

ile-de-France Office - Q4 2022

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SPOTLIGHT
Savills Research

Letting Market Ile-de-France



Office rental market trends and outlook

Economic Climate : Disruption Advisory

Although the resilience of the French economy seemed somewhat against the odds in the bleak climate of 2022, with activity up 2.6%, the situation is clearly becoming more strained. 2023 looks set for much more of a cooldown. According to the World Bank, international growth is expected to be among the lowest of the last 30 years, and with only +0.5% anticipated for advanced economies, French GDP may only grow by as little as 0.3%. These, in any case, are the latest forecasts of the Banque de France. Clearly, France looks set to avoid the recession feared only recently, but the downturn is nonetheless severe. No recovery is likely before 2024, when a cautious 1.2% is expected.

With such weak growth anticipated, the employment situation is expected to deteriorate. Whilst the unemployment rate fell to a historic low at the end of 2022, the Banque de France anticipates a rise from the current level of 7.3% to 7.7% at the end of 2023 (as defined by the International Labour Office). The upturn would be limited but would bring a halt to two years of continuous decline.

Slow growth is expected to reduce demand and therefore lead to some price moderation, particularly for raw materials and energy. France's rate of inflation fell slightly in the fourth quarter of 2022, bringing it to 5.9% year-on-year (from 6.2% in October 2022). There is no clear evidence, however, that rising inflation for the French economy, or that of its neighbours, is over. Pressure on prices has indeed spread to all goods and services. Core inflation (excluding energy and food), unlike the general price index, did not fall at the end of last year. The Banque de France is not, therefore, ruling out a spike in inflation in the first half of 2023, preceding a lull that would bring the rate of inflation back down to around 4% at the end of the year. Overall, annual inflation in 2023 should remain at a similar level to that of 2022.

This feeling of apprehension is in no way exclusive to the Banque de France. It is shared by most central banks, which have highlighted inflation as a key concern and have pulled out all the stops in an attempt to fight it. The European Central Bank, for example, raised its key interest rate by 50 basis points in December 2022 (having already increased it by 75 basis points in September, and again in October). In less than a year, the ECB's key interest rate rose by 250 basis points, increasing the interest rate on the main refinancing operations to 2.50%.

Their goal is to cool down the machine by increasing access to credit, for both individuals and businesses. It's a tricky balance, there being a risk of seizing up economies in the longer term by limiting their resilience and, for Europe, of fragmenting the eurozone – a risk that increases if sovereign bond yields inside the eurozone start to deviate too far. This is a situation that the eurozone already experienced during the sovereign debt crisis in the early 2010s, and which was particularly difficult to recover from. Between this potential danger and the immediate risk of inflation, central banks have set out their priorities. The tightening of monetary policy is therefore set to continue, in turn leading to new key interest rate hikes. When and how much? "At a pragmatic pace..." stated François Villeroy de Galhau, Governor of the Banque de France, during a hearing before the French Senate in January 2023. In other words, the future is never set in stone.

