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Research report
Jones Lang LaSalle Incorporated

The office market in the Greater Paris Region

3rd quarter 2018

Pause

Key points

Period of recovery for the Greater Paris Region with activity looking strong for Q4

Rental market

Following an extremely active start to the year, the Greater Paris Region office market slowed over Q3 2018 (504,000 sq m) resulting in an overall year-to-date take-up of 1.9 million sq m (+6% year on year).

The largest increase was seen in the medium space segment (1,000 to 5,000 sq m) at +20%.

At last! By the end of September 2018, immediate supply in the Greater Paris Region dipped below 3 million sq m (-16% year on year).

Increases in prime rent were recorded in most of the markets in the Greater Paris Region by the end of Q3 2018 and level in the CBD topped €800 per sq m/year.

Investment market

After the excellent results seen in Q2, the Greater Paris Region investment market returned to more normal levels with €3.4 billion in investments recorded over the last three months taking the year-to-date investment volume to €12.8 billion (+33% year on year).

35 transactions for lot sizes over €100 million have been recorded since the beginning of the year with a total of €8 billion, or 2/3 of the overall volume.

Record levels of investment have been recorded in Paris since the beginning of the year with €6.7 billion.

Foreign investors remained active over Q3 and have accounted for almost €4.9 billion in investments since the beginning of the year.

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Rental market

Market slowdown over Q3 following an exceptional start to the year

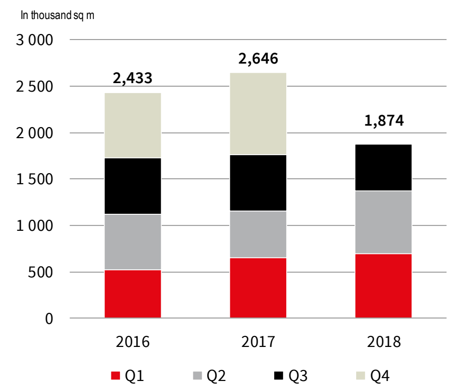
Strong activity for spaces from 1,000 to 5,000 sq m

Following an exceptional start to the year, the **Greater Paris Region office market slowed over Q3 with almost 504,000 sq m in transactions**, lower than the long-term average. **Year-to-date take-up for the Greater Paris Region therefore stands at almost 1.9 million sq m, representing a 6% year-on-year increase** and is 15% higher than the average recorded for this period since 2000. The very strong activity recorded over H1 as a whole means that the market remained on an upward trend, despite a slowdown over Q3.

By number of transactions, all space segments posted increases ranging from +5% to +18% year on year. By volume, although there was a marked increase (+20%) in the medium space segment (1,000 to 5,000 sq m) with ~567,000 sq m of take-up (over 291 transactions vs 255) due to strong activity for spaces >2,000 sq m, the small space segment (<1,000 sq m) remained virtually stable (-1%) with 566,000 sq m of take-up; this level was achieved despite a growing number of PMEs opting for **co-working spaces as they are unable to find traditional real estate solutions.** Leases are being signed in these segments **before the existing tenant has vacated the premises** – a sign of genuine tension in the market.

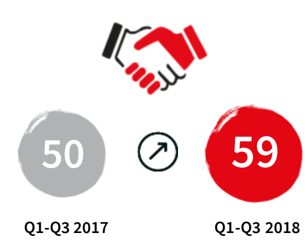
With an average of 22 transactions per quarter, only 16 transactions were recorded in the large space segment over Q3 2018. **59 transactions were carried out over the first nine months of the year, representing a 3% increase in volume with over 740,000 sq m** (43% of volume in the Greater Paris Region). **The highest level of activity was still seen in the 5,000 to 10,000 sq m segment** (33 transactions vs 26 by the end of Q3 2017). This segment accounted over half of the transactions seen for spaces over 5,000 sq m. Those recorded over Q3 include AC NIELSEN's lease of 7,700 sq m in "Sceneo" in Bezons and AG2R LA MONDIALE's lease of 7,450 sq m in Paris 8.

