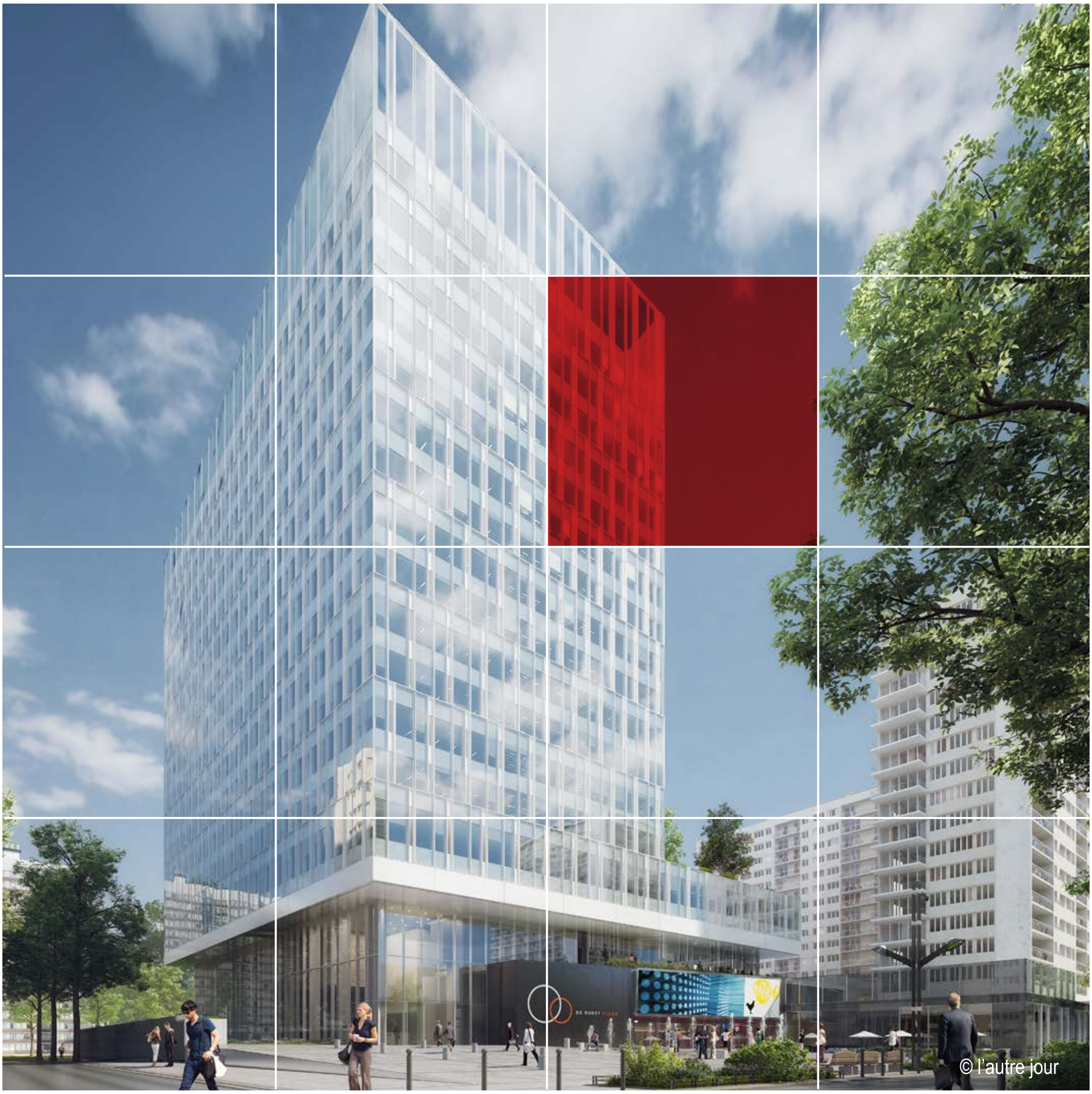
The office market in the Greater Paris Region

On Point | **4th quarter 2014**



Key messages

2014: best year for investment since 2007

Following three years in which the investment market hovered around 12 billion euros, 2014 was an excellent year for the Greater Paris Region market, which surpassed the 17 billion euro mark. It was the best year recorded since the 2007 peak, which exceeded 20 billion euros.
While the London market was down year-on-year – recording a 9% fall in investment volumes – the Greater Paris Region market recorded an increase of 46% in one year.

