In a context of economic recession, the take-up in the Ile-de-France office market decreased by 27% compared to the 1st half-year 2008. Less than 415,000 sqm of offices were transacted between April and June 2009.

Optimisation and cost cutting strategies fuelled the market, leading to a drop in net absorption and the multiplication of vacated premises. On June 30th, office availabilities amounted to 3.2 million sqm, which reflects a 6.4% vacancy rate.

The average annual rental value in IDF declined by 2.2% to stand at €308/sqm/year. The most marked adjustment was noticed in the Parisian CBD, where prime rent declined by 25% over the past 12 months (€606/sqm/year). Due to the scarcity of supply in la Défense, rents remained stable, to €550/sqm/year during the period.

Compared with the 1st quarter, the investment market showed small signs of recovery, notably in the prime segment. With €2.2 billion invested since the beginning of the year, of which €1.43 billion invested this quarter, the investment activity remains however far lower than in 2008.

In a context of extreme cautiousness, investors are showing some increasing interest for products with strong renting guarantees. The share of retail investments increased sharply, notably thanks to two large transactions.

Upward pressure on yields has reduced, notably for prime assets. In the Golden Triangle, offices offering the most secured rental income are currently sold at a yield ranging from 5.75% to 6.25%.

“The activity in both the tenant and investor markets remain very low compared to 2008. Some signs of recovery are however perceptible this quarter, notably in the prime segment.”

Hervé Blanchet - Director
Economy
A light improvement of the French economic indicators was noticed between April and June 2009. The growth bounced back by 0.3%, after a fold of 1.2% during the 1st quarter. The relatively maintained level of foreign demand slowed down the decline of exports. However, the deficit of the trade balance remains to a record level. Domestic consumption held positive and increased by 0.3% in three months. Indeed, the decline of consumer prices, the national Recovery Plan, and the increase of the French social minima compensated for the negative impact of the stagnation of wages and job losses on the purchasing power of households. The business confidence remains historically low, although it recovered since April. Industrial production is however in decline (7.0%), in particular in the automotive industry where the fall approaches 13.0%. The activity also contracted in trade services and in the construction sector. In this tense economic environment, productive investment fell back for the 2nd consecutive quarter (2.7%).

GDP and inflation
Source: Consensus Forecast

Letting market
The crisis caught up the economy of Ile-de-France in April 2009, forcing numerous companies to use their office charges as a control lever for cost cutting. In a context of rental values adjustment and of tight real estate budget, demand reached a new low level. The IDF companies favoured lease renegotiations to the detriment of office moves. Demand was essentially contracted in trade services and in the construction sector. In this tense economic environment, productive investment fell back for the 2nd consecutive quarter (2.7%).

professional activity from home.

Consequently, take-up in Ile-de-France deteriorated for the 3rd consecutive quarter and less than 415,000 sqm of offices were transacted between April and June 2009. Over the first six months of the year, the transaction volume added up to 860,000 sqm, representing a 27% drop compared to the 1st half-year 2008. The market was again backed by the real estate strategies of the large groups - Prisma Presse signed a lease of 23,800 sqm in Gennevilliers, GDF Suez let 22,800 sqm in Bois-Colombes and Total took 14,700 sqm in La Défense.

Twelve leases exceeding 5,000 sqm were signed during these last three months, a similar figure to that of the 1st quarter. However, the large transactions segment cumulated only 135,000 sqm, against 190,000 sqm during the prior three months, reflecting the decrease of the average size of letting deals. Having to face a strong slowing down activity, industrial companies were at the origin of 40.0% of the large leases, followed by the press / edition sector (14.6%) and by the banks and insurances (13.2%).

Still fuelled by buildings delivery, of which construction started before the reversal of the letting market, and also flooded by vacated redundant office space, the available stock reached the highest peak since the 1st quarter of 2004. Vacancies increased by 8% in three months and exceed henceforth the level of 3.2 million sqm. As a result of several deliveries in Paris and in 1st Inner Suburbs, the share of new and restructured offices approaches 30%. Bubbles of under-supply persist in the main business districts such as CBD, La Défense. However, with a vacancy rate for which the quarterly rise can exceed one percentage point, numerous markets run up against a profusion of supply.

The continuous declining market conditions and the cautiousness of credit institutions, developers and investors have led to numerous postponements or cancellations of projects. Since the beginning of the year, the future supply decreased by 12%. Total office developments (including those at project stage) in the pipeline until 2012 stand at 3.68 million sqm.