Total take-up



Source: JLL/ImmoStat

Number of large deals 5,000 sq m



Source: JLL/ImmoStat

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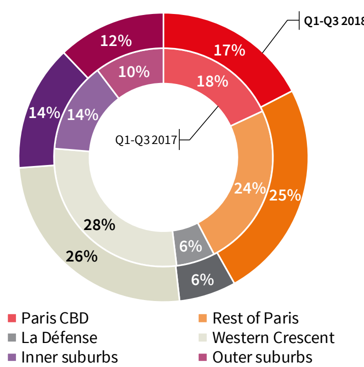
The industrial sector remained in a dominant position with 35% of take-up over 15 transactions. Next in line were companies in the **financial sector** (nine transactions) and **real estate services** with eight transactions, most all of which were carried out by co-working operators (WEWORK, SPACES and MORNING COWORKING) and located in Paris. As at the end of September 2018, these co-working operators accounted for a third of all transactions over 5,000 sq m in Paris.

Suburbs benefit from shift in focus

In Paris, levels of immediate supply continued to fall, resulting in a **vacancy rate of 2.2%** by the end of September 2018. In Inner Paris, immediate supply is now only equivalent to a few months' consumption but, despite this tension in supply, the **CBD (with a critical vacancy rate of 1.5%) remained active with over 326,000 sq m of take-up.** This activity was driven by finance and real estate firms with three transactions each (25,800 sq m and 23,400 sq m respectively).

Take-up by geographic area
(Q1-Q3 2018 vs Q1-Q3 2017)



Source: JLL/ImmoStat

In 2015 and 2016 Paris may have secured the majority of take-up in the Greater Paris Region, but companies are now being drawn to markets in the Inner Rim which are benefiting from businesses moving from Paris resulting in a 46% share of transactional activity. Following an active year for the **Western Crescent, take-up in this market posted a slight decrease (-4%) by the end of Q3 2018 due to a reduction in the number of major transactions, a segment that was particularly active last year.** Péri-Défense remained the most active market accounting for 52% of the overall take-up volume.
La Défense also performed well with double-digit increases seen across all space segments. However, with 119,000 sq m in take-up, figures remain lower than the ten-year average (127,000 sq m).
Following a slight slowdown over Q2, the Inner Suburbs posted an increase in take-up to 82,000 sq m over Q3 2018 taking the overall year-to-date performance to 263,000 sq m (+11%). The East and the South remained active, while decreases were seen in the North. However, in terms of stated demand this area is still attracting companies due to infrastructural changes that are due to be in place by 2024.

Finally, despite a slowdown over Q3, the **Outer Suburbs were active both in terms of the number and volume of transactions with increases of +8% and +25% respectively**. The take-up volume of almost 227,000 sq m was largely due to transactions for spaces over 1,000 sq m.

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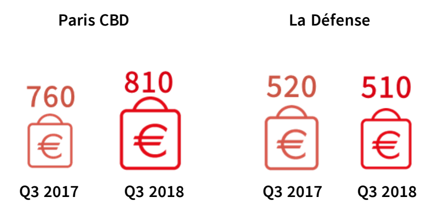
Record average rents for existing space

By the end of Q3 2018, increases in prime rental values were seen in most markets in the Greater Paris Region. Double-digit increases were recorded in some submarkets including Neuilly/Levallois, Paris 18/19/20 or Paris Centre West (excl. CBD). A sharp increase was seen in **Neuilly/Levallois,** due to the PARFUMS CHRISTIAN DIOR's transaction for "Kosmo" (€620). In the reference market that is the **Paris CBD,** the prime rent topped €800 and reached **€810 per sq m/year** following a good number of transactions for rents over €800 as well as several for values in excess of €840.

In addition, average rents for existing space continued to rise. Due to growing pressures caused by an imbalance between supply and demand **in the CBD,** the average value has been rising for the last four years and reached a high point since 2000 of **€575 per sq m/year in Q3 2018**.

Incentives stabilised over Q2 2018 at an average of 20.6% with a low-point of 9.9% in Paris - North East, 23.5% in the Inner Suburbs and reached 24.4% in Western Crescent and La Défense.

