

France - Q3 2019

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**SPOTLIGHT**  
*Savills Research*

# Office Letting Market



Result consistent with the ten-year average • Supply still down • Rents under tension

# Economic climate

## Stable with a clear view ahead

Compared with its main neighbours and trading partners, France's economy is proving remarkably resilient. Although growth forecasts have been downgraded more or less everywhere as the overall outlook darkens, France seems to have been spared the worst. There may be nothing spectacular about the country's recent economic performance, but it does offer a certain stability in a volatile and increasingly unpredictable climate – a solid advantage in the eyes of investors.

Slow, steady and sustained, the French economy is currently making a virtue of consistency, with overall growth coming in at 0.3% for the third consecutive quarter. No cause for complacency, certainly, but with global economic forecasts growing gloomier by the day, France is looking like a relatively safe bet. In fact, figures for Q3 were slightly stronger than generally expected [1]. The growth rate carried over at the end of the quarter stood at 1.2%, up from 1.1% in June. The latest forecasts for the end of the calendar year suggest an annual growth figure of between 1.3% and 1.4%, with little change on the cards for 2020.

Compared with the recent performance of many other European economies, this almost makes France a winning prospect. In the United Kingdom, despite similar levels of market activity, economic growth has been tailing off for some time, and figures for Q3 fell short of expectations. Germany has narrowly avoided official recession territory this quarter, but its economy is not anticipated to grow by more than 0.5% in 2019, rising to between 1% and 1.2% in 2020. Finally, the Italian economy remains stuck in the doldrums and is likely to end the year on an annual growth figure of just 0.1%, although again the forecast for 2020 (0.6%) is slightly brighter.

The way the French economy is structured, with a lower degree of exposure to the oscillations of international markets than many other countries, explains its ability to sustain this almost salutary performance. Exports of goods and services account for just 31% of France's GDP; in Germany, it's nearly 50%. This means that the progressive deterioration of the international climate amid tensions between the USA and China has less of an impact on France.

Its economy remains primarily driven by domestic demand, whether in the form of household spending or corporate investment. Many companies are taking advantage of low interest rates to upgrade their capital assets, pushing corporate investment up by 1.2% at the close of Q3. Meanwhile, household spending was up 0.3% at the end of the quarter. There are two main factors

behind this boost in consumer confidence. First, the labour market is performing strongly; unemployment has been falling slowly, and this is expected to continue over Q4, reaching 8.3% of the active population by the end of the year. Second, households have enjoyed a bump in purchasing power, also likely to continue through Q4 as the latest round of cuts to the residence tax come into effect. Overall, by the end of 2019 French households should have seen their purchasing power grow by 2.3%, compared with just 1.8% in 2018.

The relative stability and resilience of the French economy appears to be giving it an edge in a particularly volatile global climate. Effectively, these qualities give investors and other financial decision-makers a clearer idea of what the future might hold in the medium term. Indeed, the perception of France as a relatively safe harbour is driving a good deal of the interest we are seeing from international investors.

[1] Reuters had set its consensus forecast at +0.2%.

1.3% - 1.4%

Estimate of GDP growth in France for 2019

+1.2%

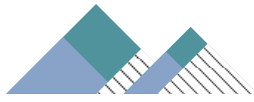
Rebound in business investment in Q3 2019

8.3%

Unemployment rate expected in France at the end of 2019, its lowest level since early 2009

+4.5%

Strong increase in the total number of business start-ups in September 2019 (+ 15.7% in the last 12 months)



**1,655,150 sqm**  
Take-up in Ile-de-France since the beginning of 2019



# Market Trends in Ile-de-France

## A slackening pace

With transaction activity not far off the ten-year average, the performance of the greater Paris rental market in 2019 produced little in the way of upsets. Quarterly take-up has essentially remained stable since the start of the year, with a total of 543,400 sqm let over the last three months.

### Take-up: Just shy of average

Since 2019 began, a total of 1,655,000 sqm of office space has been let in Île-de-France – a perfectly respectable figure and close to the ten-year average (estimated at 1,690,000 sqm). Nevertheless, this constitutes a marked decline (-11%) in comparison with 2018, despite a welcome summer surge.

