SPOTLIGHT
Savills Research

Ile-de-France – Q2 2019

Office Letting Market

savills

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

Economic context

Running like clockwork

The French economy is not entirely immune to the slowdown in growth that is taking place on a global scale, due to the decline in foreign trade and business confidence. However, France differs from most of its major partners in its strong resilience and solidity.

The international landscape has not changed since the beginning of the year, when the IMF called for a cooperative and rapid resolution of disagreements between states, as opposed to the steady accumulation of uncertainties and trade barriers. This was, in its view, the top priority for growth. The least we can say is that the IMF has not yet been heard. The Brexit deadline was postponed in extremis to October 2019, without the slightest progress having been made, and while many political hesitations persist on the part of both the EU and the UK. Transatlantic and transpacific trade tensions have exacerbated, and all future moves continue to be unpredictable. Fears over the oil price are linked to events in the Strait of Hormuz and announcements by the United States, which wants to turn off the Iranian tap completely. Logically, in this volatile environment, the global economy is treading water.

Over the months, the IMF [1] and the OECD [2] have revised down their growth forecasts. Both institutions now expect global GDP growth of between just 2.7% and 3.2% for 2019 and between 2.9% and 3.4% for 2020.

The eurozone is set to grow by just 1.3% in 2019 and by between 1.5% and 1.6% in 2020, as a consequence of poor results in Italy (0.1% in 2019 and 0.8%-0.9% in 2020) and the deterioration of the situation in Germany (0.7%-0.8% expected in 2019 and then 1.4%-1.7% in 2020).

For its part, the UK is suffering from the Brexit-related uncertainties, with GDP growth expected at between 1.2% and 1.3% in 2019 (temporarily inflated by inventory build-up by companies in anticipation of the country's withdrawal from the European Union) and then 1.4% in 2020 [3].

In this environment, it appears that France has been relatively spared. Growth forecasts are now 1.3% for 2019, with a stable outlook for 2020 (1.4%). Such results would place it in the eurozone average. This consolidation of the French outlook is explained by lower exposure to fluctuations in international trade than its main partners. It is also paradoxically due to the "yellow vests" movement, which, after having a limited negative impact at the end of 2018 and the beginning of 2019, led to measures boosting purchasing power [4]. The pick-up in household consumption is set to continue gradually, once the latency period needed to rebuild precautionary savings is over. Household confidence has also rebounded sharply since the start of 2019 [5]. This positive outlook will have logical repercussions for business investment.

The French economy should therefore continue to create an increasing number of jobs: INSEE forecasts 241,000 in 2019, following the 182,000 seen in 2018 [6]. Unemployment will continue on its downward trend (-0.4% in the first half of 2019), to end the year at a level close to 8.3%.

This economic resilience, added to political stability, means that France is running like clockwork. This is likely to be an appealing factor in the current context of international volatility.

[1] IFM, July 2019
[2] OECD, March 2019
[3] Forecasts based on an orderly Brexit followed by a gradual transition
[4] Les Echos, 30 July 2019/Les Echos, 17 April 2019
[5] Institut national de la statistique et des études économiques (INSEE), Monthly consumer confidence survey, 26 July 2019
[6] INSEE, Note de conjoncture, June 2019