The decline of rental values became widespread to all sub-markets in Ile-de-France, with more marked falls in suburbs and for second hand products. In three months, the average rent went from €313/sqm/year to €308/sqm/year. Whereas owners agreed to lower headline rents, the amount of incentives granted stabilised. As for the previous quarter, rent free period represents approximately 1.5 months per fix year of the lease agreement.
CBD

After seven consecutive quarters of decline, the demand in the CBD slightly improved. About 60,200 sqm of offices were transacted this quarter, bringing the total transaction volume since the beginning of the year to 103,800 sqm. Compared with the 1st half-year 2008, this still represents a drop of 40%. The supply continued to rise, notably due to vacated spaces, but with a slower pace. Approximately 337,000 sqm were available at the end of June 2009, reflecting a quarterly increase of 3%. Henceforth the vacancy rate approximates 3.5%. Rental values declined by 3% in three months, from €625/sqm/year to €606/sqm/year for prime premises.

The investment volume was multiplied by four compared with the 1st quarter and reached €428 million. The shortage of prime assets available led to a downward pressure on yields. Best assets were so negotiated under 6%.

Paris (excluding CBD)

As a result of the overall weaker demand, take-up in Paris decreased by 11% during the 2nd quarter. Nevertheless, the letting performances since the beginning of the year, still exceed those recorded in 2008 during the same period, with 144,200 sqm transacted against only 138,000 sqm the year before. In three months, the vacant stock increased by 11% and reached 408,000 sqm at the end of June 2009. However, depending on sub-markets, the evolution of availability is much contradicting, ranging from -1% in Paris Centre West to +21% in the South River Bank of Paris where several large office buildings were delivered. Prime rents range between €230/sqm/year in Paris 18/19/20 and €470/sqm/year in Paris 14/15.

Invested amounts recorded a further fall this quarter and stood slightly below the €100 million level. Yields currently range from 6.5% to 7.0% for the best-located products.

La Défense

After a particularly dynamic 1st quarter, the letting activity marked a blow of stop, with a volume of letting transactions cumulating a mere 28,200 sqm in three months. Limited by the shortage of new large office spaces, only one deal exceeding 5,000 sqm was recorded over the past three months - the extension of Total on 14,700 sqm in the Newton. With 127,000 sqm available at the end of June, the La Défense market remains in a strong under-supply situation. The vacancy rate is 4%. Prime rents declined by 2% during the quarter to €550/sqm/year. This is mainly due to the absence of significant transactions in the prime segment.

Only one investment deal was recorded during the first half of the year - the acquisition of the Areva Tower by Elysées Pierre for an amount of €23 million. Prime yields are estimated at 6.50%.
**NE Western Crescent, Outer-Défense, Saint-Quentin en Yvelines**

**North End of the Western Crescent**
The North End of the Western Crescent concentrated 13% of the total IDF take-up during the 2nd quarter 2009. Two big tenants including Prisma Presse and GDF-Suez left the 17th district of Paris and Neuilly/Levallois sectors to consolidate their respective teams in Gennevilliers and Wood-doves. As a result, take-up since the beginning of the year nearly doubled compared to the same period last year and reached 66,000 sqm. Due to the delivery of several new products, the market remains however over-supplied. Some 228,000 sqm were available at the end of June 2009. Consequently, the vacancy rate reached a historical height of 15%. Prime rents were negotiated at €315/sqm/year.

A single investment transaction was listed in the market between April and June 2009 for an amount of €80 million. Prime office yields are estimated between 7.25% and 7.50% this quarter.

**Outer-Défense**
Being traditionally an area that attracts companies searching for large office accommodation at competitive rental values, the Outer-Défense sector suffered from the lack of new products during the first half of the year 2009. Take-up reduced from 131,000 sqm in 2008, to less that 62,000 sqm in 2009. For the 3rd consecutive quarter, the immediate supply increased to 228,000 sqm, from 145,000 sqm at the end of the 1st semester 2008. The vacancy rate increased by 50 basis points to 4.55%. Prime rents pursued their adjustment and stand henceforth at approximately €360/sqm/year.

This quarter, one single investment deal was recorded in the Outer-Defense sector for an amount of €23.1 million. Prime yields range between 6.30% and 6.50%.

**Saint-Quentin en Yvelines**
The office market in Saint-Quentin en Yvelines dropped by 75% in twelve months. New developments and built-to-suit projects, which revitalised the sector during the past years, considerably slowed down with the selling out of land in the city. Less than 15,000 sqm of offices were transacted during the 1st half of the year, against more than 60,000 sqm one year before. Available supply remained stable to 148,000 sqm, mainly consisting of second hand products, vacated for several months or even years. The vacancy rate currently approaches 11%. Rental values remained stable and stand at €185/sqm/year for the best products.