This growth in investment volumes can be explained by the dynamism of transactions for more than 100 million euros. There were 44 of them, representing a little over two-thirds of volumes sold across the region as a whole this year, with disposals including the sale of the RISANAMENTO portfolio and "Cœur Défense", which achieved exceptional unitary amounts in excess of 1 billion euros.

Despite the bleak economic climate in 2014, real-estate investment again demonstrated its appeal as an asset class among investors.

Latest from the market

Assessment of 2014: recovery in the rental market and record investments

Mission accomplished for the rental market

The rental market ended 2014 with a respectable level of take-up above the 2.1 million sq m mark. The market is showing signs of recovery and rose by 13%, thanks to a solid 4th quarter, leaving behind the memory of a tough 2013.

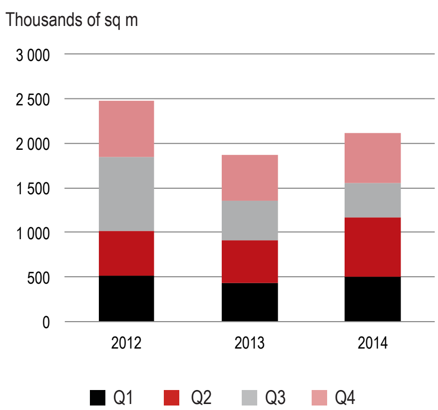
This strong performance was particularly boosted by a strong recovery in large transactions. This market segment, which proved disappointing last year, accounts for almost 40% of rental results in 2014 (62 transactions for approx. 825,000 sq m). More large companies finalised their real-estate projects, taking advantage of the market opportunities which presented themselves, particularly in La Défense.

The small and medium-sized surface area segment (less than 1,000 sq m) also performed well, while that of intermediate surface areas (1,000-5,000 sq m) fell. *"Midmarket companies were directly impacted by the local economic situation and suffered as a result of almost flat growth in France and the deterioration in their margin rate over the year, penalising them compared with large CAC 40 groups which can find sources of growth at an international level"* says Marie-Laure Leclercq De Sousa, Head of the French leasing team of JLL.

In geographical terms, **traditional business districts such as La Défense (+123%), Neuilly-Levallois (+39%) and the Central Business District (+17%) are performing well.** In Paris, marketing times remain coherent if the product is well defined and positioned at the correct level. The situation is somewhat different in the Inner Suburbs. The abundance of new offices in some markets, combined with a correction in rental values, has boosted the market, as in La Défense, for instance, which recorded a record year, comparable to 2007-2008. No fewer than 13 large transactions were agreed in 2014, compared with just four the previous year. Eight were recorded in the CBD (compared with seven in 2013), while twice as many were recorded in Neuilly-Levallois (six instead of three in 2013). At the other end of the spectrum, the Southern and Eastern Inner Suburbs, and some "knock-on" sectors such as the Northern Bend, have suffered from this fierce competition.

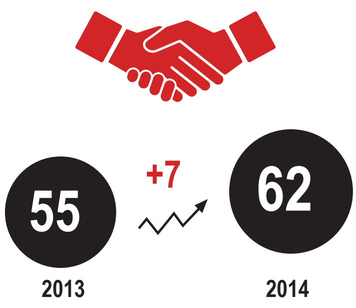
Cumulative take-up

Source: JLL/ImmoStat



Number of large deals > 5,000 sqm

Source: JLL/ImmoStat

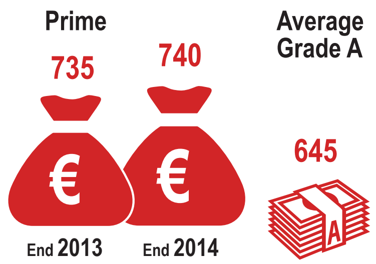


In the absence of a strong economic recovery, the market continues to offer an abundant supply. The symbolic threshold of 4 million sq m of available office space was exceeded at the end of the year, representing a current vacancy rate of 7.6% for the Greater Paris Region. Immediate supply of offices in the capital and in the Central Business District (5.6%) remains at a moderate level, with a vacancy rate close to 5%. Supply remains abundant on the outskirts of the city, particularly in the West, where 1 million sq m of office space is empty (excl. La Défense). In La Défense, the vacancy rate has only fallen slightly (12%), despite recent leases which have partly absorbed the large number of deliveries in the past three years (more than 300,000 sq m, representing approx. 10% of surface area in La Défense).