1.3%

Forecast GDP Growth for France in 2019

+2.4%

Upswing in permanent job creation in April 2019

8.3%

Forecacst unemployment rate in France in Q4 2019

+1.3%

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

1,101,800 sqm
Take-up in Ile-de-France in H1 2019

-19%
Contraction in take-up in Ile-de-France between H1 2018 and H1 2019

44%
Share of transaction activity in Ile-de-France represented by central Paris

Market Trends in Ile-de-France

Softly, softly

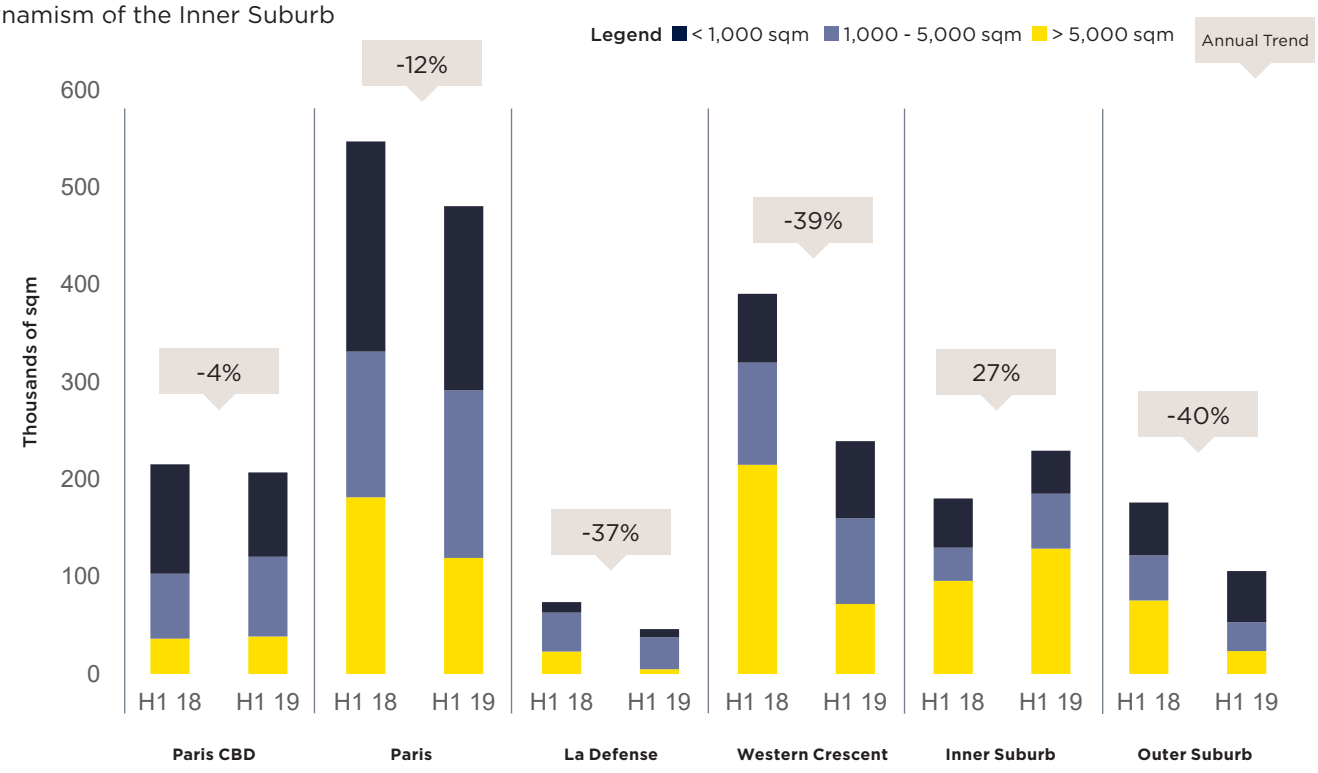
The first half of 2019 pales in comparison with 2018, with a significant decline in deal activity. To judge the state of the Ile-de-France region's rental market based solely on this short-term indicator would be misleading, however. Everything points to this market making a further demonstration of its resilience

Take-up: A return to normal
It was hard to imagine that the pace of the deal activity seen in 2018 would continue.
A deceleration was foreseeable and was confirmed: in the first half of 2019, take-up stood at 1,102,000 sq. m, down -19% compared with the first six months of 2018.
However, this fall indicates a return to calm rather than a real weakness in the rental market. Proof of this lies in the results recorded since the beginning of the year, which remain slightly higher than the 10-year average (1,088,000 sq. m). In addition, the pace of activity was faster in the second quarter than in the three previous months, showing a rise of 5% for the Ile-de-France (and 27% for central Paris).

The medium-sized deal segment (from 1,000 to 5,000 sq. m) buoyed up the rental market in the first half of 2019: it accounted for 34% of the spaces leased and was up slightly year on year (+1%). Although it still holds a key place, equivalent to medium-sized deals, the small surface area segment (less than 1,000 sq. m) is less resilient and fell slightly (-7% year on year). This fall is in line with the trend in previous years (see our spotlight on the coworking phenomenon).

