SPOTLIGHT
Savills Research

Ile-de-France – Q1 2019

Office Letting Market

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A start consistent with the ten-year average ● Supply still down ● Rents under tension

Economic Backdrop

Lots of movement but no real change

At the international level, the economic outlook remains bleak – a climate in which France is managing to stay ahead of the game

How could we describe the economic and international situation at the close of Q1 2019 in one simple phrase? The easiest way would be to paraphrase the famous line from Visconti's The Leopard: 'For things to stay as they are, everything will have to change.' The first three months of 2019 brought no grounds for a major reassessment; neither the prevailing winds nor the clouds on the horizon are significantly different from the start of the year. Jolts and surprises have come thick and fast, and the suspense has at times been riveting, equal to anything TV's top showrunners could muster. And yet, none of the millstones burdening business activity at the end of 2018 have been lifted. The deadline for securing a Brexit deal was deferred in the nick of time to October 2019, although we are yet to see even a glimmer of a way forward. Transatlantic and transpacific tensions remain unresolved, and the parties concerned remain stubbornly locked in the same old loop, veering from sabre-rattling to assurances of good faith and back again. Fears over petrol prices wax and wane with every new announcement from the United States, which is determined to shut off the supply of Iranian oil. While the US is adamant that the sanctions will have no effect on prices, it's hard to see how. ▼

▶ On presenting its economic forecast at the start of the year, the IMF called for a swift and cooperative resolution to trade disputes, in order to avoid a perpetual spiral of uncertainty and damaging barriers. This, in its view, was the No.1 priority to ensure continued growth. For the time being, it doesn't look like that message has sunk in – and, as we might have predicted, the global economy remains as sluggish as it was at the start of the year.

The IMF downgraded its growth forecast from January onwards [1]. In March, the OECD delivered a fresh dose of pessimism [2]. Neither of the two expect global GDP to grow by more than 3.3–3.5% in 2019 and 3.4–3.6% in 2020. Almost every economy on the planet has been affected by faltering growth, although the situation is particularly marked in Europe.
Growth in the Eurozone is not expected to exceed 1.0–1.6% in 2019 and 1.2–1.7% in 2020, stymied by the poor performance of the Italian economy and the worsening downturn in Germany (with forecast growth of just 0.7–1.3% in 2019 and 1.1–1.6% in 2020). The UK is suffering the effects of the uncertainty surrounding Brexit; here GDP growth in 2019 is expected to be in the range of 0.8–1.5%, 0.9–1.6% in 2020. Wherever we look, the gulf between IMF and OECD forecasts gives an indication of just how cryptic and unpredictable the current climate is.

In such a climate, it is clear that France has got off rather lightly. Growth forecasts for the French economy stand between 1.3% and 1.5% for 2019 and between 1.3% and 1.6% for 2020 – ahead of the Eurozone average, with better results than most major neighbouring countries. Paradoxically, France has the gilet jaunes (yellow vest) movement to thank for its brightening prospects. Following a modest adverse impact at the end of 2018 and the beginning of 2019, the crisis has already prompted new measures to improve purchasing power – spurring household spending and business investment in the short to medium term. Consequently, unemployment should continue to fall. In Q1 2019, job creation leading to new permanent contracts spiked by 2.4% [3], driven chiefly by smaller firms. ▼

> **“Forecasts put France ahead of the Eurozone average, with better results than most major neighbouring countries.”**

▶ With figures for Q4 2018 having been revised upwards, the y-o-y expansion reached 5% – a sure sign that business leaders are feeling upbeat about the state of their order books. Another expression of confidence is the sizeable contribution that major French or Franco-European conglomerates (such as LVMH, Kering, L'Oréal, Airbus, Total and Dassault Systèmes) made to the overall growth in market capitalisation in Europe.

Historically, this has not always been the case, but for now the French economy seems robust enough to withstand the buffeting of international winds. France might fittingly adopt the Parisian motto: Fluctuat nec mergitur. Loosely translated as 'She is tossed by the waves, but does not sink'.