Changes in headline prime rents vary considerably between sectors although remain in the lower end of values overall. There are no notable changes in the main tertiary markets. Prime rent in the Central Business District is stable at €740, with the most expensive transactions only occasionally exceeding €750 in the last year. Companies are still in fragile health, and many of them have neither the ability nor the desire to pay high rents, even for prime buildings in central districts. In La Défense, however, having reached its low point mid-year, the rent curve has turned and is gradually rising, at €520. **Rental conditions are still particularly attractive and real rents have reached a low point.** Incentives now represent 19% on average in the Greater Paris Region, ranging from 15% in Central Western Paris (or even lower in some Parisian arrondissements) to 20% or more in the Inner suburbs, obviously depending on the size of surface areas leased and the fixed term of the commitment.

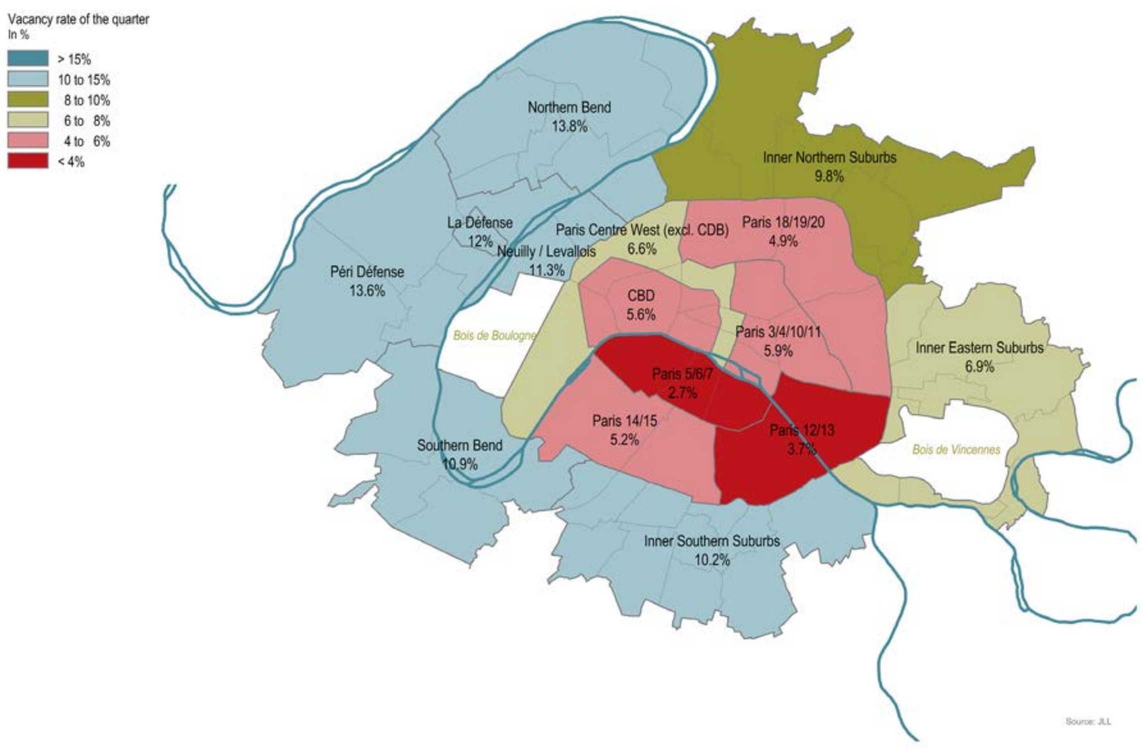
Rent - Central Business District €/sq m/yr

Source: JLL



Vacancy rate as at 4th quarter

Source: JLL/ORIE



Investment market approaches its historic record

The investment market outperformed in 2014, to a greater extent than we had forecast. At the end of December, the Greater Paris Region market **broke through the 17 billion euros threshold** following an increase of 46% in a year, with two particularly impressive quarters, the 2nd and the 4th, accounting for two-thirds of the capital invested in the region. ***"This performance, which exceeded even our optimistic forecasts,"* says Stephan von Barczy, Head of French Capital Markets Group at JLL, *"makes 2014 the best year recorded since 2007, demonstrating that the investment market is out of step with the rental market and the local economy, instead reflecting activity on the financial markets. But it demonstrates above all the appeal for investors of the Parisian market"* he continues.** In terms of number of transactions, 2014 made up for ground lost at the start of the year, recording 227 transactions, an equivalent level to 2012 and 2013.