The situation is quite different at the other end of the spectrum: major leases (5,000 sq. m and above), which literally held up the market in 2018, were down very sharply (-41%). This segment's share in deal activity plummeted, falling from 43% of deal activity to 34% in the space of a year. In total, 34 deals were signed in the first half of 2019, none of which exceeded the 40,000 sq. m mark. The two main deals were carried out in the inner outskirts of Paris, with the leasing of the Moods building in Saint-Denis by Société du Grand Paris, and the leasing of Sakura, in Fontenay-sous-Bois, by Société Générale. This state of affairs differs greatly from 2018, when 43 deals were completed in six months, including two record-breaking XXL leases (Vinci for 62,650 sq. m and Technip for 48,500 sq. m in Archipel and Origine, respectively, which are two projects under development in Nanterre).
This segment is inherently volatile, relying as it does on a small number of deals. It is therefore normal that it has slowed after the strong activity recorded in 2017 and 2018. It is also expected to pick up again in the coming quarters, as current negotiations are completed and with the lifting of certain clauses precedent, which are often linked to building permits (many of these deals involve buildings to be constructed). A major lease was signed by CACEIS (Crédit Agricole SA banking

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



Sources Savills Research - Immostat

5,3%
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

group) at the beginning of the third quarter of 2019, for example. Others are to follow, involving groups such as CNP Assurances and Total. Geographically, the downward trend applies to the whole of the Paris region, with one exception: the inner suburbs, which is the only market to record significant growth year on year (+27%) and which benefits from its attractive rents. However, the extent of the decline varies from one market to the next, ranging from -12% in central Paris to -40% in the outer suburbs.

With 480,000 sq. m leased in six months, the city centre has therefore consolidated its domination, with market share up from 40% to 44% in one year. Central Paris has been able to count on the strength of deals relating to small and medium-sized spaces, which form its traditional core target market. Nearly 40% of take-up in Paris in fact involves surface areas of less than 1,000 sq. m (compared with 34% in Ile-de-France).

The CBD is showing resilience, since it only dropped by 4%, with 207,300 sq. m leased. This performance is commendable in view of the current under-supply situation. It is now very difficult for a user looking for a space of more than 5,000 sq. m to position themselves in this market because of the lack of available supply and rising prices.
With less than 50,000 sq. m marketed in the first half of the year, La Défense saw a significant fall (-37%), remaining below its potential. Only one deal for more than 5,000 sq. m was recorded in the first half of 2019. However, the outlook is more favourable for the second half of the year, with Loxam's interest in 10,000 sq. m and WeWork's interest in 13,500 sq. m in the Collines de l'Arche building.