[1] IMF, January 2019
[2] OECD, March 2019
[3] Acoss, April 2019

1.3% - 1.5%

Forecast GDP Growth for France in 2019

+2.4%

Upswing in permanent job creation in April 2019

8.8%

Unemployment rate in France in Q4 2018, the lowest level since the start of 2009

+1.3%

Rise in the total number of new business registrations in March 2019

541,300 sqm
Take-up in Ile-de-France in Q1 2019

-23%
Contraction in take-up in Ile-de-France between Q1 2018 and Q1 2019

39%
Share of transaction activity in Ile-de-France represented by central Paris

Market Trends in Ile-de-France

Time for a breather

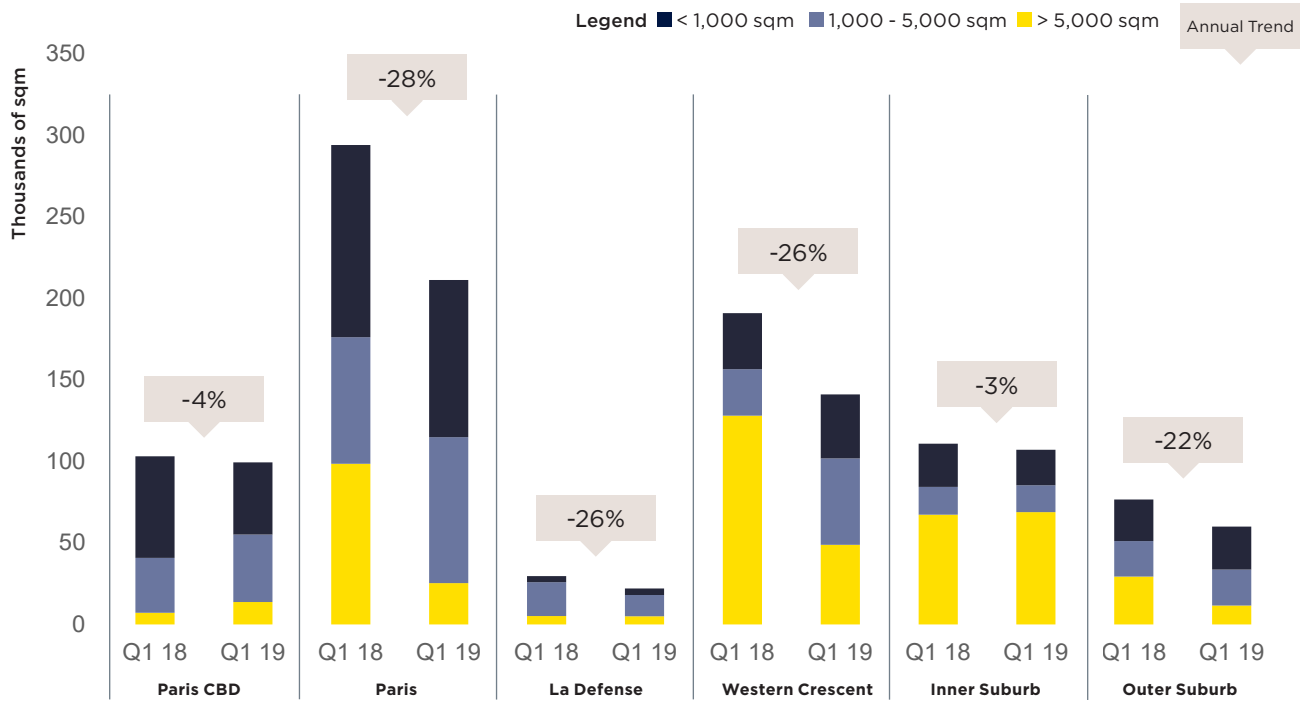
After a record-breaking 2018, the lettings market started the new year on a more leisurely note, while continuing to outperform the ten-year average

Take-up: A return to normality
By the end of Q1 2019, office take-up in Île-de-France had reached 541,300 sqm, marking a y-o-y slump of 23%. There is no question that we are seeing a slowdown; however, it is worth bearing in mind that the comparison is based on the record figures of early 2018. This was the strongest start to any year in a decade, and so this drop should be viewed in perspective. The Île-de-France market is actually performing very well, as confirmed by the fact that take-up in the first three months of 2019 once again outstripped the ten-year average (535,270 sqm).

When we break the figures down by floorspace category, we find that the market was primarily driven by mid-scale lettings (properties between 1,000 and 5,000 sqm). These accounted for 36% of the total area let, a y-o-y increase of 17%. The small-scale transactions segment fared less well, shrinking by 10% y-o-y. However, this is still a key section of the market, representing 35% of take-up in the Île-de-France region as a whole.