There has been little significant change in market conditions since the start of the year. Once again, the average was pulled down by the major transactions segment (i.e. deals involving floorspace in excess of 5,000 sqm), where activity fell by 29% year-on-year. This difference can be seen both in the number of transactions and in the scale of completed deals. There have been 50 completed transactions so far in 2019, down from 59 in 2018. When we look at floorspace, again the downward trend is clear; the majority of this year's completed transactions have involved smaller

properties. Just five deals for office space of more than 20,000 sqm have been completed this year (SNCF, Société Générale, Crédit Agricole, Société du Grand Paris and EDF) and none at all in the >35,000-sqm bracket. The market was significantly livelier in 2018, with eight completed transactions for spaces of more than 20,000 sqm – including three that exceeded 40,000 sqm (Vinci, Technip and Nestlé).

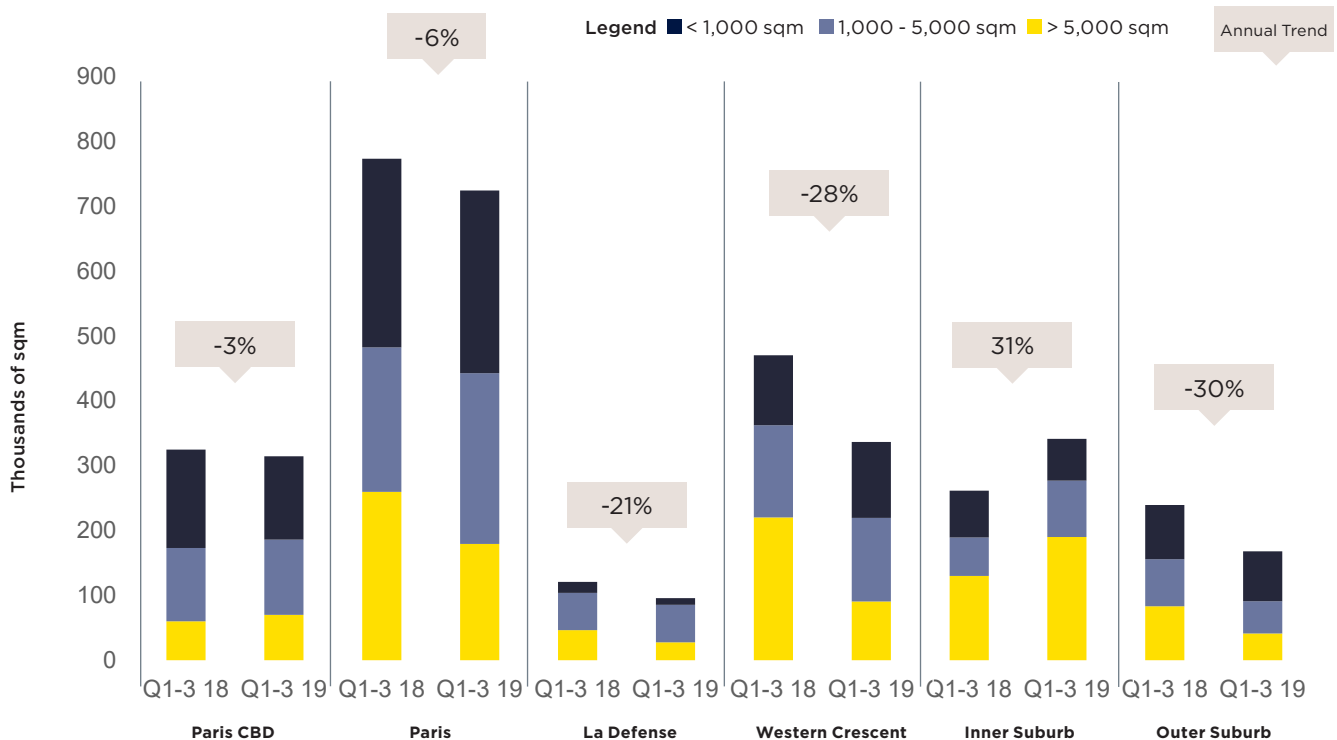
It was all but inevitable that we would see a slowdown in the major transactions segment in 2019, given that the figures for 2018 were so strong. However, there are two other factors at work here: the dearth of available supply and the fact that many leases agreed at a time when rental values were generally lower are now reaching the end of their terms. Given the choice, many major tenants are therefore focused on negotiating a new deal for the property they are already occupying.