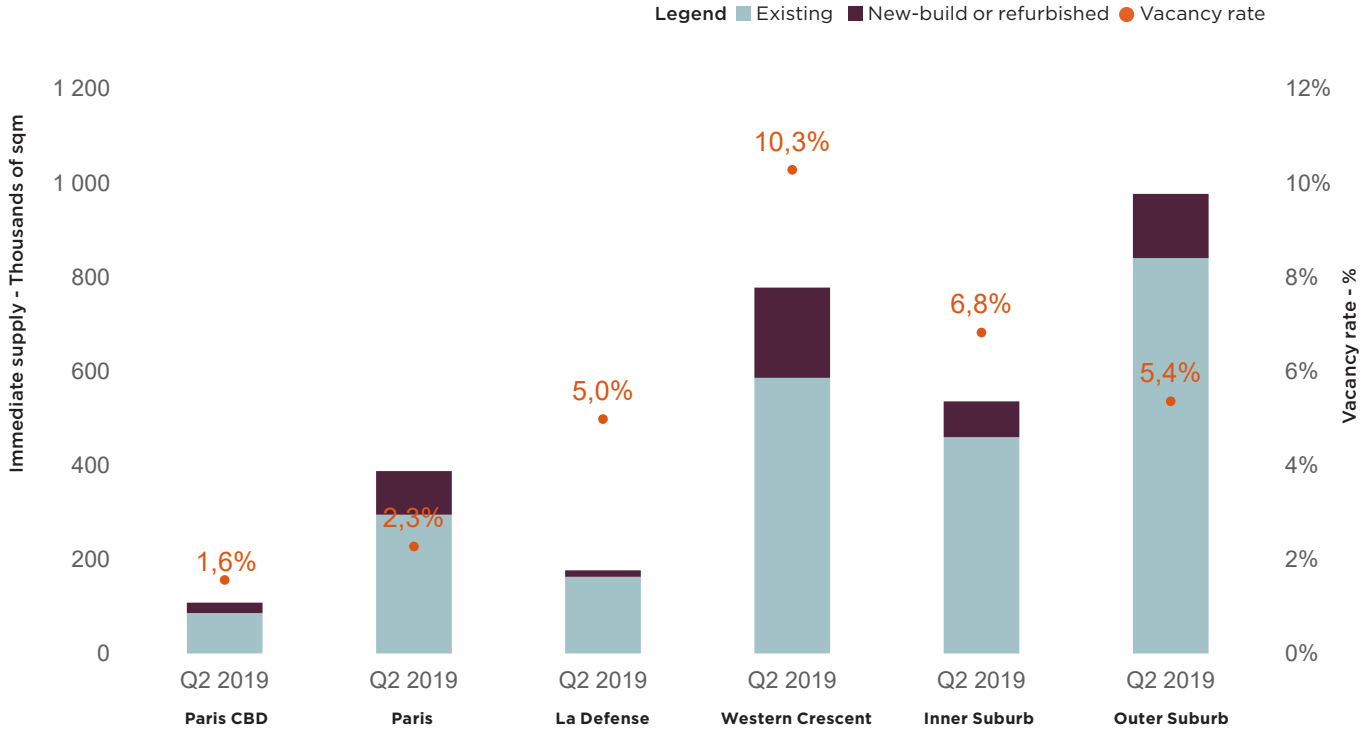
In the Western Crescent, take-up also took a sharp downwards turn (-39%). The Southern Loop and the La Défense outskirts sub-areas were behind this downturn. Note that they played a leading role in the performance achieved in 2018 and that it would have been extraordinary to remain at these levels.

Available supply: Still falling
The contraction of immediate supply appears to apply to the whole of the greater Paris region. A few rare areas are an exception to the rule, however, such as Paris's 18th, 19th and 20th districts and the northern inner suburbs, where availability is rising, mainly due to strong construction activity.

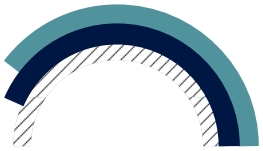
In some geographical areas, the lack of supply is becoming obstructive. In central Paris, immediate availability represents just five months of sales. The vacancy rate is low at 2.3% and even drops to less than 1% in the 5th, 6th and 7th districts of Paris. In the CBD, the vacancy rate has fallen to 1.6% and the volume of immediate supply (108,000 sq. m) is equal to only three months of activity.

Although the vacancy rate is higher in La Défense (5.0%), and immediate supply is stabilising at around 180,000 sq. m, such levels are insufficient to ensure the fluidity of this market, which is traditionally dedicated to major real estate users. In the Inner Suburbs, due to the buoyant deal activity observed in the first half of 2019, the contraction of supply was more significant, falling by 14%. The Eastern Inner Suburbs are seeing their stock of available spaces melt away, with less than 60,000 sq. m vacant at the end of Q2 2019 (-45% year on year). Its vacancy rate of 2.5% is symptomatic of a market that operates almost

Level and quality of immediate supply by geographical area
A quantitatively and qualitatively richer supply in the Western Crescent



Source Savills Research - Immostat



€736 sqm/year
Average rent for new-build and/or refurbished property in the CBD in Q1 2019

4%
Growth in the average rent for new-build and/or refurbished property in Île-de-France (€384/sqm/year in Q2 2019)

exclusively through the pre-sale of buildings to be constructed.
The Western Crescent has avoided such a shortage: supply has contracted less there and the overall volume offered to users remains substantial. The La Défense outskirts sub-area has the highest vacancy rate in the Ile-de-France region, for example, at 15.5%, followed by the Northern Loop at 13%. This relatively high availability is likely to be an asset in a context of increasingly scarce supply.

