



RESULTS 2010 & OUTLOOK 2011

PARIS DIGEST

Commercial Real Estate markets in Ile-de-France

Knight Frank

HIGHLIGHTS

- ◆ Companies occupied nearly 2.2 million sq.m. of office space in Ile-de-France (greater Paris region) in 2010. Transaction activity rose by 16% over the previous year.
- ◆ One of the main features of 2010 was the start of a new cycle on the rental market, which started an upward phase that is likely to be long lasting.
- ◆ The rental market continued to be spurred primarily by the objective of streamlining real estate. However, there were also more companies responding to the growth in their real estate requirements. Net absorption climbed back to nearly 25% of transaction activity.
- ◆ Companies focused primarily on modern buildings, as obsolescence was clearly perceived as a handicap for the user.
- ◆ Stabilisation and a slight contraction were the main features of 2010 as far as supply was concerned. The vacancy rate amounted to 7% in Ile-de-France at the end of December.
- ◆ Office space offered to companies continued to be marked by obsolescent items; new or renovated structured accounted for only 22% of available supply.
- ◆ Upward pressure on rents was confirmed for prime buildings, especially in the Paris central business district and La Défense.
- ◆ The investment market grew at a fine pace in 2010. The increase in investment levels amounted to nearly 57% with nearly € 8.3 billion invested in the Paris region.
- ◆ Yields remained stable in the fourth quarter of 2010, although prime rates contracted by nearly 100 basis points over the year as a whole and are now between 4.75% and 5.00% in the Paris central business district.

THE LETTING MARKET: SEVERAL SWALLOWS CAN MAKE A SUMMER

Office take up: net absorption makes a comeback

2010 will be remembered as a watershed in the rental market. Transaction activity rose by 16%, compared to the 22% contraction in 2009. Overall, nearly 2.2 million sq.m. were transacted over 12 months in the Paris region, making 2010 the sixth highest in results terms since 1974, when statistics on the office rental market began. Such a result was rather flattering, to say the least, given the sluggish economy of the last three years.

The result was indicative of positive forecasts by companies with regard to the medium and long-term outlook. The boost in transactions was the main new factor to be seen in 2010 and was measured in net absorption, which returned to levels last seen in 2007. Our preliminary estimates for 2010 as a whole amounted to 515,000sq.m. in Ile-de-France, compared to 10,000 sq.m. in 2009. This growth in corporate office space requirements is admittedly the consequence of forward planning phenomena, although the improvement was appreciable. Net absorption accordingly accounted for 24% of office space transacted in 2010.

This new factor is what drove the acceleration of the rental market, combined with the belief demonstrated for nearly three years and increasingly widespread among users that it was time to officialise real estate decisions to avoid conditions likely to be less favourable in the future. The desire to seize opportunities arising on the rental market emerged as the main driving force of the rental market in 2008 and 2009.

It must be admitted that the margin for improvement is huge; 80% of all office space is falling irrevocably into technical obsolescence and has not had renovation or compliance work in the last ten years. However, users have often been in place for a long time and pay rents which – thanks to the indexing system – is quite comparable to, or even exceeds, rent for modern leases currently on offer. The anomaly was exacerbated by the drop in rent in 2009 until the start of last year, and explains why the streamlining objective remains the main driving force behind transactions for nearly three-quarters of all leases signed in 2010. This driving force, however, is no longer exclusive.

The combination of two driving urges – the desire to streamline and forward planning for growing requirements – is all the more appreciable given that it is widespread among large and not so large companies, as shown by the stability of the breakdown in rental activity by surface area. Transactions concerning more than 5,000 sq.m. accounted for 36% of surface areas transacted in 2010, compared to 37% in 2009. The same stability can be seen with users of medium surface areas (1,000 sq.m. to 5,000 sq.m.) at 39% of activity in 2010, compared to 38% in 2009. The recovery of the rental market is therefore based on a large number of users, not on the decisions made by a few very large groups.