Prime headline rents (in €/sq m/yr)



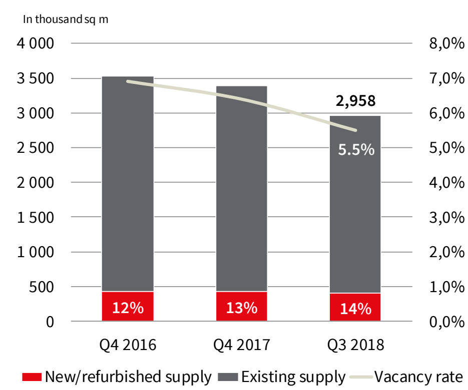
Source: JLL/ImmoStat

Immediate supply now under 3 million sq m

Immediate office supply in the Greater Paris Region dipped below the 3 million sq m barrier (-16% year on year) at the end of September 2018, a first since 2009. This equates to an overall vacancy rate of 5.5% which is below the fluidity threshold for the market. **Immediate supply of new space remained stable** and most projects coming onto the market have already been pre-let. As a victim of its own success, **volumes of new availability remain low and now only account for 14% of overall supply, or barely 405,000 sq m of availability;** this equates to half of the volume of new space consumed annually in the Greater Paris Region since 2018.

In Paris, the lack of supply is even more marked with an average vacancy rate of 2.2% and 1.5% for the CBD. Although falling, immediate supply is still highest in the Western Crescent (891,000 sq m) where the overall vacancy rate stands at 10.8% and only 4.7% in La Défense.

Immediate supply and vacancy rate



Source: JLL/ImmoStat

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Investment market

Summer break

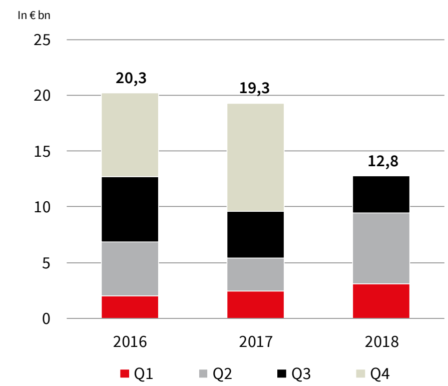
Market driven by major transactions

After excellent results in Q2 (€6.4 billion in investments) the Greater Paris Region investment market returned to more normal levels with €3.4 billion in investments recorded over the last three months. These results take the year-to-date investment volume to **€12.8 billion; this represents a 33% year-on-year increase and is 58% higher than the long-term average.** Activity in the Greater Paris Region investment market **remains very strong**.

These results are mainly due to exceptional performance in the major transactions segment; six transactions were recorded over the summer adding to the 29 recorded over H1 2018. **The 35 transactions recorded since the beginning of the year constitute the third-best performance in this market segment which accounted for €8 billion in investment or almost 2/3 of activity in the Greater Paris Region since the beginning of the year.** The quarter's largest transactions include COVEA's acquisition of the 26,500 sq m "Néo" building on Boulevard Haussmann (Paris 9) which is mainly occupied by national newspaper LE FIGARO and EMERIGE's sale to TH REAL ESTATE of the tertiary part (26,100 sqm), of the "Morland Mixité Capitale" project (Paris 4), which was a winner of the 2016 "Réinventer Paris" call for projects that offered a €350 million prize. As for the other market segments, **a 38% increase was seen for transactions from €50 to €100 million,** both by number and by volume, **whereas those for lot sizes under €50 million posted an 8% decrease in number and a 7% reduction in investment volume.**

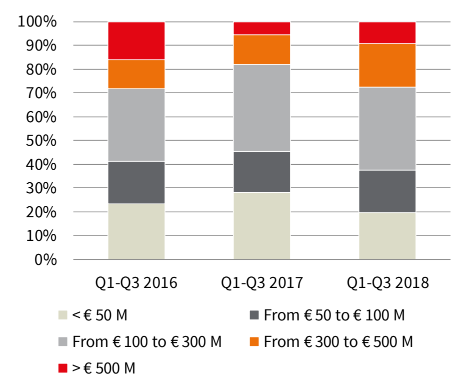
All segments combined, the number of transactions remained relatively stable year on year with 212 recorded year to date (compared with 209 last year); this is far higher than the long-term average (157).

