of 2017, French economic activity slowed down during the 1st half of 2018. This drop does not, however, indicate a reversal of the cycle. Unless anything unforeseen arises, growth should return to its cruising speed during the 2nd half of the year, prolonging the bright spell seen for several months. In the Greater Paris Region, the slowdown at the start of 2018 was reflected by a slight increase in the unemployment rate (8% as at the 1st quarter, compared to a national average of 9.2 %). Job creations, hiring of executives, small and medium sized business' turnover, creation of companies: in spite of everything, most economic indicators remain well positioned, highlighting the favourable outlook for the office rental market.

THE BEST 1ST HALF OF THE YEAR SINCE 2007

With a little under 600,000 m² of office take-up during the 2nd quarter 2018 in the Greater Paris Region, the pace of lettings remained steady, in spite of a decrease of 21% compared to the previous quarter. This decrease needs to be put into perspective with the exceptional nature of the lettings market over the first three months of 2018, which constituted the best start to the year in the Greater Paris Region market since 2007. Over the 1st half of the year, areas that were let or sold to occupiers already totalled 1,360,000 m², an increase of 15% year-on-year and a level that hasn't been seen since 2007.

The strength of occupier demand was seen in almost all area categories. Whilst take-up volumes for areas under 1,000 m² saw a slight decrease of 4% year-on-year, the results remain respectable, particularly in Paris (+1%) in spite of the strong growth of co-working. In the intermediate area category (comprised between 1,000 and 5,000 m²), demand remained very robust and saw an increase of 27% year-on-year. It is outside of the capital that increase was the most significant, as seen in the Outer Suburbs and La Défense, where this dynamism enabled the very limited number of large transactions to be compensated.

Examples of office lettings in Q2 2018

Asset/Adress	Tenant	Area (m²)
Shift / Issy-les-Moulineaux	Nestlé	44,300
Convergence / Rueil-Malmaison	Danone	25,100
Le France / Paris 13	WeWork	17,200
23-29 rue de Châteaudun / Paris 9	Galeries Lafayette	14,500
Map / Paris 16	Lacoste	13,800
123 boulevard de Grenelle / Paris 15	WeWork	11,600
Carré Michelet / Puteaux – La Défense	MSD	10,000
Highlight / Courbevoie	Kaufman & Broad	9,200
Primopera / Paris 9	Burrus / Diot	8,600
34-36 rue Guersant / Paris 17	Perial	5,700

Source: Knight Frank

At a regional level, the quick take-up of large areas is also behind the good results seen during the 1st half of 2018. 43 transactions over 5,000 m² were recorded, totalling almost 570,000 m², an increase of 21% year-on-year and 42% of total take-up. The result is even more remarkable given that there were relatively few large transactions: there were three over 40,000 m², including the letting to NESTLÉ during the 2nd quarter of "Shift" in Issy-les-Moulineaux. All three deals were for new or redeveloped areas. For all lettings over 5,000 m², new and redeveloped areas accounted for 77% of take-up compared to 81% for the same period last year. This slight decrease does not contradict occupiers' strong preference for Grade A assets. The increase in large second-hand office deals (14 compared to 10 in the 1st half of 2017) conveys the general growth in activity, as well as the success of less expensive alternatives and the deferment of certain occupiers within a context of a pronounced lack of new and redeveloped offices.

"GO WEST"!

The 2nd quarter confirmed the great shape of the Parisian market. With 543,500 m², the capital concentrated 40% of lettings in the Greater Paris Region during the 1st half of 2018, a slight increase of 4% year-on-year, related to the dynamism of western areas. The CBD and Paris Centre West as such reached peak levels due to the clear increase in lettings of large areas. New deals over 5,000 m² in these areas have been signed since January for a total volume 103% above that of the 1st half of last year. Amongst the deals undertaken in the 2nd quarter are the letting to LES GALERIES LAFAYETTE of 23-29 rue de Châteaudun in the 9th district, and the letting to LACOSTE of "Map" in the 16th district. These lettings illustrate the fast take-up of redeveloped space in the capital, a success which continues to push rental values upwards: the CBD prime rent henceforth stands at €830/m²/year compared to €810/m²/year at the end of 2017. Outside of these two sectors, take-up registered a decrease of 20% year-on-year in Paris, and a decrease to varying degrees in all area categories. Even so, we would highlight the first incursion of WEWORK on the Left Bank, with the letting of 11,600 m² at 123 boulevard de Grenelle in the 15th district, and the letting of 17,200 m² in "Le France" in the 13th district.