	2022	2023	2024	2025
GDP	2.6%	0.3%	1.2%	1.8%
Inflation (HICP)	6.0%	6.0%	2.5%	2.1%

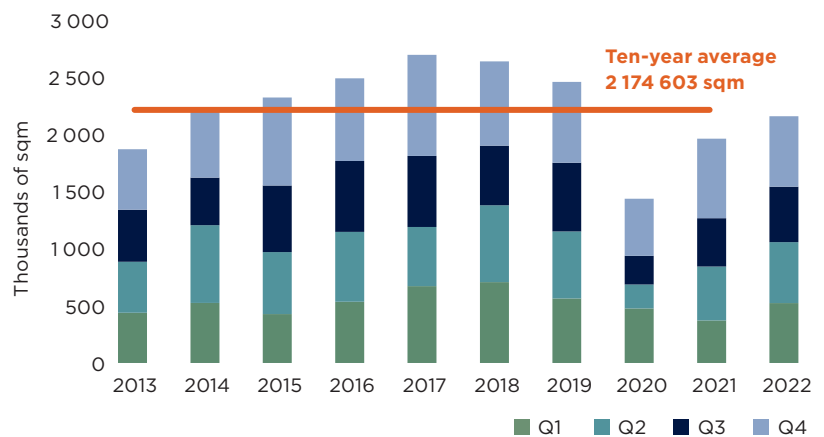
Source: Banque de France, December 2022

Take-Up : Paris Far Ahead

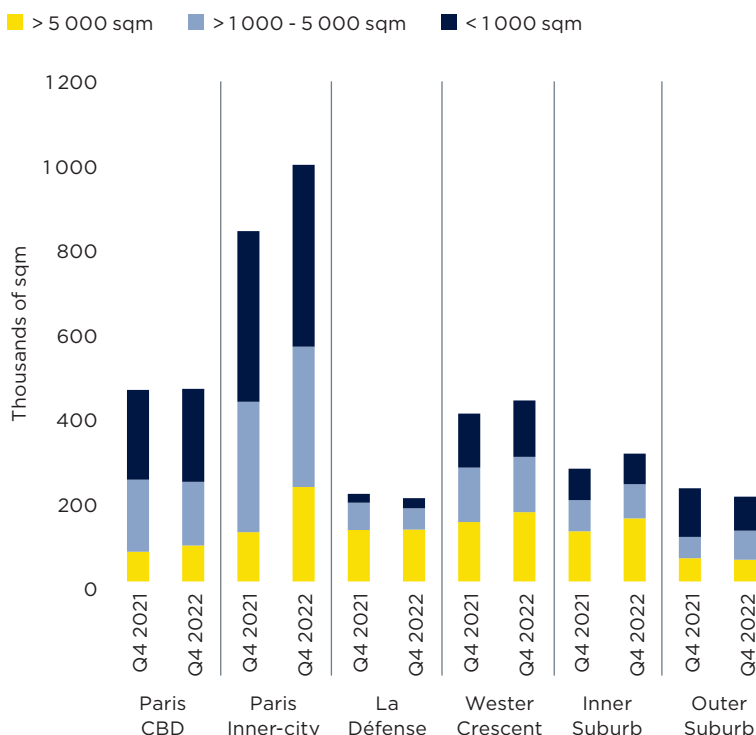
Despite a slowdown in the last three months of 2022, the Ile-de-France rental market performed strongly with 2,108,300 sqm let, coming close to the ten-year average of 2,200,000 sqm.

Across the entire Ile-de-France region, take-up was at a level not reached since the health crisis. The increase was 10% year-on-year. A welcome result, even though the majority of the growth took place in the first three quarters of the year, with a slight downturn in the fourth quarter.

Graph 01 :
Changes to take-up in Ile-de-France



Graph 02 :
Take-up by geographical area and floorspace segment



Transactional activity was boosted by all floorspace segments, the most dramatic growth being in the largest (5,000 sqm or more). The take-up volume in this sector grew 29% year-on-year, amounting to 34% of office space occupation in the Ile-de-France region. As proof of this gain in momentum, over the year some 61 transactions of over 5,000 sqm were completed in the Ile-de-France region. Occupier profiles here are varied: public institutions (French Ministry of Health and Solidarity in the Tour Olivier de Serres building, French Ministry of the Interior in Saint Denis and AFD in central Paris, which at greater than 46,000 sqm is the largest transaction of the year), alongside luxury, such as Hermès, Moët Hennessy, Christian Dior and Jacquemus, coworking (Welkin & Meraki, Morning Coworking, etc.) and banks (La Banque Postale).

In the floorspace segments under 5,000 sqm, growth was less significant. The medium-scale transactions segment (1,000 to 5,000 sqm) grew by only 6% in a year, while the small-scale segment (under 1,000 sqm) was stable year-on-year.

Occupier interest in Grade A floorspace was sustained throughout the year. As a result, these account for 40% of take-up across Ile-de-France. This is a little lower in central Paris, at 30%, but this distortion is due only to the lack of new or refurbished office space in the city centre.

Geographically, the peripheral sectors that are less well established in the tertiary market continued to suffer. Their activity lacked any of the momentum driving central Paris further forward. As such, there were some major disparities within the Ile-de-France region.

Unsurprisingly, central Paris maintained its position at the top of the regional ranking with 984,000 sqm transacted during 2022, of which 454,000 sqm were in the CBD alone. With such a volume, the capital city accounts for almost half of the total take-up in Ile-de-France. Small floorspace occupies a dominant position, comprising 44% of the volumes transacted, and followed by the medium-sized transactions segment at 34%. The large floorspace segment brings up the rear, with 22% of the take-up volume in central Paris. Although still the smallest segment, this volume does reflect the strong upsurge of major occupiers within the city centre, considering that it accounted for only 14% of transactional activity at the end of the fourth quarter of 2021.