While office sales account for the majority, retail represented 13% of investment in the Greater Paris Region. At a national level, this market achieved an exceptional performance of more than 6 billion euros, the highest level since 2004.

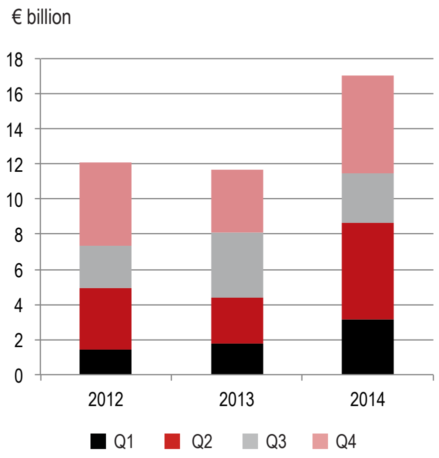
The usual sprint on the investment market in the last quarter was seen more than ever last year. **The 4th quarter 2014 recorded an excellent performance, with a volume of 5.5 billion euros.** Unlike the 2nd quarter, the 4th quarter did not benefit from any "mega transactions" such as the sale of the RISAMENTO portfolio or "Cœur Défense". However, there is a real depth to the market in the segment of transactions between 100 and 300 million euros, with 16 transactions in the 4th quarter, representing almost 2.6 billion euros of commitments. Headline transactions in the 4th quarter include the sale by KANAM to a Korean investor of the SANOFI head office in the 8th arrondissement, for an estimated 350 million euros. We could also mention the acquisition by AEW of a portfolio sold by EUROSIC, three Parisian assets and one in Montrouge for 301 million euros.

In all, throughout the year as a whole, **44 transactions for more than 100 million euros** were finalised. **These represent 11.5 billion euros** and have increased in number by 47% compared with 2013. **This unusually high proportion is at the same level as that observed in 2006 and 2007.** Historically, foreign investors represent two-thirds of large transactions in this market segment, as in London, which is an even more international market. In 2014, however, **French investors accounted for the majority** being behind 29 of the 44 transactions, for a volume **of more than 6.4 billion euros. Foreign investors represented 45%** of amounts invested in large transactions, **or 5.1 billion euros**.

Other segments were no less dynamic, particularly **that of medium-sized transactions** (between 50 and 100 million euros). Although this segment did not perform well in the first nine months of the year, **the 4th quarter inverted the trend, making it possible to catch up lost ground** (21 transactions compared with 11 in the 4th quarter 2013). Overall, 40 transactions were recorded in this segment compared with 42 last year, for an amount equivalent to more than 2.8 billion euros.

Total investment volume

Source: JLL/ImmoStat



Investment deals

Source: JLL/ImmoStat

In terms of forward funding sales, 2014 recorded levels not seen since 2011. More than 1.6 billion euros were invested over the year, a performance up by 39% compared with last year, although investors are still taking little risk. In fact, **just four speculative transactions** were finalised (31% of capital invested). These speculative forward funding sales are mainly located in Paris and the inner suburbs.

Under pressure from sustained demand for the best assets, we are again seeing a **marginal contraction in prime yields** although with potentially wider range of yields in some suburban markets. In terms of Paris' **Central Business District**, prime yields are now **between 3.75% and 4.25%**, almost their record low. The CBD is now positioned at the same level as London. Real estate has become especially attractive since OATs fell below 1% at the start of December.

"Link" **-** Paris 15th district

Outlook

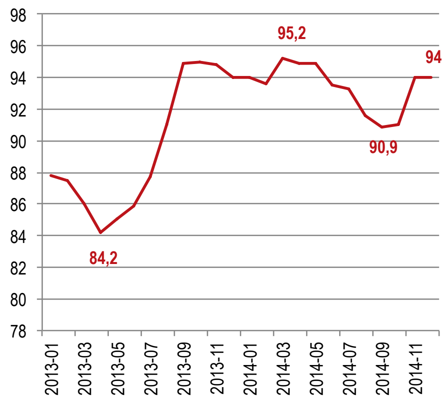
Following three years of dashed hopes, French growth in 2014 is expected to be low but positive in France following two years of stagnation. Hopes are now turning to the current year, with very reasonable growth projections of between 0.8% and 0.9%.