Total investment volume



Source: JLL/ImmoStat

Investment volume by deal size



Source: JLL/ImmoStat

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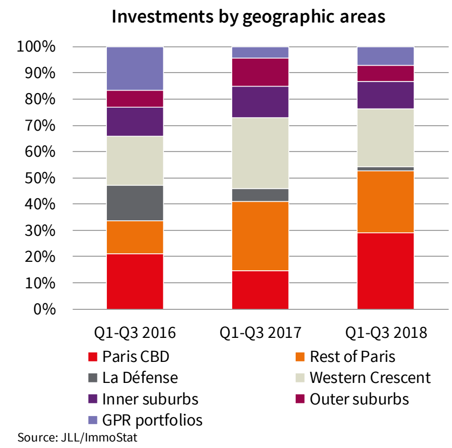
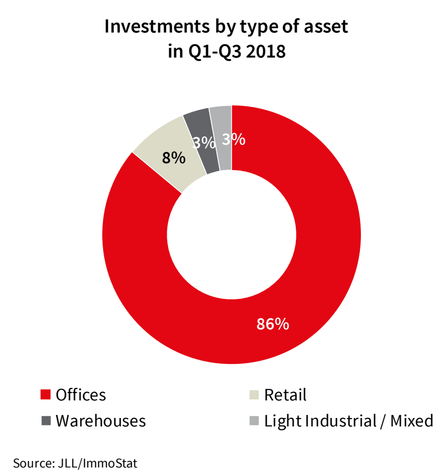
Capital highly attractive



In high demand over H1 2018, Parisian assets retained their appeal over the last three months. Since the beginning of the year, the capital has accounted for over a record level of €6.7 billion in investments. These results were bolstered by 18 transactions for lot sizes over €100 million which **accounted for almost €4.6 billion in investment. These figures reflect activity in the Paris rental market as investors see the potential for improvements in their current returns.** After a highly active year in 2017, **the La Défense market is currently having a flat year with only €190 million in investments since the beginning of the year.** However, the number of towers currently on the market does lead us to believe that the market will be more active over the end of the year. Excellent activity continued in the **Western Crescent** which has already seen over **€2.8 billion in investments so far this year** - its **second-best performance on record.** The geographic distribution of these investments is reasonably well balanced across the various submarkets, apart from the Northern Bend which has only seen €190 million in investments. **Over €1.3 billion has been invested in the Inner Suburbs (+15% year on year), most of which was in the North** (€800 million). Saint-Denis alone secured half of this investment volume. However, no transactions were recorded at all this quarter in the Inner Eastern Suburbs.

Performance increases were seen for all asset types



With **€11 billion in investments** since the beginning of the year **(+33% year on year), offices remained by far the most popular asset type among investors Retail investments posted a year-on-year decrease** with only 20 transactions compared with twice that number over the same period last year. This decrease is linked to investor caution as well as difficulties in reaching a consensus on prices for retail assets. However, thanks to HINES' acquisition of 114 Avenue des Champs Elysées, so far this year, the year-on-year **investment volume for retail has posted a slight increase (+5%) to €992 million**. In contrast, due to a high number of transactions (17 compared with an average of eight for the last ten years), **there was a 48% year-on-year increase in activity for warehouses with €433 million in investments.** Although many portfolio transactions were recorded over H1 2018, all of the transactions over Q3 were for single assets. **But the sharpest increase was for industrial premises which posted four times the investment volume seen over the same period last year;** with **over €360 million in investments,** this was the **best performance since 2007.**

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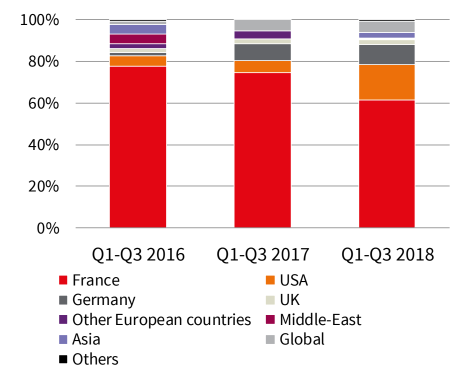
Stable market share for foreign investors