At the other end of the spectrum, the small transactions segment (i.e. floorspace of less than 1,000 sqm) is faring better, although activity has dropped in this part of the market as well, with a year-on-year decline of 3%. As more and more smaller occupiers are swept up by the co-working juggernaut, the resilience of this segment almost feels like a coup. This remains a key segment of the market, representing 33% of take-up in the Île-de-France region as a whole. Finally, it is only in the middle of the range (1,000 to 5,000 sqm) that we find signs of positive growth; with activity up 3% year-on-year, this segment is still the driving force of the Paris lettings market, accounting for 35% of all transactions in the office sector.

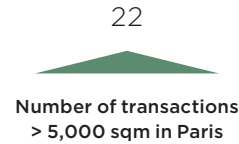
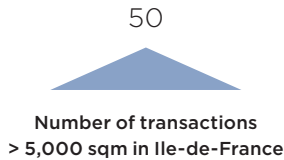
In terms of geography, the Inner Suburbs have been out in front since 2019 began, with the most upbeat market in the region. In fact, this is the only market to post significant year-on-year growth

### Breakdown of take-up in the Ile-de-France region by geographical and surface area

Rental activity declines in all sectors, except the Inner Suburb



Sources Savills Research - Immostat



(+31%), buoyed by a more ample supply, attractive rental prices, good public transport links and proximity to the city's established business districts. Elsewhere, there has been a general slackening off, but not all areas are affected to the same degree – the drop in activity ranges from -6% in central Paris to -30% in the Outer Suburbs.

### Paris

Take-up in Paris has now reached almost 713,500 sqm, with most of the action concentrated in the CBD (44%), the 14th and 15th arrondissements (14%) and West Central Paris (13%). This amounts to an 8% drop in comparison with 2018. The French capital remains the jewel in the crown of the Île-de-France lettings market, representing 43% of take-up, but Paris is now feeling the pinch of a severe shortfall in supply; the vacancy rate at the close of Q3 stood at just 2.2%.

Within the city limits, the primacy of the CBD remains undisputed, almost managing to buck the general trend. Despite a historically low vacancy rate of just 1.3%, the CBD is holding its own – at 324,300 sqm, take-up here is fast approaching 2018 levels. The summer months were especially upbeat, with a spike in demand for large and medium-sized office space (up 3% and 16%, respectively). In contrast, there was a distinct slump at the other end of the scale, with demand for smaller spaces down 15%. This is almost certainly due to the exuberant growth of the co-working sector in the heart of the city.

Still, there are some signs that this trend may have peaked. Co-working operators have been riding a wave of demand for more than two years now and have been particularly keen to court occupiers looking for larger spaces, but this summer brought a very noticeable slowdown. Speculation surrounding WeWork – the market leader in Paris with around 15 completed transactions in 2018 and 2019 at an average floorspace of 9,000 sqm – and its business model have not helped matters.

At the moment, the co-working sector seems to be regrouping around alternatives to the WeWork model, at least in its current form. Deskeo, which was snapped up by the US company Knotel at the start of this year, has been doing particularly brisk business in the small and medium-sized office segment. It was involved in around twenty deals (for spaces ranging from 500 sqm to 3,200 sqm) in central Paris, representing a total area let of almost 22,500 sqm.

Moreover, the co-working market has now sprouted a 'luxury' branch, spearheaded by new entrants such as Welkin & Meraki. A Belgian company that only recently arrived in Paris, it has now opened a second co-working space of almost 3,000 sqm in Rue de Suresnes. This trend towards premium co-working spaces is very likely to catch on, and we expect to see more of them cropping up across the city in the coming months.

Finally, there are a number of new operators just finding

their feet in the Paris market, including the British company The Instant Group, which is betting on a bright future for Paris's flexible office sector in a post-Brexit climate.

### La Défense

The third quarter of 2019 brought no change in fortunes for La Défense; this prime business hub is still performing well below its potential. The first nine months of the year saw take-up of less than 100,000 sqm, marking a substantial year-on-year decline (-21%). Although there were two major transactions here, with both WeWork and Loxam leasing spaces larger than 5,000 sqm, a sluggish performance in the first half of the year is dragging down the overall figures. However, with a raft of new supply expected to hit the market in the next few months, there is still a good chance that activity will start to pick up.