Three positive factors could boost French business as we enter the new year. Firstly **the fall in the euro against the dollar** restores the country's export capacities, and this fall could be here to stay, since the United States, which needs to control its economic growth, is set allow its currency to become stronger. The **oil price has also fallen sharply**, removing the main disadvantage of the fall in the euro concerning oil imports. Finally, **the global economic picture should be more favourable** with stronger growth in the USA and UK and an improvement in the Eurozone, resulting in stronger international demand.

The obstacles to a strong French recovery are now purely domestic, with a weak business climate, high tax pressure and company margins in need of strengthening: **2015 – a year of recovery needed for the national economy** before consolidation in 2016.

Synthetic index of Climate Business

Source: INSEE / December 2014



Rental market

In terms of demand expressed on the market, rental activity should confirm its recovery in 2015. Leased volumes could increase to between 2.2 and 2.3 million sq m. Midmarket companies will probably continue to seek local premises and extensions rather than relocations, while large groups are increasingly incorporating real estate strategy into their overall planning.

Markets able to offer high-quality products at an attractive rent will benefit the most from this growth. *"In terms of rental values, the coming year is unlikely to see significant increases in rents, which will remain at their current levels, with the adjustment variable applying more to the level of incentives granted,"* adds Marie-Laure Leclercq De Sousa, Head of the French leasing team of JLL.

In terms of supply, in the absence of significant economic recovery, companies will continue to seek to control costs, rather than focusing on growth. **Supply is therefore not likely to fall in the short term**, even though some markets are beginning to absorb their new surplus supply.

Investment market

An exceptional year was recorded in 2014 due to a combination of one-off phenomena: fund liquidations and insolvency proceedings led to the sale of large assets such as Cœur Défense and the RISANAMENTO portfolio. Another factor was the strategic reorientation of some property companies, such as GECINA, which is withdrawing from retail by selling the Beaugrenelle shopping centre, and FONCIERE DES REGIONS which is pulling out of logistics by continuing with the disposal of its portfolio. Finally, KLEPIERRE and UNIBAIL have adopted a similar approach by choosing to refocus on their best shopping centres. **In principle, these movements, which brought some very large assets to the market in 2014, will not be seen again in 2015 at comparable volumes.**

We anticipate **an investment volume of between 12 and 14 billion euros in 2015**, provided there are enough products available on the market. However, *"following the recovery in rental activity in 2014, it is possible that 2015 will see the trade-off of significant – recently leased – assets,"* emphasises Stephan von Barczy, allowing the market to remain towards the upper end of our forecast.

Finally, concerning **prime yields**, although the economic news is not really good, rates **could still fall for the best assets, pushed down by demand and due to a lack of alternative products.**

Notebook

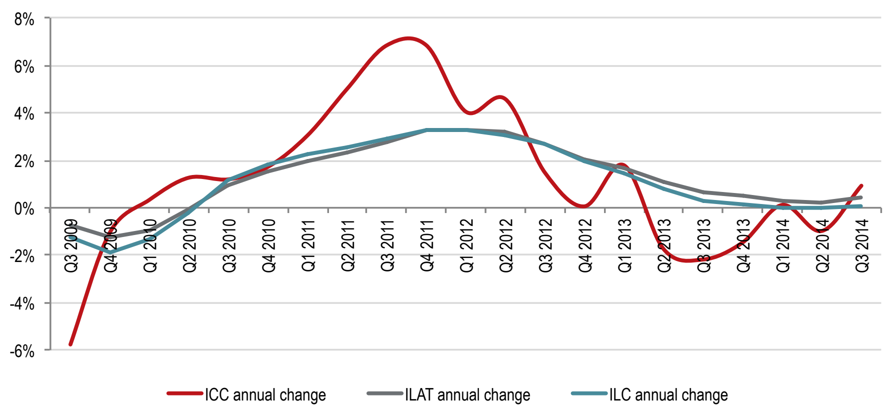
ICC, ILAT and ILC: indexes rise

Having recorded a fall of nearly 1% in the 2nd quarter, the **ICC** (French construction costs index) rose in the 3rd quarter of 2014. It recorded a year-on-year **increase of 0.93%**, to reach **1,627 points**.