Foreign investors, who were very active towards the end of 2017, **continued to invest over the last three months. Since the beginning of the year they have accounted for close to €4.9 billion in investments or 39% of activity.** With almost €2.2 billion (17% of activity) **American investors were by far the most active** and mainly invested in value-add office buildings in a bid to benefit from the dynamic rental market. Acquisitions carried out by **German investors** (€1.2 billion, or 10% of activity) were more varied in terms of asset type. Foreign investors have been relatively inactive on the sell side with barely €3 billion in portfolio disposals since the beginning of the year. **American investors were most active on the sell side** (almost €1.2 billion). **German investors** were again in second place with €700 million in disposals since the beginning of the year.

Split of investment volumes by nationality



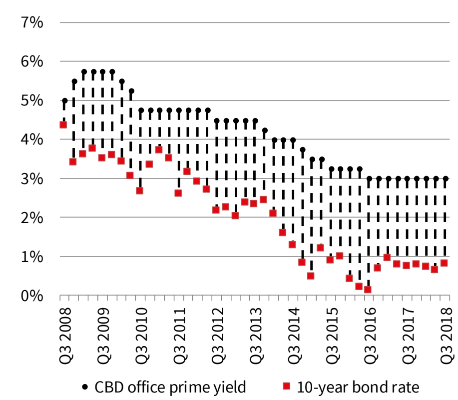
Source: JLL/ImmoStat

In terms of **French investors, SCPI/OPCI managers remained the most active, despite a slowdown over Q3** (€610 million compared with €1.4 billion over Q2 2018). Year to date, they have carried out **€2.6 billion** in investments. A close second were **insurance companies and pension funds (€2.1 billion).**

Core assets were the most popular accounting for almost 50% of investment volume while Core+ and value-add assets accounted for 24% and 27% of investments respectively. **There were a good number of forward-funded (VEFA) investments over Q3 2018** with 5 transactions recorded.

Prime office yields remained stable over Q3 across the various markets of the Greater Paris Region, **although at minimal levels.** However, **further compression was seen in prime yields for logistics warehouses. The best assets are now being traded at 4.50%.** As for **retail,** yields may have remained stable over Q3, **but further compression over Q4 may be seen for shopping centres that are currently struggling.**

Risk premium



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Outlook

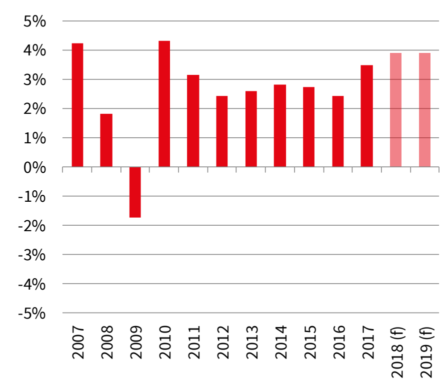
Growth forecasts revised down

Growth should gain pace over H2 2018

Global economic improvements have now been compromised as some of the threats recently outlined by economists appear to have become reality. Firstly, **trade conflicts** and their impact on international trade and investment - two major components of global growth - and secondly, public and private **debt,** both of which are higher than before the 2008 crisis. In addition, **global growth is less synchronised,** particularly for some **emerging markets following the appreciation of the dollar,** such as Turkey and Argentina which are currently heading into recession. In terms of the developed economies, Donald Trump's economic policy is causing the American economy to overheat leading the FED to introduce interest rate rises to offset inflation while **other factors are causing uncertainty in Europe.** Given this climate, the **OECD** lowered its 2018 growth forecasts last quarter (3.8% instead of 3.9%) with a **projection for global GDP of 3.7% in 2018 and 2019.** The **IMF,** which had not altered its forecasts until now, **has announced that it will revise down its projections for global growth** at the beginning of October.