At the other end of the spectrum, the Q1 report tells a very different story. Transactions involving office space in excess of 5,000 sqm plummeted (down 51% y-o-y). In turn, the share of transaction activity attributable to these larger spaces dropped to 29%, in marked contrast to last year's 47%. However, 2018 was an exceptional year for a number of reasons, and the large-scale transactions segment was inflated by two mammoth deals in particular (Vinci's lease of 62,650 sqm in the Archipel development in Nanterre, and Technip's lease of 48,500 sqm in the Origine building, also in Nanterre) and by a sudden flurry of signings. Overall, 21 large-scale leases were signed in Q1 2018, amounting to a total area let of almost 330,000 sqm. This year, Q1 activity has been more sedate, with 15 large-scale transactions completed and a total area let of 159,868 sqm. The most substantial deal concerned a property of slightly more than 30,000 sqm in Fontenay-sous-Bois, let to Société Générale. As a result, the lettings market is now less concentrated on a small number of major deals than in the past, and it should continue to gather strength and stability going forward.

Take-up by geographical area and floorspace category
Activity has slackened in all Île-de-France markets



Sources Savills Research - Immostat

5.4%
Vacancy rate in Ile-de-France

Share of immediate supply in Ile-de-France comprising new-build and refurbished property

-7%
Annual trend in immediate supply in Ile-de-France

Moreover, the large-scale transactions segment, volatile by nature, is poised for a wave of prominent signings (e.g. such as the space leased by CNP Assurance), while certain transactions agreed over the last few months have yet to be recorded. These include a lease for over 5,600 sqm in Paris Centre West that was signed by one of the 'Big Four' tech companies and several deals struck with co-working operators.

There's been a general easing off across the entire Île-de-France region, but the pattern is not geographically uniform. At one extreme, activity in Paris's Inner Suburbs is down just 3%; while at the other, central Paris has seen the quarter's sharpest drop, at 28%. Although the city centre still dominates the market, its share of total transaction activity has fallen from 42% in Q1 2018 to 39% in the same period of 2019. Occupiers are switching their allegiance to more outlying areas, starting with the Inner Suburbs, which are benefitting from the displacement of demand from central Paris and rising rents.

With less than 23,000 sqm let in three months, the La Défense market has also cooled significantly (down 26% y-o-y) and is still performing below its potential. Just one transaction involving floorspace in excess of 5,000 sqm was recorded this quarter, a disappointing result for a business district that has always been popular with major occupiers.

Take-up is also down 26% in the Western Crescent, which enjoyed a sizeable uplift from major transactions in 2018.