The **ILAT** (French index of tertiary sector rents) was also published and saw its annual growth rate increase for the first time this year, rising by **0.43%** year-on-year. The index therefore stood at **107.62** in the 3rd quarter of 2014.

Finally, in relation to retail leases, **the ILC** (French index of commercial rents) **was again stable at 108.52** in the 3rd quarter of 2014. The ILC has remained in a range between 108.46 and 108.53 points for more than a year now.

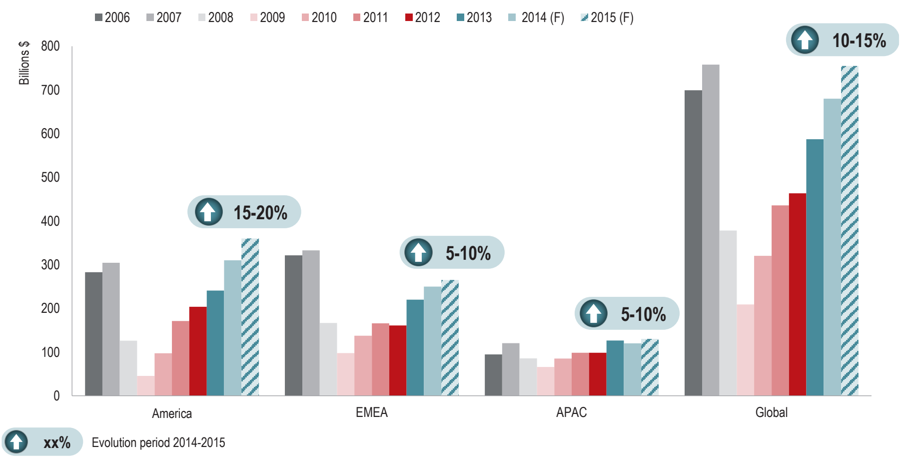
Comparison of ICC, ILAT and ILC changes



Source: INSEE

Market volatility strengthens the appeal of real estate

Investments picked up again, with a total of 168 billion dollars invested globally in the third quarter, confirming our forecast of a total volume of 700 billion dollars in 2014. America and Europe are pushing up volumes, with increases in investment of 23% and 7% respectively. **For 2015, we anticipate a further 10%-15% increase in investments globally, with America again proving more dynamic.**



European markets continue to grow, reaching a total of 129.4 billion euros of investment at the end of September. The UK, Germany and France, which account for two-thirds of European investment, have seen their volumes increase by 25% to 30% compared with 2013. Most European markets have grown, particularly Spain, which is up by 189% (5 billion euros invested) and Ireland, up by 181% (2.8 billion euros invested).

In Europe, demand is showing no sign of weakening. According to Preqin, private equity funds dedicated to Europe have doubled their capital and are poised to invest more than 50 billion euros, while debt funds have also seen a significant increase in their inflows. These players are joined by "core" European investors, who are still very active, along with American and Asian investors. New players are also appearing on the European scene, for example Cathay Life (Taiwan), which acquired the Woolgate Exchange for more than 300 million pounds in the 3rd quarter, along with an Asian fund which completed its first acquisition in Germany.

The impressive health of real-estate markets may appear surprising given the international context. The slowdown in Chinese growth, economic sanctions against Russia and necessary structural reforms, will probably result in weak growth in Europe. **Nevertheless, the volatility of financial markets and fall in bond yields mean that real-estate investment is competitive compared with other asset classes. Furthermore, with attractive rates compared with other regions and a weak euro, European markets are now more competitive and are set to continue to appear at the top of the list of investment destinations.**

News from the Grand Paris development project

• Four billion euros for the Grand Paris Express

On 12 December 2014, Société du Grand Paris and Caisse des Dépôts signed a cooperation agreement concerning the allocation of 4 billion euros in loans, corresponding to half of expenditure between now and 2020. This is an unprecedented financial commitment which guarantees the project's credibility.

An initial tranche of one billion euros will be paid by Caisse des Dépôts from 2015 to finance line 15 South (Pont de Sèvres - Noisy-Champs), among other projects.