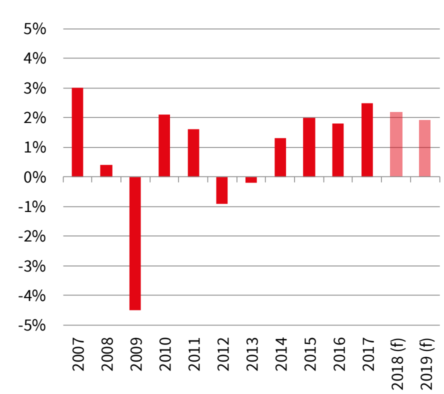
In the Eurozone, economists point to several threats that are currently weighing on activity: the impact of trade conflicts, Brexit, political outcomes in Italy, the return of inflation and the withdrawal of favourable monetary policies. Considering these risks and following lower-than-expected levels of activity over H1 2018, **growth forecasts for the Eurozone in 2018 have recently been revised down,** by both the **OECD (2% compared with 2.2% last quarter)** and the **IMF (2.2% compared with 2.4%). Unemployment has however continued slowly fall,** with levels reaching **8.1% in August** - the lowest level since November 2008 - while **inflation remained stable at 2%** (2.1% in September), driven mainly by a sharp increase in energy costs as well as, according to the ECB, by **salaries which rose by 1.8% year on year over Q1 2018.**

Global growth



Source: IMF

Growth in the Eurozone



Source: Banque mondiale, IMF

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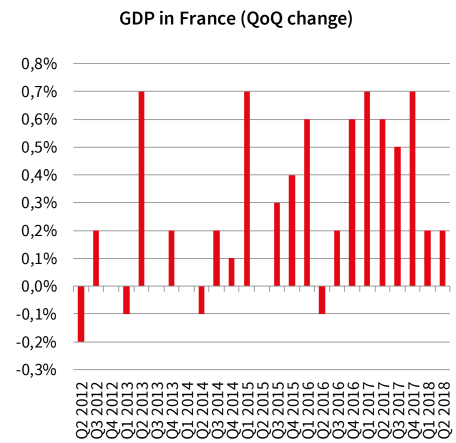
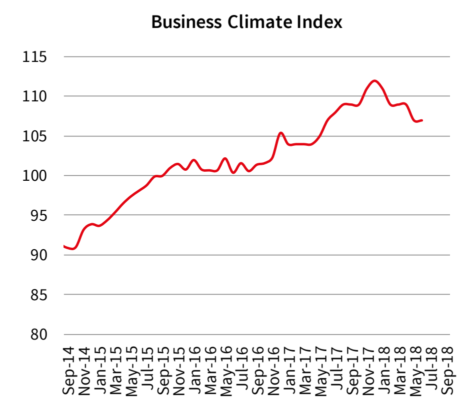
The slowdown seen in the French economy over Q1 continued into Q2 2018 with only a 0.2% increase in French GDP, or half the level predicted. There are several reasons for this: household consumption fell (-0.3%), foreign trade made a negative contribution, transport strikes, … However, increases were seen in total output (0.2%) and business investment (+1.1%). Unemployment remained high at 9.1% in Q2 2018.



Source: Insee

The **Business Climate**, which had reached a high point in December 2017, seems to have stabilised after falling for several months. The indicator published by INSEE stood at **106 in September;** this is far higher than the long-term average. **The French PMI Markit index also appears to be stabilising** and has remained between **54 and 56** since May. **Conversely, householder confidence continued to fall; after having reached a high point in December 2017 (104)**, the index has seen a series of decreases reaching **94 in September.** With fears that inflation may rise over the next 12 months, householders are increasingly pessimistic regarding their future financial position and their ability to save.

Even so, growth should gain pace over H2 2018 due to a range of factors that include an upturn in consumption driven by the positive outcomes of tax changes with the withdrawal of property tax and salary deductions for unemployment and illness. **French growth for 2018 as a whole should therefore reach 1.6% according to the BANQUE DE FRANCE** (which is also forecasting 1.6% for 2019 and 2020) and **1.8% according to the OECD** (1.8% in 2019) while the **IMF is forecasting 1.8%** (1.7% in 2019).



Source: Insee

In France or around the world, it is clear that **there is more uncertainty in the economic and financial climate than a few months ago** and with higher risks. Some economists are revisiting the topic of financial crisis, even though, for the time being, the outlook for 2019 appears to be similar to 2018.