Available supply: Still shrinking

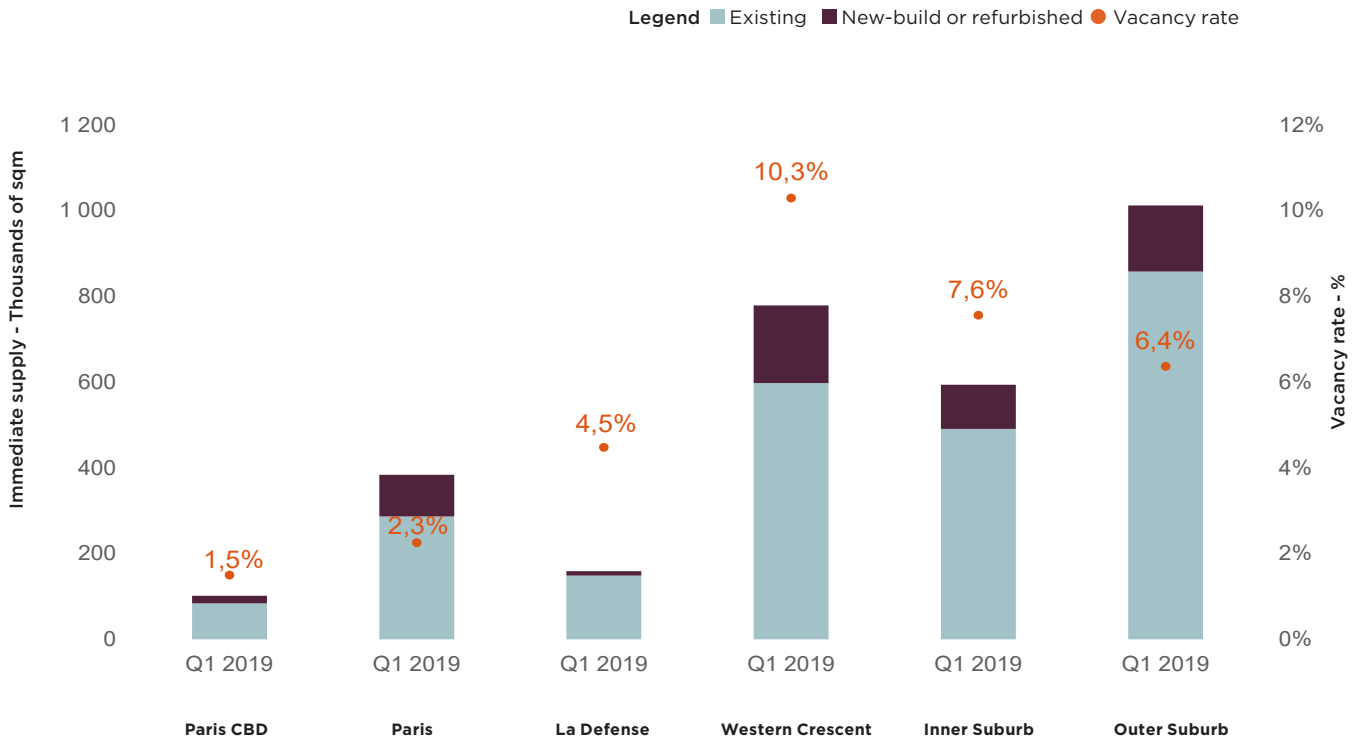
At a total of 2.9 million sqm across Île-de-France, immediate supply is still dwindling (down 7% y-o-y). Vacancy rates are low throughout the region, with the average currently standing at 5.4% (down from 5.8% in Q1 2018).

Undersupply is starting to stifle the Île-de-France lettings market, with certain areas more conspicuously affected. In central Paris, the immediately available stock is barely enough to satisfy five months of demand. The vacancy rate in this zone is just 2.3%, slumping to as low as 1.5% in the Central Business District.

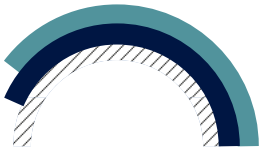
Also suffering from a contraction in available space are La Défense (down 26% y-o-y) and the Western Crescent (down 12% y-o-y). In the Inner and Outer Suburbs, this trend is less pronounced.

While still struggling with a quantitative shortfall, the issue of quality is no longer quite so pressing. The supply of Grade A properties, often occupiers' first choice due to their efficiency and practicality, is expanding. At the end of Q1 2019, a total of 545,000 sqm of Grade A space was available to let, representing 19% of immediate supply. This influx of higher quality stock, redressing a deficit that was dampening activity, is due to a greater volume of new-build or refurbished space entering the market (1,075,000 sqm has been delivered since this time last year, compared with 830,000 sqm in the preceding 12-month period). Over the next few months, the situation should continue to improve, with 1,010,000 sqm of fresh supply already in the pipeline and due for delivery by the end of March 2020 – even though 54% has already been pre-let (60% if we just include deliveries expected by the end of 2019).

Quality of immediate supply by geographical area
Richer pickings in the Western Crescent



Source Savills Research - Immostat



€719
Average rent for new-build and/or refurbished property in the CBD in Q1 2019

7%
Growth in the average rent for new-build and/or refurbished property in Île-de-France (€386/sqm/year in Q1 2019)