• Final green light for line 15 South

The decree declaring the public utility of work on line 15 South, the section running from the Pont de Sèvres and Noisy Champs, was published in the Journal Officiel on 24 December 2014.

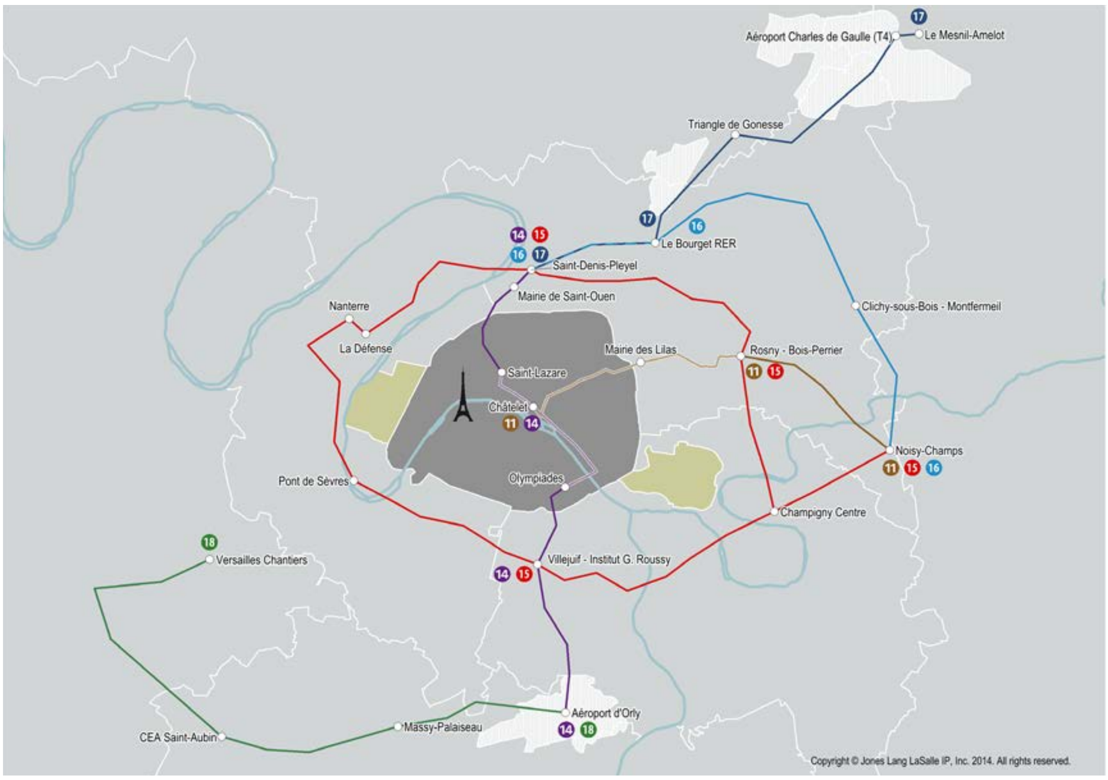
Work is scheduled to begin in 2015, for opening of the line by 2020.

• Public consultations over for future lines serving the Le Bourget and Charles de Gaulle airports

Public inquiries for development of the Grand Paris Express lines 14 North (Mairie de Saint-Ouen - Saint-Denis Pleyel), 16 (Saint-Denis Pleyel – Noisy – Champs via Le Bourget) and 17 (Saint-Denis Pleyel – Le Mesnil-Amelot via Charles de Gaulle) were held from October to December.

The inquiry commission must now submit favourable, favourable with reservations or unfavourable conclusions concerning the projects. A Council of State decree would then declare the public utility of the projects.

Find all the latest news on the Grand Paris development project at: www.grand-paris.jll.fr/



Greater Paris Region transport news

• Tramway T6 comes into service
The new tramway T6 line opened in December now links Vélizy-Villacoublay to Châtillon-Montrouge, the terminus of metro line 13. This line is designed to encourage crucial mobility between suburbs, in an area in which 150,000 people live and work. With trains departing every four minutes during rush hour, the line will eventually link Châtillon to Viroflay in 40 minutes and will carry 82,000 passengers a day.

• Tramway T8 on track
The new tramway line T8 linking Saint-Denis to Épinay-sur-Seine / Villetaneuse came into service in December. It connects to metro line 13, T1 and RER D and C. The main objective of these new transport links is to improve services to the north west of Seine-Saint-Denis and facilitate access to the region’s educational institutions and business and employment hubs.