### The Western Crescent

Flagging since the beginning of the year, the Western Crescent market is still contracting rapidly (down 28% y-o-y). Take-up here stands at 336,400 sqm, split mainly between the South End (37%), Péri-Défense (36%) and Neuilly-Levallois (22%). While both Neuilly-Levallois and the North End have surged ahead, boasting some very encouraging figures, they cannot compensate for the full extent of the drop-off in Péri-Défense. A key market for the entire the Western Crescent, Péri-Défense has failed to live up to its 2018 performance, particularly in the major transactions segment.

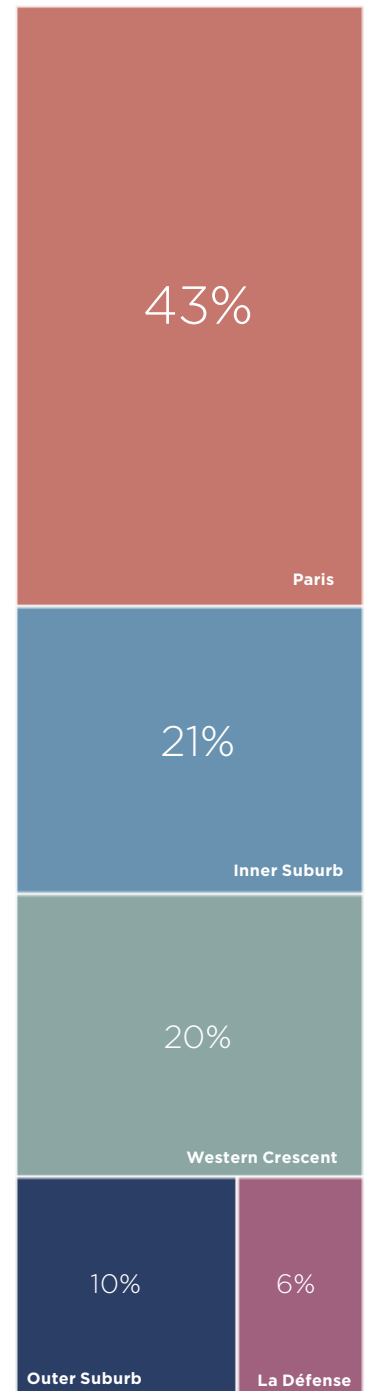
### The Inner Suburb

If there's one bright spot in the Paris lettings market, it's here; the Inner Suburbs are breezing through the year with aplomb. With a total area let of 341,500 sqm so far, there has been a marked upturn in activity (transactions are up 31% compared to 2018), and the market is performing strongly in both the northern and eastern zones. Much of the credit is owed to the completion of some very major deals, three of which involved floorspace of over 30,000 sqm. St-Denis (North Inner Suburbs) was the location of choice for SNCF and Société du Grand Paris, whereas Société Générale opted for Fontenay-sous-Bois (East Inner Suburbs). To the south, the step-up since 2018 is less pronounced, simply because last year's performance was already strong. Take-up, however, has remained relatively stable, thanks in part to transactions involving Crédit Agricole and EDF in Montrouge.

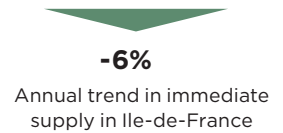
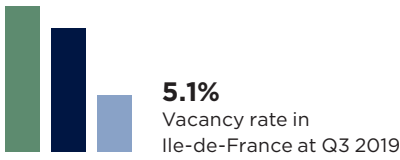
### The Outer Suburb

Meanwhile, take-up in the Outer Suburbs is down 30%. Occupiers have tended to give more weight to proximity to the main business hubs, leaving the Outer Suburbs to fall back on internal demand. The sole outlier is Pôle de Roissy, where take-up rose by 16%.

## Breakdown of take-up by sector (Q1-Q3 2019)







**Immediate supply: A little more space to breathe?**

Immediate supply is becoming even harder to find, with a patent shortfall in available office space in certain markets. Still, occupiers have one reason to be cheerful; the chokehold on grade A supply has finally been lifted.

There is currently 2,790,000 sqm of office space ready to let across the Île-de-France region, down 6% year on year. The overall vacancy rate remains low, at 5.2%. While the situation is by no means uniform, the downward trend in immediate supply is now evident across all major markets in Île-de-France. In certain parts of the region, lack of supply is beginning to put a brake on activity.