Rental market

Despite the greater economic certainty seen in recent months, **stated demand remains strong and we expect 2018 to end on a similar note to 2017.** Two factors are worth noting: Firstly, demand activity may be affected by the lack of supply that is pushing companies towards forward-funded leases (BEFA) which take longer to agree.

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In addition, the Brexit effect which has been talked about in the media has not been enough to have had a significant impact on figures for the Paris market (apart from a few transactions in the banking sector). Faced with ongoing negotiations, we have yet to see a huge influx of companies leaving the United Kingdom.

In terms of new office production, deliveries in 2018 should be similar to 2017 with volumes for 2018 almost 60% pre-let. **As a result, the vacancy rate, which currently stands at 5.5% in the Greater Paris Region, should fall further over the next three months,** as will the proportion of new space. Limited by the growing lack of supply in Paris, **companies based in the capital will have to extend their search beyond the ring road** into markets that offer high-quality supply at competitive rents.

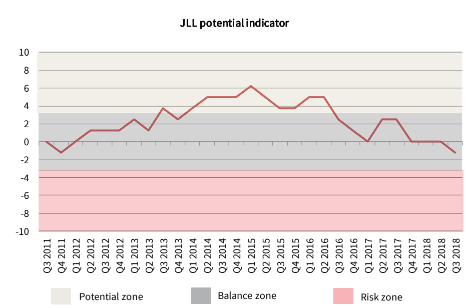
Strong demand combined with limited supply and a high percentage of pre-lets will encourage further rent increases for both prime and existing space. **Incentives** have been reducing since 2017 and, **given these market conditions, should continue to fall.**

Investment market

Considering all the transactions we are aware of and, following an excellent H1 2018, **the Greater Paris Region investment market should recover with a particularly active Q4. Foreign investors should remain active, both in Paris due to changes in rental values as well as in some suburban markets that will benefit from considerable improvements from infrastructural projects that are currently underway.**

Given these factors, **we are confident in the results for 2018 and expect the investment volume for the Greater Paris Region to stand at over €20 billion.**

With the prime rent considerably higher than the long-term average and a risk premium that is slightly higher than average (219 basis points), the **JLL potential indicator, which analyses the capacity for value creation in the Greater Paris Region, remains in the balanced zone at -1.25.**



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Paris

40-42 rue La Boétie
75008 Paris
T: +33 (0)1 40 55 15 15
F: +33 (0)1 46 22 28 28

Saint-Denis

3 rue Jesse Owens
93210 Saint-Denis
T: +33 (0)1 40 55 15 15
F: +33 (0)1 48 22 52 83

Le Plessis-Robinson

"La Boursidière" - BP 171
92357 Le Plessis-Robinson
T: +33 (0)1 40 55 15 15
F: +33 (0)1 46 22 28 28

Lyon

"King Charles" - 132 cours Charlemagne 69002 Lyon
T: +33 (0)4 78 89 26 26
F: +33 (0)4 78 89 04 76

Marseille

21 rue de la République
13002 Marseille
T: +33 (0)4 95 09 13 13
F: +33 (0)4 95 09 13 00

Bordeaux

16 cours de Tournon
33000 Bordeaux
T: +33 (0)5 57 83 60 44
F: +33 (0)1 46 22 28 28

Lille

46 rue de Valenciennes
59000 Lille
T: +33 (0)3 20 17 93 10
F: +33 (0)1 46 22 28 28

Rennes

20 rue d'Isly
35042 Rennes Cedex
T: +33 (0)1 40 55 15 15
F: +33 (0)1 46 22 28 28

Contacts

Virginie Houzé
Director
Research – Paris
T: +33 (0)1 40 55 15 94
virginie.houze@eu.jll.com

Delphine Mahé
Manager
Research – Paris
T: +33 (0)1 40 55 15 91
delphine.mahe@eu.jll.com

Manuela Moura
Consultant
Research – Paris
T: +33 (0)1 40 55 85 73
manuela.moura@eu.jll.com

www.jll.fr

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