• RER E ″Rosa Parks″: opening planned for 13 December 2015 !
The new RER E station, ″Rosa Parks″ – a stone’s throw from Porte d’Aubervilliers and in the centre of the new Claude Bernard-Macdonald district – will welcome its first travellers in less than a year. It will link to Magenta-Gare du Nord in three minutes and Haussmann-Saint-Lazare in seven minutes, instead of the 30 minutes it takes at present. It will also connect to line T3b, which links the various portes (gateways) of Paris. 50,000 passengers are expected to use the station each day.

• Extension of metro line 1: public consultation in progress
Metro line 1, which crosses Paris east-west is used by one million passengers a day. Its eastern extension, from Château de Vincennes to Val de Fontenay, is currently the subject of a public consultation lasting until 10 January 2015. Three possible routes are currently being studied, although the northern route with a stop in Montreuil is the preferred choice of local authorities. This extension will not come into service until 2025-2030.

• Network modernisation: RATP to invest 1.65 billion euros in 2015
RATP will invest a record 1.65 billion euros (93 million euros more than in 2014) in the Greater Paris Region in 2015, to continue the extension, modernisation and maintenance of its network. Plans include:

- The start of work to extend line 4 to Bagneux and continuation of work on line 12 to Mairie d’Aubervilliers and line 14 to Mairie de Saint-Ouen.

- The start of initial work to extend tramway lines T1 and T3, to Val de Fontenay and Porte d’Asnières respectively.

- Acquisition of new trains to increase the transport capacity on RER A and metro lines 2, 5, 9 and the extension to 14.

- Modernisation and renovation of transport spaces and systems. Metro lines 5, 9, 13, 14 and RER A will benefit from investments in the transport system, to eventually ensure an improvement in supply. In this respect, the central section of RER A will be closed round-the-clock for automation work for four weeks each summer from 2015 for four years.

Finance Act -
real estate not forgotten

The vote on the amended Finance Act for 2014 and the 2015 Finance Bill did not forget real estate once again.

Two new taxes were created in the Greater Paris Region to finance transport investment expenses (art. 77 of the 2015 PLF):

1. The first applies to car parks, based on the same criteria as the Annual Tax on offices, retail premises and warehouses. The rates will be €4.22/sq m for the first sub-district, €2.42/sq m for the second sub-district and €1.22/sq m for the third sub-district.

2. An additional tax, on top of the land tax on built properties and the CFE (corporate real-estate contribution), has also been created. This will generate 80 million euros, to be distributed in the same proportion as revenues from the two taxes in the previous year.

The 2015 Finance Bill definitively enshrines the 0.70% rise in the TPF (real-estate publication tax) (art. 116 of the 2015 Finance Bill). Although General Councils' authorisation to increase the TPF was scheduled to end in 2016, the new Finance Act has removed this time limit. The normal rate remains 3.80%, although the amendment to the second paragraph of article 1594-D of the French General Tax Code now allows General Councils to increase the rate to 4.50% without a time limit.

The 2014 Amended Finance Act (art. 46) also imposes a **50% increase in the tax on retail outlets** with sales space larger than 2,500 sq m.

We should note a positive development, however, concerning the fee for the creation of office space in the Greater Paris Region. French legislators have revised some provisions of the 2011 reform in the 2014 Amended Finance Act.

1. Reconstruction projects are again exempt from the fee (art. 45 of the 2014 Amended Finance Act). While the 2011 law removed exemption from the fee for reconstruction works from 1 January 2014 (art. L520-8 of the French Urban Planning Code), the Amended Finance Act repeals this provision and completes the current article (in red): *"*Reconstruction operations on a building for which the building permit was issued before 1 January 2014 or for which the recovery notice stipulated in article L520-2 was issued from 1 December 2014, are only subject to the fee in respect of square metres of useful surface area exceeding the construction surface area of the building before reconstruction.*"*

2. The conditions for smoothing the rise in the office fee have been simplified, with a single allowance of a third (art. 27 of the 2014 Amended Finance Act);

3. The sliding scale for the fee for storage premises throughout the Greater Paris Region is now set at the rate for the third sub-district of €14.03/sq m (art. 27 of the 2014 Amended Finance Act).

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