In addition to the quantitative supply aspect, the Ile-de-France has not resolved its qualitative problem, despite the acceleration of construction activity since 2017. Grade A supply in fact remains limited to 16% of the spaces available in the Ile-de-France region, i.e. a level that is insufficient to meet demand, which is mainly focused on new and restructured spaces. The CBD is in a better position, as it has a larger Grade A supply (23%). It is probably no coincidence that deal activity held up better in this area than elsewhere in the first half of 2019.

Rents: Inflationary tensions are still at work

The upwards trend, which has been notable since 2017, continued in 2019. In the CBD, the average rent for Grade A spaces rose by 7%, and is currently estimated by Immostat at nearly €740. However, it is no longer rare to see values of much higher than €800 for the best properties: at the end of the second quarter of 2019, the prime rent was €845 [7] in the CBD.

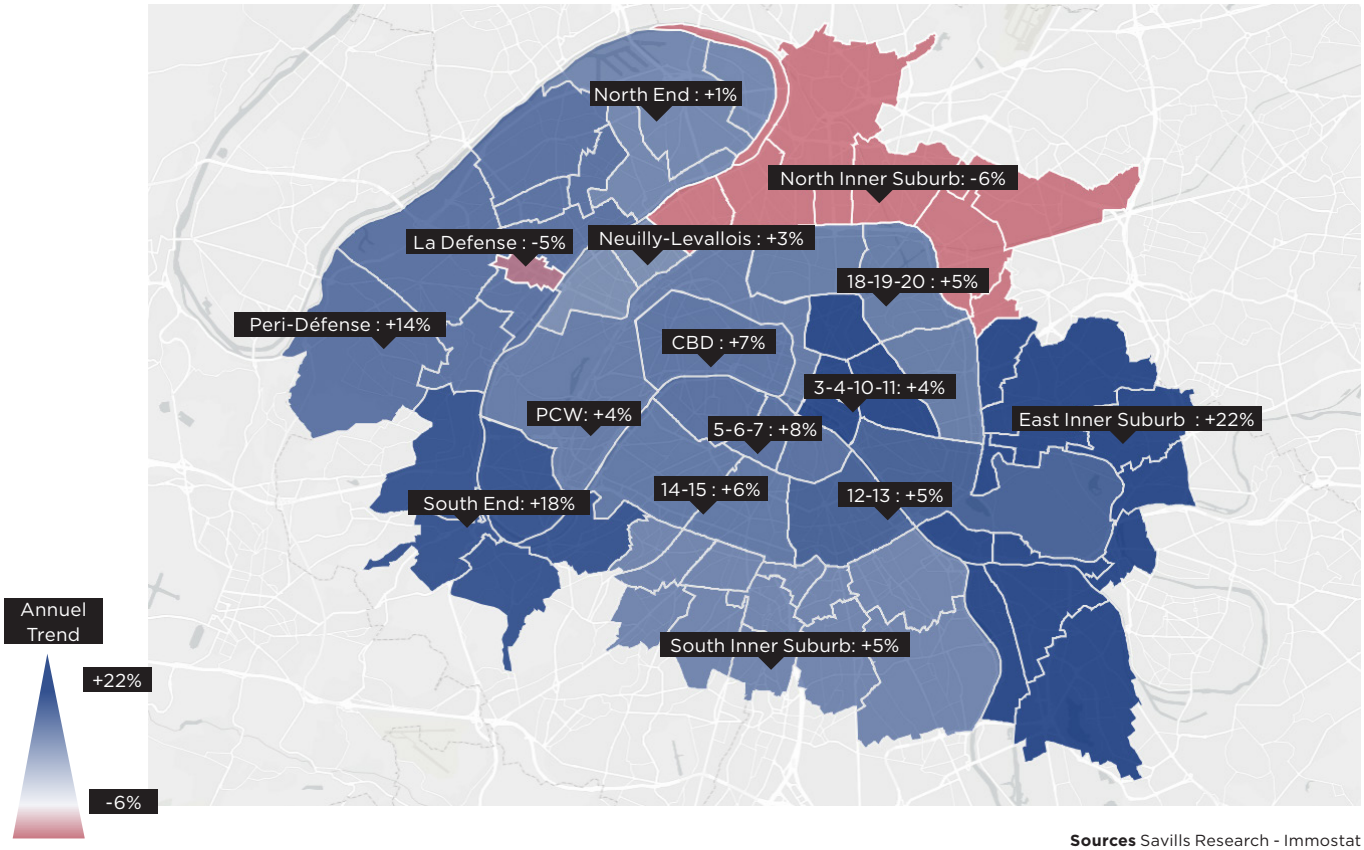
The phenomenon of rising in rental values is less and less confined to Paris. It is spreading to areas sought after for their proximity to business centres and the quality of their transport services. This is typically the case for the Western Crescent, where all the sub-areas saw rises, with a peak of +18% for the outskirts of La Défense.