With a vacancy rate of just 2.2%, the Paris market as a whole is still feeling the pressure of very limited immediate supply, amounting to just 376,000 sqm. While there is still a great deal of interest from potential occupiers, the available stock will barely satisfy five months of demand. Immediate supply is shrinking fast in every part of the city, with just a few arrondissements (18-19-20 and 12-13) bucking the trend. These two areas have seen a veritable glut of available property, but

without much effect on their vacancy rates, which remain below 5% in both cases.

In the La Défense business district, the vacancy rate has dropped further and now stands at 4.6%. Here, immediate supply is down to just 164,000 sqm. However, the next two years may breathe new life into La Défense, as 200,000 sqm of new development comes onto the market.

The Western Crescent is also suffering from dwindling supply, although with an overall vacancy rate of 10.2% it's too early to talk of a shortfall. Following the delivery of some major new developments, Péri-Défense has emerged as a distinct outlier in the Île-de-France market. Immediate supply is up 17%, while the vacancy rate is the highest in the region at 16.2%. At the other end of the spectrum, Neuilly-Levallois has seen a rapid contraction in available supply (down 43%); here, the vacancy rate is looking distinctly more Parisian at 3.4%.

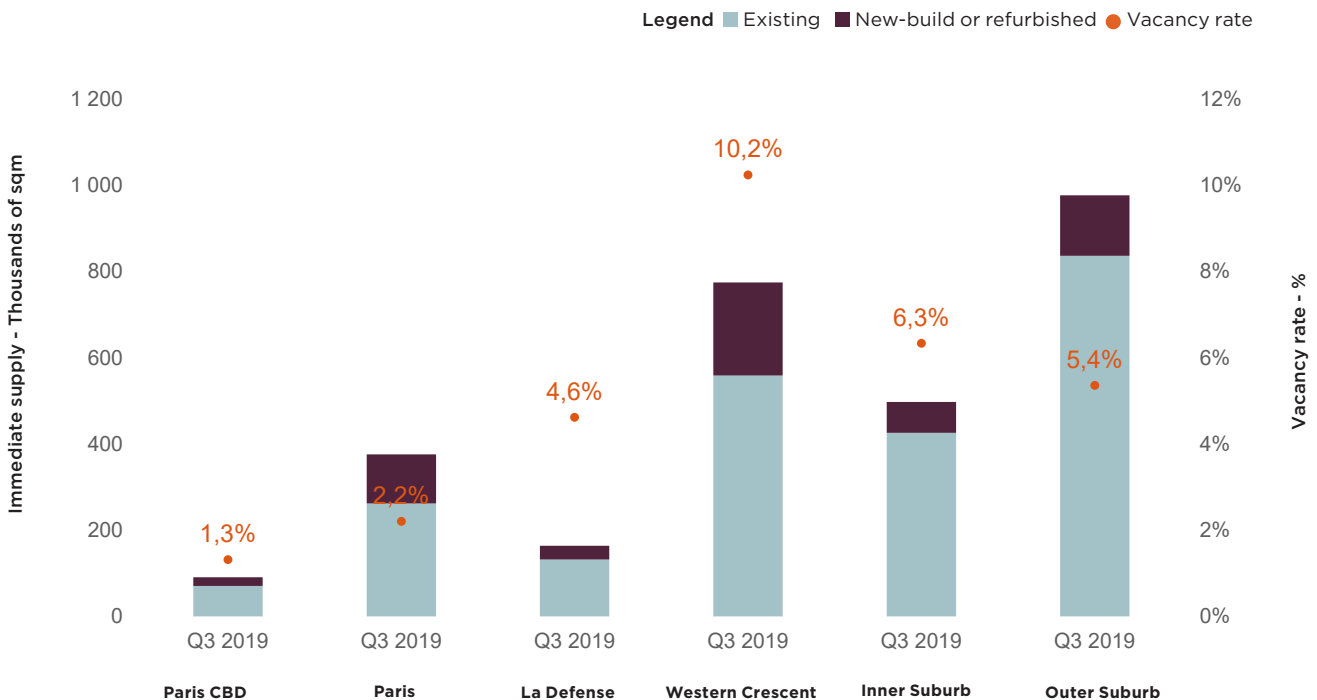
After a few months of brisk activity in the lettings market, supply has fallen sharply in the Inner Suburbs (down 18% y-o-y). More than half of the

available office space is clustered in the North Inner Suburbs, where more than 10% of stock is lying vacant. In stark contrast, the East Inner Suburb has very little to offer potential occupiers, with a vacancy rate of 2.6%.