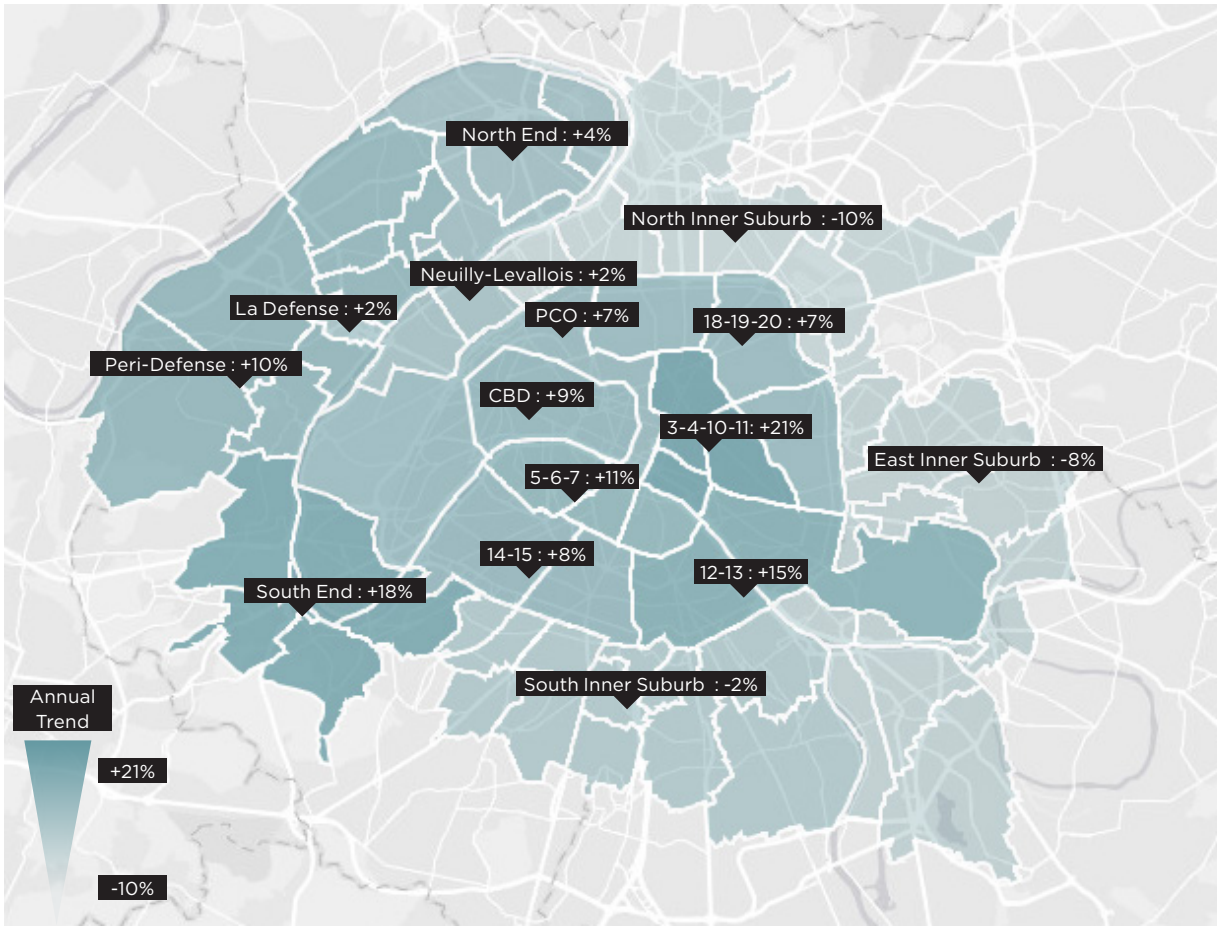
Rents: Inflationary forces still at work
Continued strong demand for office space combined with diminishing supply is a sure-fire recipe for upward pressure on rental prices. Rents have been rising steadily since 2017 and are not levelling off just yet. However, a number of shifts can be observed.
Following steep rental growth for Grade A space in the most highly prized or well-established locations, the pace is now slowing. Rents have even started to dip in the La Défense market, where the dearth of prime property means that this segment is no longer pushing up the cost of new-build or refurbished space.

The flip side to this is that Grade A workspace in neighbouring markets is becoming more expensive, as long as good public transport links are available. This is the typical pattern in various parts of the Western Crescent and the East and South Inner Suburbs.

The view from the existing property segment is quite different. Here, signing rents had been taking longer to adjust but are now catching up to some extent, at least in the most sough after markets.

Throughout central Paris, average rents for existing property are now on the rise (the 3rd, 4th, 10th and 11th arrondissements, for example, have seen rents soar by 22% y-o-y). Even La Défense has been lifted by the tide, with a 2% bump in the average rent for existing property, pushing €450 at the end of Q1 2019.