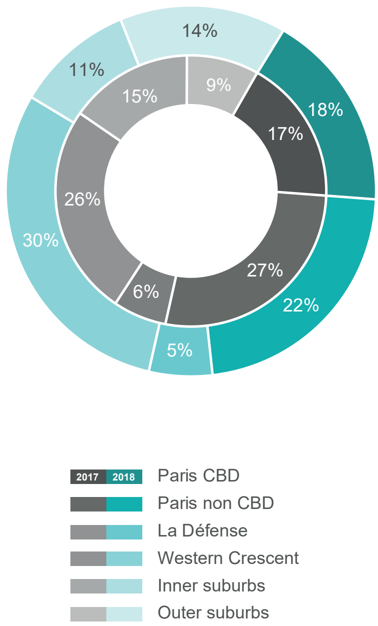
Outside of Paris, it is also the sectors to the West that steal the limelight. With take-up of almost 410,000 m² during the 1st half of 2018, the Western Crescent saw take-up activity increase by 35% year-on-year. This increase is related to the return to form of the Northern Loop, but above all to the increase in take-up volumes on large deals, particularly in Rueil-Malmaison (DANONE on 25,100 m² in "Convergence") and in Nanterre (VINCI on 61,400 m² in "Archipel", TECHNIP on 51,500 m² in "Origine"). Performances in other office sectors of the Greater Paris Region are contrasting, decreasing by 19% in the Inner Suburbs and increasing strongly by 91% in the Outer Suburbs, driven by numerous large and medium sized transactions.

UNDER 3 % VACANCY RATE IN PARIS

Decreasing by 3% in in one quarter and 14% year-on-year, the volume of available space in the Greater Paris Region totalled 3.05 million m² as the end of the 1st half of 2018. The vacancy rate henceforth stands at 5.7%, its lowest level since 2009. The situation is particularly strained in Paris itself, where the vacancy rate is progressively approaching 2%.

More than 230,000 m² of new and redeveloped offices have been completed since January in the Greater Paris Region. The pace will distinctly accelerate during the 2nd half of the year given that 750,000 m² are due for completion between now and the end of the year, including several large properties that are still available in Paris and the Western Crescent. However, only 49% of the 2.4 million m² that is currently under construction with completion due between 2018 and 2021 is still available. Almost 42% of this volume is concentrated in Paris itself, where future supply has recently been further reduced by new large deals, such as LACOSTE in "Map". In other sectors of the Greater Paris Region, the Inner Suburbs (excluding the Western Crescent) stand out due to an acceleration in the pace of developments. Following 80,000 m² of developments in 2017, 130,000 m² will be completed in 2018, followed by 280,000 m² in 2019. More than a million m² are potentially due for completion in the Inner Suburbs by 2021, proof notably of the expansion of office programmes related to the opportunities provided by Grand Paris Express.

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



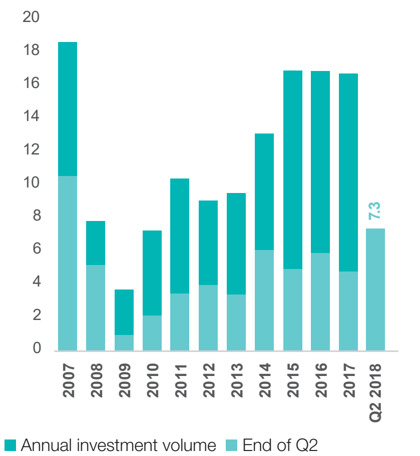
Source: Knight Frank

INVESTMENT MARKET

PARIS DOMINATES…A LITTLE LESS

Paris continues to act as a magnet for investors. The city of Paris concentrated 56% of investment volumes in offices in the Greater Paris Region, fairly evenly spread between the CBD and other areas of the capital. Among the most significant and most recent deals in the CBD we would highlight the two acquisitions by ARDIAN REAL ESTATE (former headquarters of Europe 1 on rue François 1er, 2 place Rio de Janeiro) and the sale to BNP PARIBAS REIM of the future BANK OF AMERICA offices at 49-51 rue La Boétie. In spite of a limited number of deals, volumes invested outside of the CBD are also significant, inflated by the sale to PRIMONIAL REIM of 50% of "Quadrans" (Paris 15th district) for over 500 million euros.