Since the beginning of the year, no investment transaction was recorded, partly due to the lack of product available on the market. At the end of June 2009, prime yields were estimated to range between 7.25% and 7.50%.
Investment and outlook

Investment

Less than €2.2 billion were invested in the French commercial property market during the 1st half-year 2009, which is a 70% drop compared to 2008. If investors’ interest for secondary products remains apathetic, but some signs of recovery noticed since April on the prime market suggest that the bottom of the cycle was reached at the end of the 1st quarter. First, the credit conditions are less strict. Banks keep a selective attitude but agree to finance large assets when rental income is strongly secured. Four investments exceeding €50 million were signed between April and June and the share of deals below €30 million decreased from 60% to 49% in three months. Besides, the number of products available for acquisition is slightly increasing. Most opportunities are supplied by investors (54%), and more particularly by SIIC (Property listed companies) that started debt pay down strategies. End-users are also increasingly positioning themselves as potential sellers. The cost cutting context and the reversal of the letting market prompt certain companies to dispose of part or all their property portfolio as the tenants’ status is currently more favourable than the owners’ one. Therefore, sales generated by the end-users increased by 6 percentage points during the quarter, to 19%. Finally, and in spite of still very long periods of negotiation, the price issue between buyers and sellers is slowly unfreezing. For a long time on hold, some negotiations that started during the 2nd part of 2008, were finally closed down this quarter - the acquisition of “31” in Lille by TMW Pramerica for an amount of €160 million. The combination of these factors led to a surge in the investment volume, which doubled in the course of the past three months from €751 million during the 1st quarter to €1.43 billion between April and June.

Still extremely cautious, investors strongly favour assets with the best letting guarantees and remained mainly interested in offices (56%). However, two large investments concerned retail units - the sales of the “31” shopping centre in Lille and the “Trois Quartiers” in the Paris CBD, bringing the share of retail investment up to 23% of the total turnover. Conversely, the invested amounts in industrial and logistics products reduced to €87 million. Investments in other commercial services added up €210 million.

The slow recovery noticed on the prime market benefitted essentially to the Parisian CBD. The investment volume in the area went from €104 million to €400 million in three months, supported not only by the acquisition of the “Trois Quartiers” but also by a revival of activity from the German Closed-Funds. Due to the shortage of products and the high amount of available assets, the investment market in La Défense was retrained to €23 million. Still attractive, the regional markets concentrated one third of the total invested volume. Domestic investors remain the main active players (43%) but the German funds made a noticed return on the market (26%), concluding four of the main Parisian deals and the most important acquisition in the French region. Debt-driven investors remain rare, limiting the activity of the UK and the US funds to 6% of the total investments. With the acquisition of the largest deal closed this 2nd quarter, Australian investors accounted for 15% of the total investments.

Upward pressure on yields is less tense notably on prime assets, whereas it is still strong on secondary products. In Paris, demand is on the rise while quality and secured products are rare, leading to a mechanical decline of the prime yield.

The best assets were sold on a 6% base (-25bp). Yields for industrial warehouses remained stable, between 8% and 8.75%. In the retail sector prime yields increased by 25 basis points, to 7.25% for shopping centres and 7.25% for retail parks.

Yields

Source: Savills Research

Outlook

At the end of 2009, the recession of the French economy could be as low as -2.8%, with consequent negative impacts on other key economic drivers. The companies based in Paris will concentrate their effort on the optimisation of real estate costs, still opting for consolidation and leases renegotiations. Overall, net absorption will remain negative and the annual take-up should approximate 1.6 million sqm. The available supply will reach a peak at the end of the year, as a result of vacated buildings, weak demand and a still significant rhythm of office deliveries, which will not stop before another few months. At the end of the year, the vacancy rate in Ile-de-France could be around 7.5%. With the accentuation of the imbalance between supply and demand, downward adjustment of rental values is set to continue.

Distressed sales could bring more opportunities to the investment market during the 2nd part of the year but €6 billion will probably be the maximum amount of investment at the end of 2009. The prime office yield could continue to move down a little but it will remain above the 10-year average, which is 5.3%.
Ile-de-France office market

Submarkets

For further information please contact:

Hervé Blanchet
PDG
+33 1 44 51 73 21
hblanchet@savills.fr

Pascal Rupert
Investment
+33 1 44 51 73 89
prupert@savills.fr

Magalie Mollet
Research Paris
+33 1 44 51 73 88
mmollet@savills.fr

Lydia Brissy
Research Europe
+44 20 7016 3776
lbrissy@savills.com

Savills is a leading global real estate service provider listed on the London Stock Exchange. The company established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 180 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East. A unique combination of sector knowledge and entrepreneurial flair give clients access to real estate expertise of the highest calibre. We are regarded as an innovative-thinking organisation backed up with excellent negotiating skills. Savills chooses to focus on a defined set of clients, therefore offering a premium service to organisations with whom we share a common goal. Savills takes a long-term view to real estate and works hard to invest in long-term and strategic relationships and is synonymous with a high quality service offering and a premium brand.

This bulletin is for general informative purposes only. Whilst every effort has been made to ensure its accuracy, Savills accepts no liability whatsoever for any direct or consequential loss arising from its use. The bulletin is strictly copyright and reproduction of the whole or part of it in any form is prohibited without written permission from Savills Research. (c) Savills Ltd August 2009