Variation in the average rent for existing property
Rental prices for existing property are catching up



Sources Savills Research - Immostat

Outlook

'I will uphold'

The Dutch national motto sums up our predictions for the lettings market nicely. Early figures for 2019 bear out our earlier forecast for the Île-de-France market – less spectacular than in 2018, certainly, but still undeniably solid.

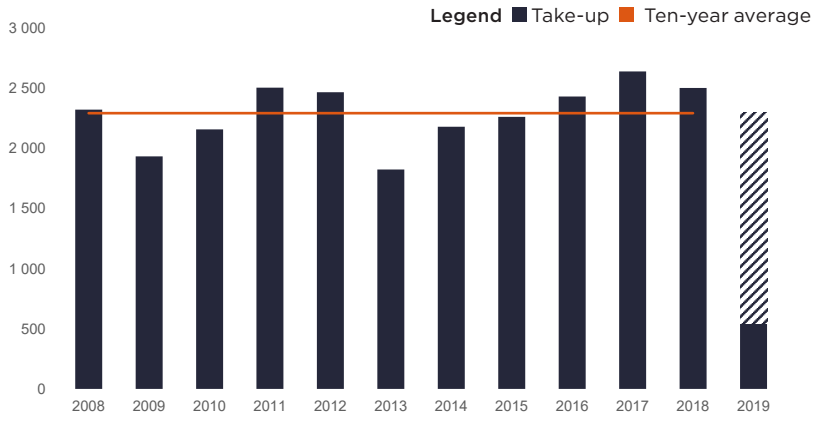
As we pointed out in our 2018 end-of-year report, the scarcity and unsuitability of the available office stock was one of the distinguishing features of last year's lettings market, going some way to explain the slowdown in transaction activity. This remains a significant issue in early 2019 and will continue to have an impact for some months to come.
While deliveries scheduled for 2019 are expected to yield more new-build or refurbished space than in 2018 (1,050,000 sqm versus a little under 950,000 sqm), it would be unwise to bank on a significant upswing in Grade A supply or in the vacancy rate – almost 60% of this new space is already spoken for. This leaves less than 420,000 sqm available to let in the entire Île-de-France region, a paltry amount for a market that has seen average annual lettings of 2.3 million sqm over the course of the last decade. Only towards the end of 2019 and, particularly, in 2020 can we expect more plentiful supply and greater fluidity in the lettings market (1.23 million sqm of fresh stock is due for delivery in 2020, 670,000 sqm of which is still available to let).

We also highlighted the fact that occupier demand may slacken off as the economic slowdown rumbles on and uncertainties in the international business environment make large companies inclined to sit tight. Although take-up is only partially correlated with growth, this conjecture appears to be supported by the many companies taking a more cautious approach in their real estate decisions.

Results from Q1 2019 provide further confirmation, revealing a slowdown that is essentially concentrated in the large-scale lettings segment. This should be kept in check over the next few months by the completion or recognition of several major deals (CNP Assurances in the South End, Safran in the South Inner Suburbs, a Big Four tech firm in the CBD, etc.). The total area let will continue to fall in 2019 in line with the 2018 trend, and so should return to a level consistent with the ten-year average (2.3 million sqm).

Such market conditions are likely to encourage companies to re-evaluate the rents they are willing to pay, something that we started to see at the end of Q1 2019. It is therefore reasonable to expect that the current upward pressure on rents will ease to some degree. Rents soared in 2018 for Grade A property, both in central Paris and in a number of other markets, and these pressures are now spilling over into the existing property segment in areas where supply is particularly tight. The next few months should have a calming effect on this incipient overheating. That does not necessarily mean that prime lettings (i.e. those valued at around €850 in the CBD) will dry up; this premium segment of the market may in fact continue to benefit from the bullish mood among high-value-add firms and co-working operators, who are vying aggressively to offer their clients the most appealing properties in the most desirable locations. However, the rents agreed in this segment, if they remain at current levels, will be far removed from general market trends.

Forecast take-up in Ile-de-France in 2019
Stable and steady



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Savills team

Please contact us for further information

Bertrand Renaudeau d'Arc
Head of Agency
Paris Agency
+33 1 44 51 73 22
brdarc@savills.fr

Cyril Robert
Head of Research
France Research
+33 1 44 51 17 50
cyril.robert@savills.fr

Emilie Renté
Analyst
France Research
+331 44 51 50 37
erente@savills.fr

savills