The La Défense business district ended the year with a very decent level of transactional activity, albeit 5% down in volume terms (i.e. only -10,000 sqm). This demonstrates a renewed interest in the sector, with major occupiers particularly dynamic here and accounting for 62% of take-up volume in La Défense in 2022 (stable year-on-year). No fewer than nine transactions over 5,000 sqm were recorded throughout the year, three of which were in excess of 15,000 sqm. Conversely, the medium-sized floorspace segment was down 22% year-on-year, while the share of small floorspace rose 14% year-on-year.

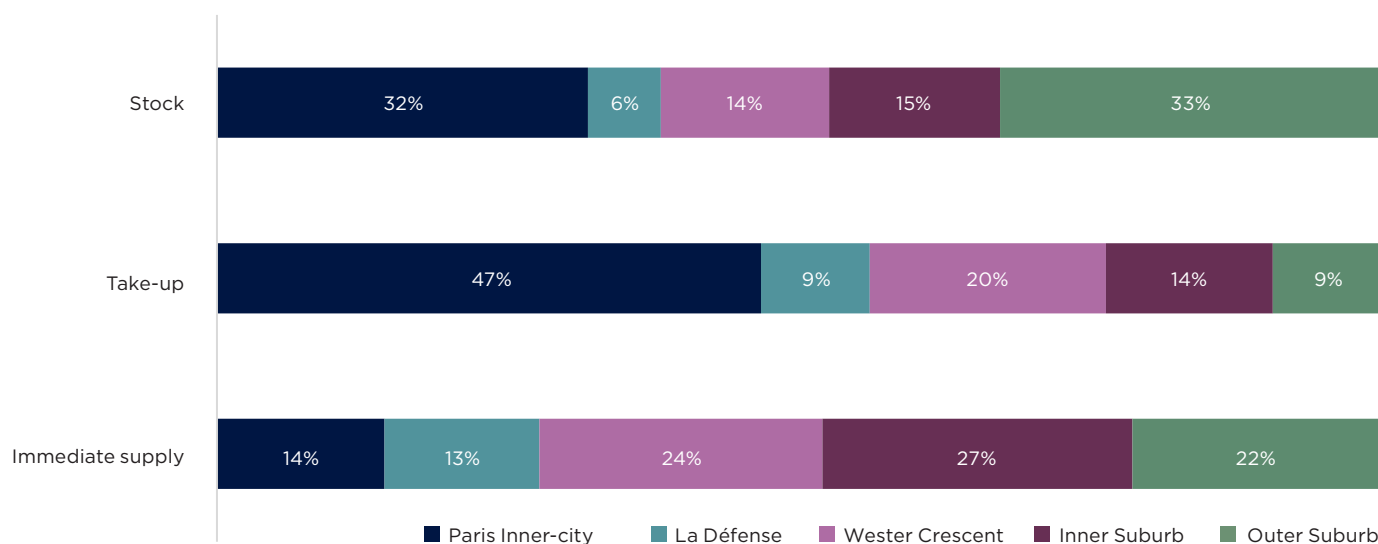
The strong performance of Neuilly/Levallois is also a highlight of 2022: take-up in the sector leapt 64% year-on-year to more than 130,000 sqm. Neuilly/Levallois can pride itself on having concentrated 31% of take-up in the Western Crescent, a level not witnessed in a long time. Transactional activity here was boosted by the large floorspace segment, with five transactions of more than 5,000 sqm completed across the year, including two of more than 10,000 sqm (LVMH lease of 12,000 sqm in CREATIVE and MAZARS lease of more than 22,000 sqm in Levallois-Perret).

In peripheral areas, the South Inner Suburb also picked up, due – once again – to the upturn of the large-scale transactions segment (+435% year-on-year). This is followed by medium-sized floorspace, which leapt 135% year-on-year. The South Inner Suburb did, however, start from a low point and remained far behind its performance pre-health crisis. This is generally the case throughout the Inner Suburb.

In the Outer Suburb, there was an overall downward trend across all sectors, with the exception of the slipstream effect caused, in the first quarter of 2022, by the lease of 21,700 sqm by the DGFIP in the Envergure complex in Romainville – a transaction that was something of an epiphenomenon in light of recent years of activity in the Outer Suburb.