In this context, La Défense is an exception: its average rent for Grade A spaces fell by 5% to €460/sq. m/year. Low deal activity, particularly in the prime space segment, is behind this phenomenon. This situation is likely to be corrected in the coming quarters: given the deliveries expected, deal activity is likely to rebound, particularly in the prime segment. This would result in an automatic rise in rental value indicators.

[7] Average surface area-weighted rents for the five most expensive 500 sq. m deals over one rolling year

Change in the average rent for new and restructured spaces

A rise in rental values in most sectors: Paris under pressure, catching up in the periphery



Sources Savills Research - Immostat

The coworking phenomenon in Paris

The rush to find flexible spaces

Coworkers have been major players on the Paris market in recent years, and even more in recent months. This is not without consequences for the market.

In central Paris, coworking players were particularly active and have become major players, especially in the large lease segment. They are responsible for eight out of the 16 deals of more than 5,000 sq. m recorded in the capital in the first half of 2019. By volume, they total more than 70,000 sq. m let since the beginning of 2019.

Unsurprisingly, these users target the best assets and prefer central districts (the CBD and, more generally, West Central Paris). However, they are not confined to these areas and are now looking to extend their reach to the whole of the city centre, with a preference for areas such as the 12th-13th and 14th-15th districts. Their interest also stretches to La Défense: the figures for the third quarter of 2019 should, for example, include WeWork's leasing of 13,500 sq. m in the Collines de l'Arche building.