Île-de-France office investment volumes
€ billion



Source: Knight Frank

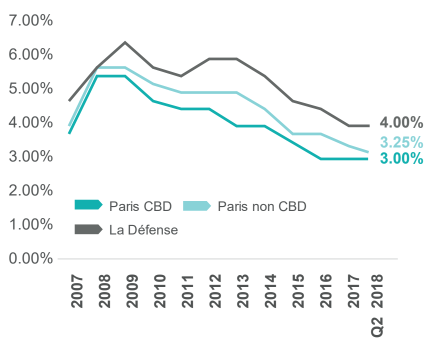
Whilst Paris still concentrates most activity, the geographical readjustment in the investment market that we anticipated at the end of the 1st quarter did indeed take place. The shift mainly benefitted the Western Crescent and the Northern Inner Suburbs which, over the 1st half of 2018, concentrated between them 38% of office investment volumes in the Greater Paris Region. In the West of the Greater Paris Region, Neuilly-Levallois and the Southern Loop take the lead due to the completion of some major transactions, such as that to SOGECAP of "Kosmo" in Neuilly-sur-Seine, that of "M Campus" in Meudon to PGIM REAL ESTATE and the acquisition by PRIMONIAL REIM of the "Dueo", "Trieo" and "Galeo" buildings in Issy-les-Moulineaux. During the 2nd quarter, investment activity remained buoyant in areas close to La Défense (Courbevoie, Nanterre), which contrasted with the lack of significant deals within the business district itself. In the Northern Inner Suburbs, almost 800 million euros have been invested since January, of which 600 million were invested during the 2nd quarter. In this sector, which is benefitting from investors focusing on future Grand Paris Express hubs, large deals have recently been recorded, for example the "Balthazar" in Saint-Denis which was bought by LA FRANÇAISE on behalf of Korean investors.

The increase in amounts invested in the Greater Paris Region is also due to the growing interest for core+ and value-added assets, even if core assets account for the majority of investment volumes in the Paris Region office market due to the weight of a few very large deals. Whilst the historically low vacancy rate and the dynamism of the letting market make Paris an obvious target for the acquisition of assets that need refurbishing, investors' risk-taking is not limited to the capital. Reassured by the lack of new supply and the improvements promised by large urban projects, investors are also betting on other less established areas of the Greater Paris Region, as seen with the forward-funding sale recently undertaken in Saint-Denis ("#Curve" bought by GCI and BENSON ELLIOT) or Fontenay-sous-Bois (38 rue Roger Salengro bought by STAM and TRISTAN CAPITAL PARTNERS).

Prime yields remain at their lower limit (between 3.00 and 3.25% in Paris), even if some recent deals have shown that new decreases are occasionally possible for new or recent office assets, secured on long term leases. The emphasis placed on value creation transactions also contributed to the compression of yields for non-core assets, provided that they are based on good fundamentals which reassure investors in their risk-taking strategy. Whilst retail yields are subject to upward pressure, this increase does not seem to extend to offices. However, upcoming sales of individual large office buildings show a slight upward pressure on yields, as we foresaw a few months ago.

A more general increase in yields does not seem to be looming before 2019. The expected increase in policy rates should furthermore remain limited and largely depreciable, whilst the buffer that comprises the spread between French 10-year government bond rates and the prime CBD yield remains significant (more than 230 basis points at the end of June 2018).