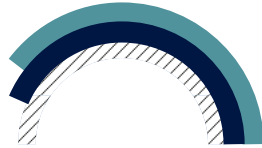
While the overall picture is one of shrinking supply, sharp occupiers may spot an emerging opportunity in the next few months: grade A space (both new and refurbished) has become more plentiful in Q3. With the boom in construction and refurbishment showing no signs of waning, grade A supply now represents 21% of all available office space, compared with 16% at the start of the quarter. In central Paris, much prized by business and seen as an increasingly safe bet by investors willing to provide unsecured funding, grade A space now accounts for as much as 30% of total supply. It appears, then, that obsolescence has become a far less pressing issue.

**Level and quality of immediate supply by geographical area**

A quantitatively and qualitatively richer supply in the Western Crescent



Source Savills Research - Immostat



**€748 sqm/year**  
Average rent for new-build and/or refurbished property in the CBD in Q3 2019



**6%**  
Growth in the average rent for new-build and/or refurbished property in Île-de-France (€399/sqm/year in Q3 2019)

### Rents: Inflationary forces still at work

Rental prices have been climbing steeply, and for the last two years we have seen a gradual spillover effect that has pushed up rents beyond the CBD and the prime market. This pattern remains strong at the end of Q3 2019; in fact, it is now starting to be reflected in occupier behaviour.

The average rent is still rising across Île-de-France. Quarter after quarter, the advance seems unstoppable, with another 6% hike in Q3. Sustained levels of take-up (not far off the ten-year average) coupled with shrinking supply has intensified the upward pressure on rental values. There have been some stunning leaps, particularly on the outer edges of the main business hubs.

Rents in the most sought-after locations rose significantly in both 2017 and 2018, particularly in the CBD, and this trend has continued through 2019. However, there are signs that the pace is slackening. In Q3, the average rent for grade A office space remained stable at around €748 sqm/

year, according to estimates from Immostat. Nonetheless, for high-quality space in a coveted location, it is not unusual to find agreed rents of €850 sqm/year or higher.

It's not just Paris that is experiencing soaring rental values. Other submarkets popular for their proximity to major business hubs and the quality of their transport links are also being swept up in the trend. This is the overriding pattern in the Western Crescent, where grade A space is becoming more and more expensive in all markets: rents are up 14% in Péri-Défense and 10% in the South End. The trend is even more marked for existing property, especially in Péri-Défense (up 20%) and Neuilly-Levallois (up 17%).