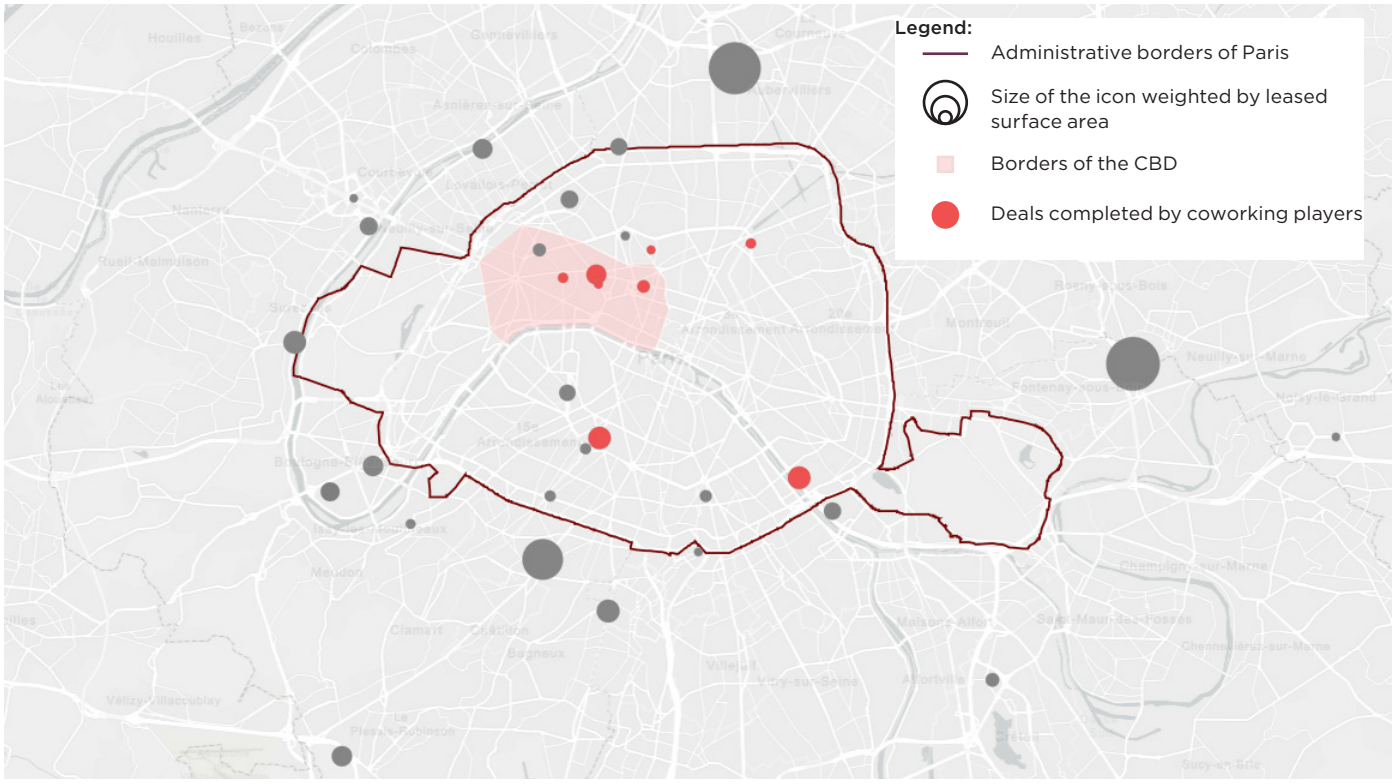
In 2018, WeWork was already a leading protagonist in the major deal segment in the capital, with no fewer than five leases signed for an average unit surface area of nearly 10,000 sq. m. This situation is continuing in 2019: WeWork has signed six leases of more than 5,000 sq. m each for an average surface area of 9,500 sq. m (plus one lease for less than 5,000 sq. m).

In the small- and medium-sized spaces market niche, Deskeo (recently acquired by US company Knotel) proved to be a particularly active player at the beginning of 2019. At end-July, it had signed 14 leases of between 500 sq. m and 2,800 sq. m in central Paris, representing a total volume of nearly 19,000 sq. m.

The Paris network of coworking players is therefore clearly developing. This is of course affecting the rental market, particularly in the small deal segment (less than 1,000 sq. m). Since 2016, this segment has seen a continual decline each year. Small users are not deserting Paris, but are increasingly turning to solutions that now seem natural to them.

Location of deals > 5,000 sq. m in the Ile-de-France region in the first half of 2019

Coworking players trust the center of Paris, large transactions > 20 000 sqm are in the periphery



Source Savills Research

Outlook
Moderation

The scarcity and inadequacy of available supply remain the key characteristics of the greater Paris market and partly explain the slowdown in deal activity.

These factors are expected to remain in play for the rest of 2019. A lessening of supply constraints and increased fluidity in the rental market cannot be hoped for until the end of the year, and especially from 2020 (1.25 million sq. m should be delivered in 2020, of which 52% have already been pre-sold).
In addition to this supply-side limit, demand from users may be lower due to the economic slowdown seen in recent months and uncertainties linked to the international environment. This slowdown is particularly significant in the large surface area segment. It is therefore logical to expect a lower deal volume at the end of 2019 than in 2018, with a market approaching its 10-year average (2.3 million sq. m).
Such conditions should lead companies to opt for caution in terms of letting values. Rents already increased significantly in 2018 for Grade A buildings in central Paris and in several markets on the outskirts. These tensions have tended to spread to the second-hand segment in areas with less supply. This situation encouraged a delay in deal activity (especially for large surface areas) on the less expensive markets, and is what led to the Inner Suburbs' success in the first half of 2019. The trend should continue over the coming months, and may cause a lull in rent increases. This does not mean, however, that take-up at prime values (around €850 in the CBD) is about to disappear, but such values are far from reflecting the market as a whole.

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