Prime yields for office properties
In %



Source: Knight Frank

Examples of office investment transactions in Q2 2018

Asset/Adress	Seller	Purchaser	Area (m²)
Quadrans (50%) / Paris 15	Altice	Primonial Reim	-
Kosmo	Altarea Cogedim	Sogecap	26,300
Parisian portfolio (50%)	Oxford Properties	JP Morgan	-
Metropolitan / Paris 17	JP Morgan	Deka	21,500
M Campus / Meudon	AXA IM / NBIM	PGIM Real Estate	46,000
26 bis rue François 1er / Paris 8	Lagardère	Ardian	11,800
Balthazar / Saint-Denis	CDC / CNP	La Française REP	32,600
Dueo, Trieo, Galeo / Issy-les-Moulineaux	Naropa Properties	Primonial Reim	21,500
49-51 rue La Boétie / Paris 8	Poste Immo	BNP Paribas Reim	10,600
Highlight / Courbevoie	Kaufman & Broad	Eurazeo	24,300
2 place Rio de Janeiro / Paris 8	DCI	Ardian	7,000
#Curve / Saint-Denis	BNP Paribas Real Estate	GCI / Benson Elliot	24,000

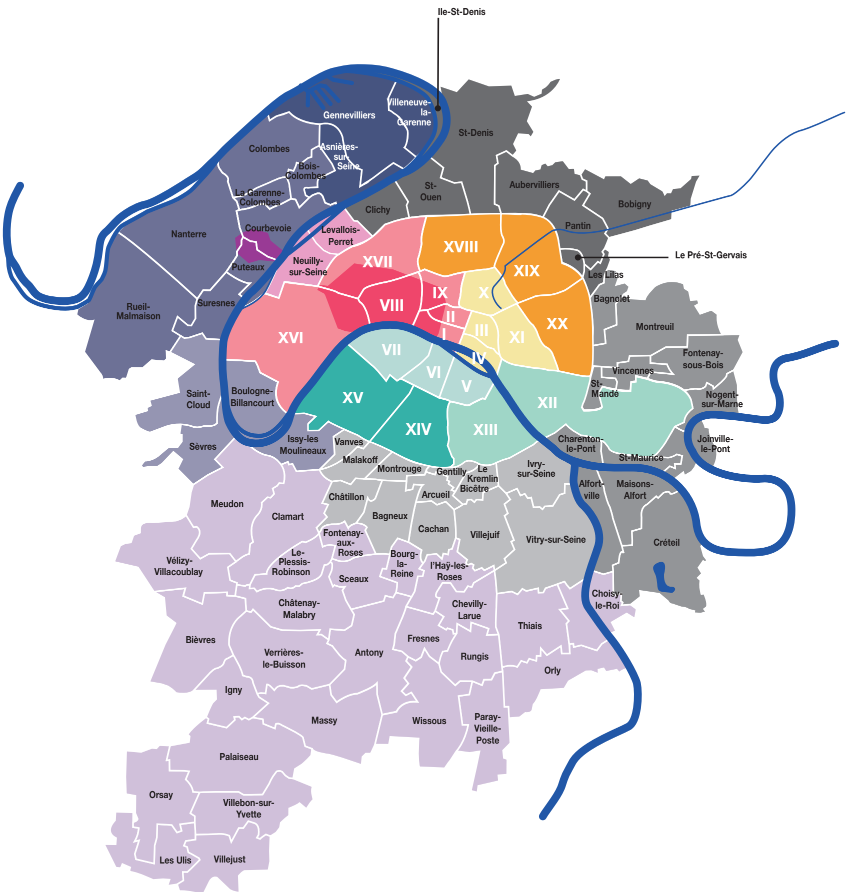
Source: Knight Frank

Office market indicators in Île-de-France

	Île-de-France End of Q2 2018	Île-de-France Q1 2017	Annual growth
Take-up	1,360,440 m²	1,183,520 m²	+15%
Take-up > 5,000 m²	566,820 m²	466,740 m²	+21%
Available supply	3,051,120 m²	3,544,000 m²	-14%
Vacancy rate	5.7%	6.6%	-0.9pts
Prime rent*	€830/m²/year	€765/m²/year	+8%
Investment volume	€7.3 billion	€4.8 billion	+52%
Transaction > €100 million | Share	75%	56%	+19pts

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

Source: Knight Frank



Paris CBD

Paris Centre West (excl. CBD)

Paris 3th/4th/10th/11th

Paris 18th/19th/20th

Paris 5th/6th/7th

Paris 12th/13th

Paris 14th/15th

La Défense

Northern Loop

Péri-Défense

Southern Loop

Southern Outer Suburbs

Neuilly/Levallois

Northern Inner Suburbs

Eastern Inner Suburbs

Southern Inner Suburbs

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