Graph 03 :

Real estate stock, take-up & immediate supply: share of sectors at regional level



Source: Savills Research / Immostat / ORIE

Immediate Supply : Ever Higher

Despite dynamic transactional activity throughout the year, immediate supply continued to increase. It reached an unprecedented level, exceeding the 4,300,000 sqm mark in the Ile-de-France region.

Since early 2020, immediate supply in Ile-de-France has continued to grow. It now stands at 4,320,000 sqm. The vacancy rate has also risen in parallel. With an increase of 51 basis points year-on-year, it now stands at 7.9% (compared to 7.5% in the previous quarter). As is the case for transactional activity, these figures reflect significant disparities between the different sectors of the Ile-de-France region.

The Western Crescent (excluding La Défense), Inner Suburb and Outer Suburb account for nearly 75% of the immediate supply at regional level. The East Inner Suburb and North Inner Suburb sectors saw their stock increase the most, with annual growth of 99% and 29% respectively.

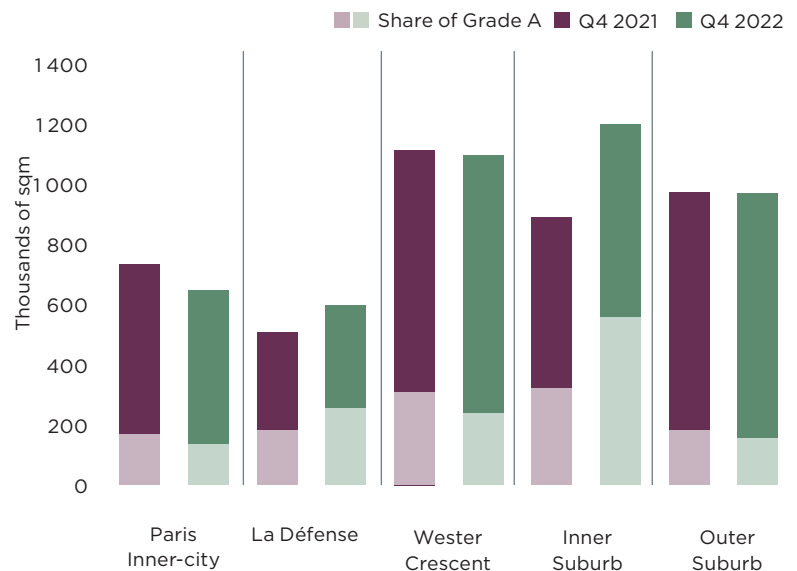
It is quite a different picture in central Paris. At the end of 2022, less than 625,000 sqm was immediately available to occupiers, down 12% on the previous year. The only exceptions were the Paris 14-15 and Paris 18-19-20 sectors, with supply on the up. This exception is in no way indicative of occupier disinterest, with take-up here +143% and +82% on the previous year respectively.

The capital city is clearly in a situation of under-supply. Its share of the immediate supply in Ile-de-France (14%) is significantly lower than its share of take-up (47%). The occupier need for centrality, related in particular to the current problems with recruitment and retention of talent, only accentuates this phenomenon from one quarter to the next.

Grade A rental stock in Paris continued to shrink and was down 30% year-on-year, representing only 20% of available floorspace within the capital.

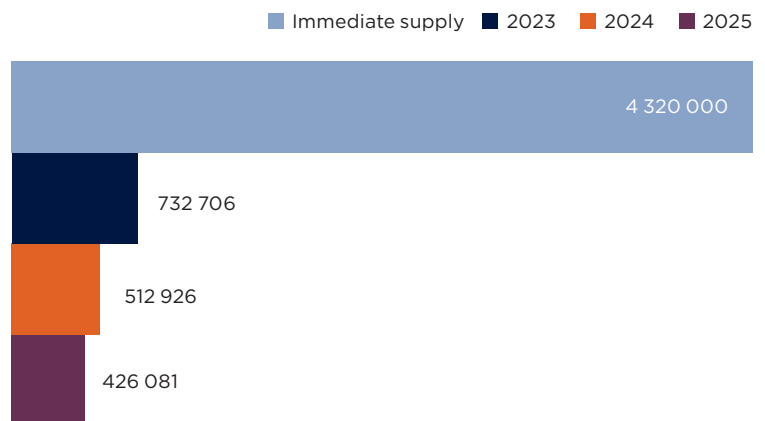
As a logical consequence of the momentum in take-up, the vacancy rate in central Paris plummeted (-47 basis points year-on-year), ending December at 3.5%.