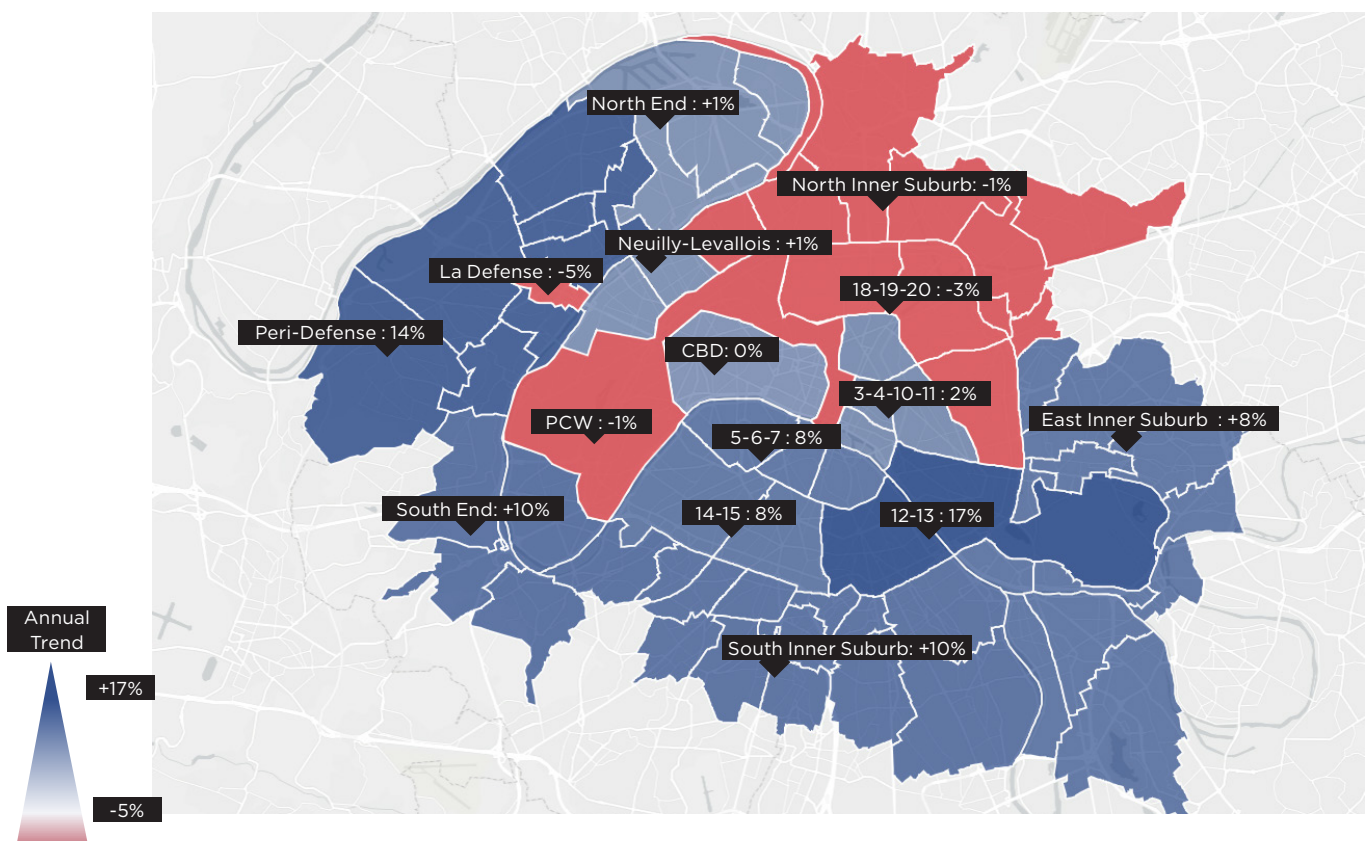
Rental values are also rising in the Inner Suburb, except for more northerly areas. In the past, these markets have always been resistant to upward pressure from the centre, which goes some way to explain their strong performance since the start of the year – it seems that these more outlying areas

are finally starting to catch up. There's still quite a lot of scope for further rental growth, and these areas still have two crucial advantages to offer: an abundant supply of new office space and modest rents in comparison with the city proper. With transport links set to improve as plans for 'Grand Paris' take shape, these areas will be hoping to attract occupiers put off by prices in more central locations.

Only La Défense remains stubbornly resistant; here, rental values for grade A space have actually dropped by 5%, taking the average to around €460 per sqm per year. A quiet spell for transactions, particularly affecting new-build property, has put a dampener on rents in this business hub. Over the next few quarters we expect the market to pick up; new developments now approaching completion should give a boost to activity, particularly in the prime segment.

### Evolution of the average rent for Grade A office space

A rise in rental values is still observable in most sectors



Sources Savills Research - Immostat

# Outlook

## 2019: A so-so year for the Île-de-France market

While Q3 brought some welcome signs for the future, with a new influx of grade A supply, the defining features of the Île-de-France market in 2019 remain shrinking supply and unsuitable stock. This explains, at least to some degree, the downturn in transaction activity recorded so far this year.

Yet, the third quarter of the year also seemed to bear out the optimism of our previous report; we predicted a loosening of supply-side constrictions and a greater fluidity in the lettings market in upcoming quarters, and that prediction still holds. Approximately 1,280,000 sqm of fresh supply is anticipated for 2020, although a little over half of this space (51%) has already been pre-let.

In the short term, the lack of supply – and the inevitable upward pressure on rents this creates – is deterring many potential tenants. This situation is compounded by the fact that many leases, agreed at a time when the average rent was significantly lower, are now coming to an end. Occupiers are therefore tending to focus on renegotiating their existing terms. The slowdown may well persist for another few months, even if the pressure on supply is eased. The downturn that cast a shadow over 2018, together with an uncertain global climate, can be expected to result in a flattened demand curve – especially among occupiers with greater space requirements.

All things considered, the Île-de-France market is set to end 2019 on a more muted note in terms of transaction activity when compared with 2018. All indicators suggest that take-up will come in close to the ten-year average (2,300,000 sqm) for the region as a whole.

No major upsets then, as we speed towards 2020... just an average year.



### Savills Research

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