**Graph 04 :
Immediate supply by geographical area**



Source: Savills Research / Immostat

**Graph 05 :
Immediate and future supply in Ile-de-France (in sqm)**

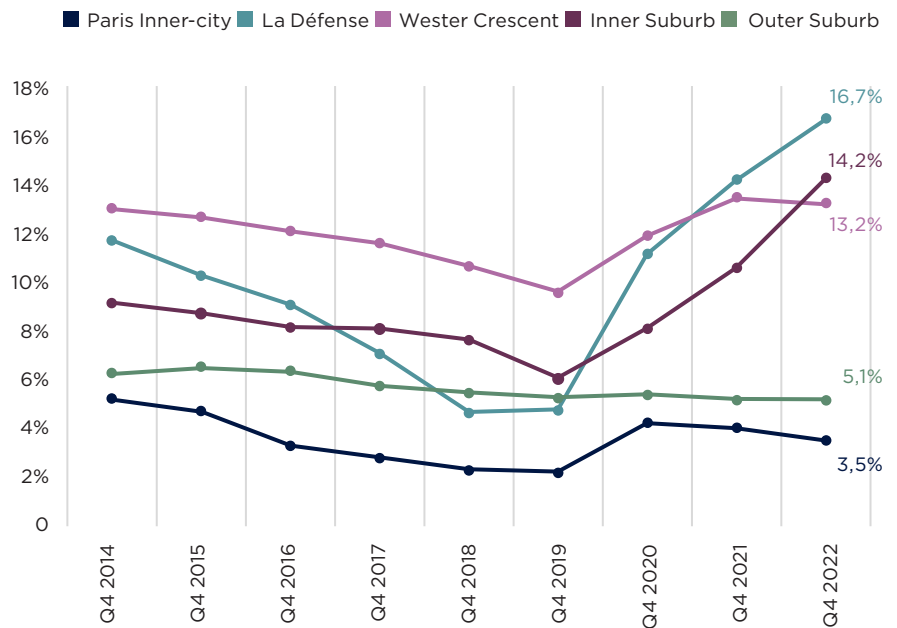


Source: Savills Research / Immostat

With regard to the absorption index (the number of months taken to absorb all available supply in line with the transaction activity over a rolling one-year), there is again a striking contrast within the Ile-de-France region. Starting from an already very low level, this continued to decline in central Paris, down from 10 months to 8 months in one year. It also fell in the Western Crescent but remained much higher (30 months compared to 32 months in 2021). In parallel, it continued to grow in La Défense (35 months compared to 28 months in 2021), in the Inner Suburb (46 months compared to 38 months a year earlier) and in the Outer Suburb (56 months compared to 51 months in 2021).

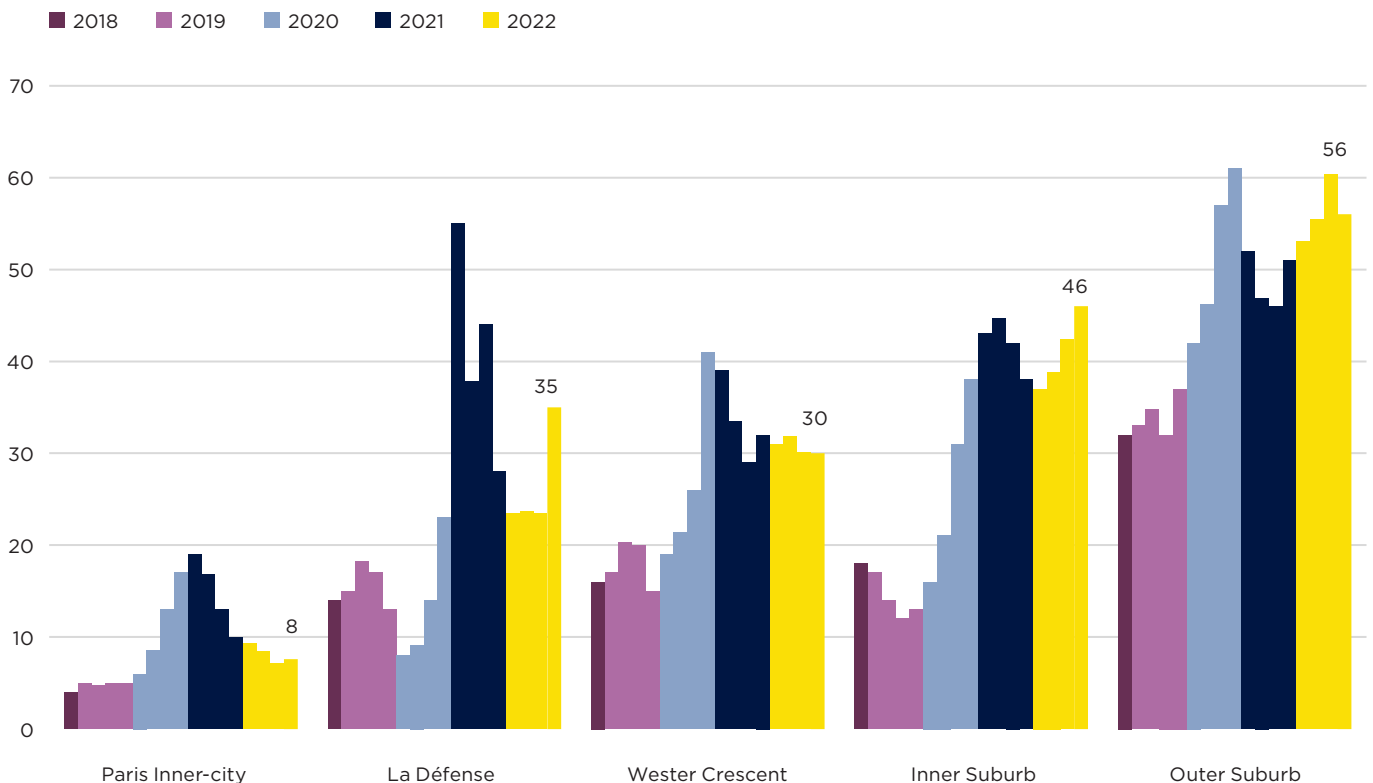
These figures demonstrate once again that the capital is undeniably the most attractive sector in Ile-de-France, to the detriment of less established peripheral sectors.

Graph 06 :
Vacancy rate by geographical area



Source: Savills Research / Immostat

Graph 07 :
Change in the absorption index of immediate supply (in months) between Q4 2018 and Q4 2022



Source: Savills Research / Immostat

Rents : Wide Discrepancy & Record Broken

Like other market indicators, rental prices in the Ile-de-France region are very disparate, but there is a general upward trend. In parallel, although they declined over the course of the year, accompanying measures began to increase again in the fourth quarter.

At the end of December, prime rent in the Ile-de-France region ranged between €246 per sqm per year (Inner Suburb) and €1,003 per sqm per year (Paris CBD).

Within the capital, prime rents were up in all sectors, with the exception of Paris 14-15, which fell 4% year-on-year. At the same time, Paris Centre Ouest (excluding CBD) posted the largest increase (+11%), rising to €821 per sqm per year. Unsurprisingly, the CBD still monopolises first place on the podium with prime rent up 8% compared to the fourth quarter of 2021 – for the first time crossing the symbolic 1,000-euro mark (€1,003 per sqm per year).

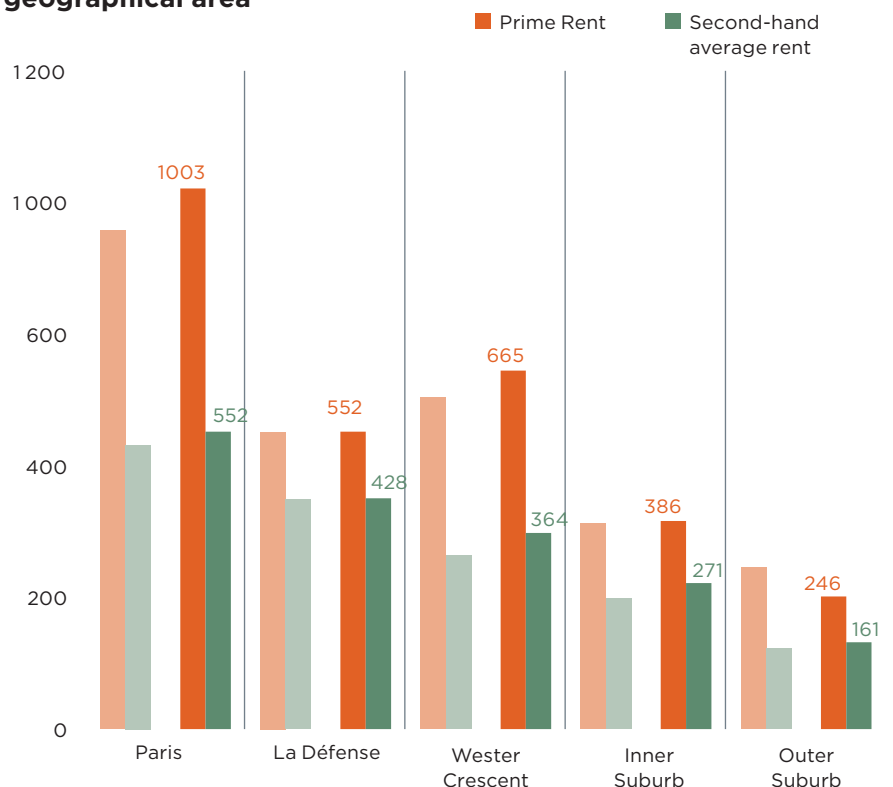
As for the La Défense tertiary division, prime rent at the end of the year was €552 per sqm per year (stable over one year) and the average rent for second-hand followed the same trend, at €428 per sqm per year. These trends need to be regarded against the very high level of supporting measures granted to the sector, which can be up to one third of the headline rent.

The Neuilly/Levallois sector – where transactional activity performed well during 2022 – saw its prime rent increase 8% year-on-year to €665 per sqm per year. There was slightly less pressure on the average second-hand rent for the area, which stands at €432 per sqm per year (+4% year-on-year).

In the current economic climate, the number of companies able to accommodate rent prices such as these would indicate that prime rental values – for the majority of Ile-de-France sectors – seem to have reached a ceiling.

In the periphery, prime rents – although hypothetical for certain more sluggish sectors – are relatively stable, with the exception of decreases for the South Outer Suburb (-13%) and Rest of Outer Suburb (-18%).

Graph 08 :
Rental prices Q4 2022 compared to Q4 2021 by geographical area



Source: Savills Research / Immostat

And Going Forward?

1

Going forward into 2023, the situation looks somewhat less rosy than the previous year. The strong momentum that drove the Paris market during the first nine months of 2022 showed its first signs of slowing down in the fourth quarter – due mainly to economic difficulties resulting from the global geopolitical situation. This slowdown is expected to continue in the coming months, although it is still too soon to estimate to which extent it will occur.

2

Peripheral sectors are detrimentally affected by the appeal and competition of the major service hubs in Paris, where transactional activity tends to be concentrated. This centripetal trend is set to persist. It is, however, likely to be attenuated and corrected as a consequence of economic turmoil. This could easily be the case if an increasing number of companies are compelled to cut their real estate costs further, not only by reducing their floorspace occupation, but also – critically – by seeking out lower rental prices. The price variance between Paris and its neighbouring periphery would then be staring them in the face. This is all the more true given that, in step with the upward trend in Paris rental values (which have never been so high), the differential with sectors such as Neuilly/Levallois, the Southern Loop and La Défense also reached new peaks. This well-established, “connected” periphery, located in the western side of Ile-de-France, would likely fare rather well, although this would not necessarily be the case for other peripheral sectors. This means the market is unlikely to turn centrifugal: it is the city centre – as perceived and experienced by companies – that would expand by spilling over into the West.

3

In terms of rental prices, the variances between rents for prime and second-hand office space widened further within central Paris, reaching more than €305 per sqm per year in the CBD at the end of 2022. With prices already hitting all-time highs in the premium segment (which concerns only a small number of buildings), it is likely that the majority of the increase for this segment has already occurred. The knock-on effect of this, exacerbated by the scarcity of supply in Paris, is likely then to push up rents for quality non-prime office space (new or second-hand).

It is quite a different picture in less established sectors, where the main draw is price appeal. There is zero room for growth here, especially as supporting measures are often high and supply is abundant.



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