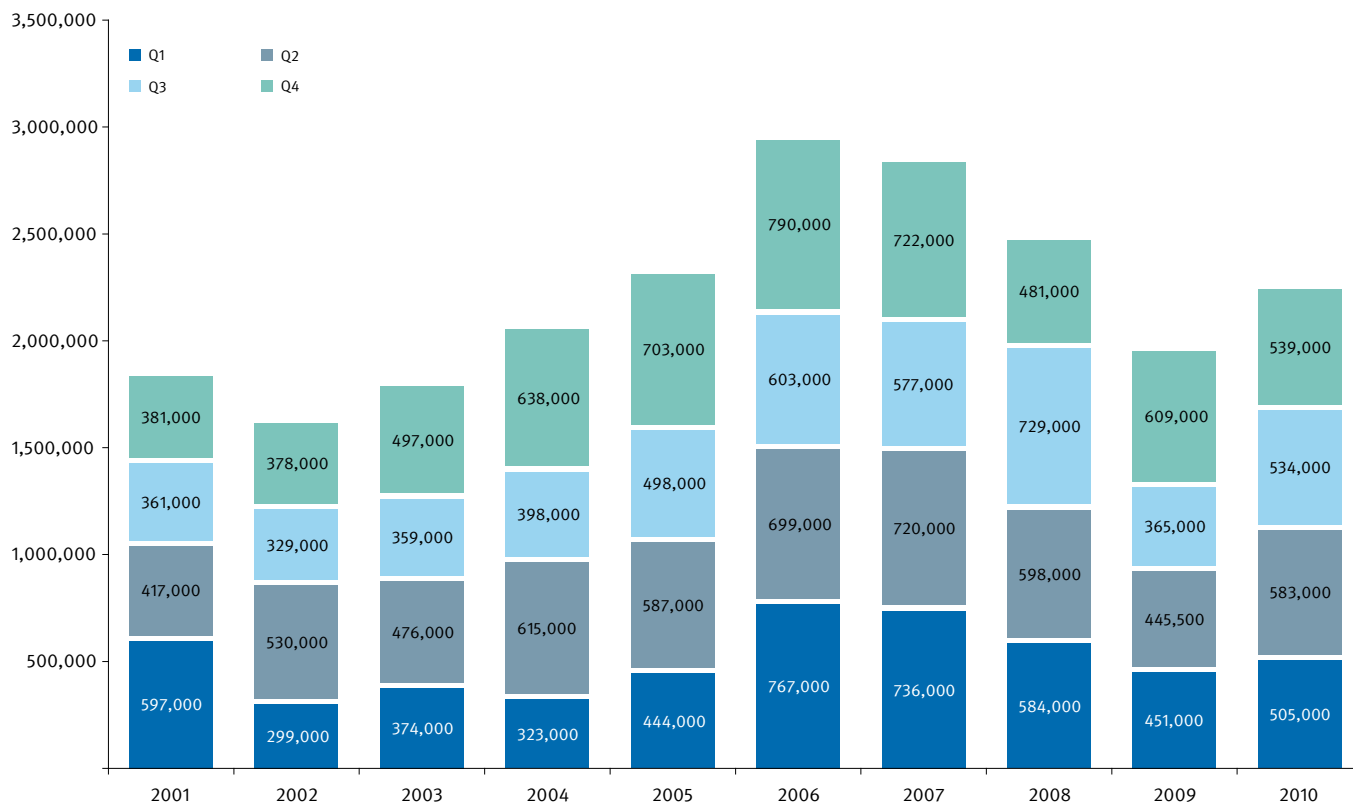
Examples of leasing transactions (Q4 2010)

Adress	Area	Tenant	Size (sq. m.)	Rent (€/sq. m./annum)
Green Office - Meudon la Forêt	Southern Inner Rim	Steria	21,000	235
Les Bureaux du Canal - Aubervilliers	Northern Inner Rim	Direccte (Ministère du Travail)	12,400	300
Adamas - Courbevoie	La Défense	Société Générale	9,400	460
Bayard Seine - Immeuble Seine	Paris CBD	Gide Loyrette Nouel	7,300	750
Jazz - Boulogne-Billancourt	Southern Bend	Michelin	7,300	430



Take up in Ile-de-France (sq. m.)

Sources: Knight Frank, Immostat



Office supply: when quality becomes a luxury

2010 will be remembered as a watershed in terms of supply as well. The rising spiral was checked in the first quarter. A ceiling appeared at above 7% vacancy rates before falling slightly in the third quarter of 2010. A slight contraction can therefore be seen emerging although vacancy rates are far lower in Ile-de-France than in most other European cities. Despite a stronger decline, the vacancy rate in central London, for example, amounts to 8.1%. Not all markets in the Paris region were in the same situation. Some emerging sectors posted vacancy rates in excess of 10% and even 13% or 15% in the inner suburbs, the northern loop and around La Défense. Sales in the major developments built in these areas to attract users were slower and sometimes chaotic, as shown by the French Justice ministry's shilly-shallying with regard to the Qualis tower in Bagnolet.

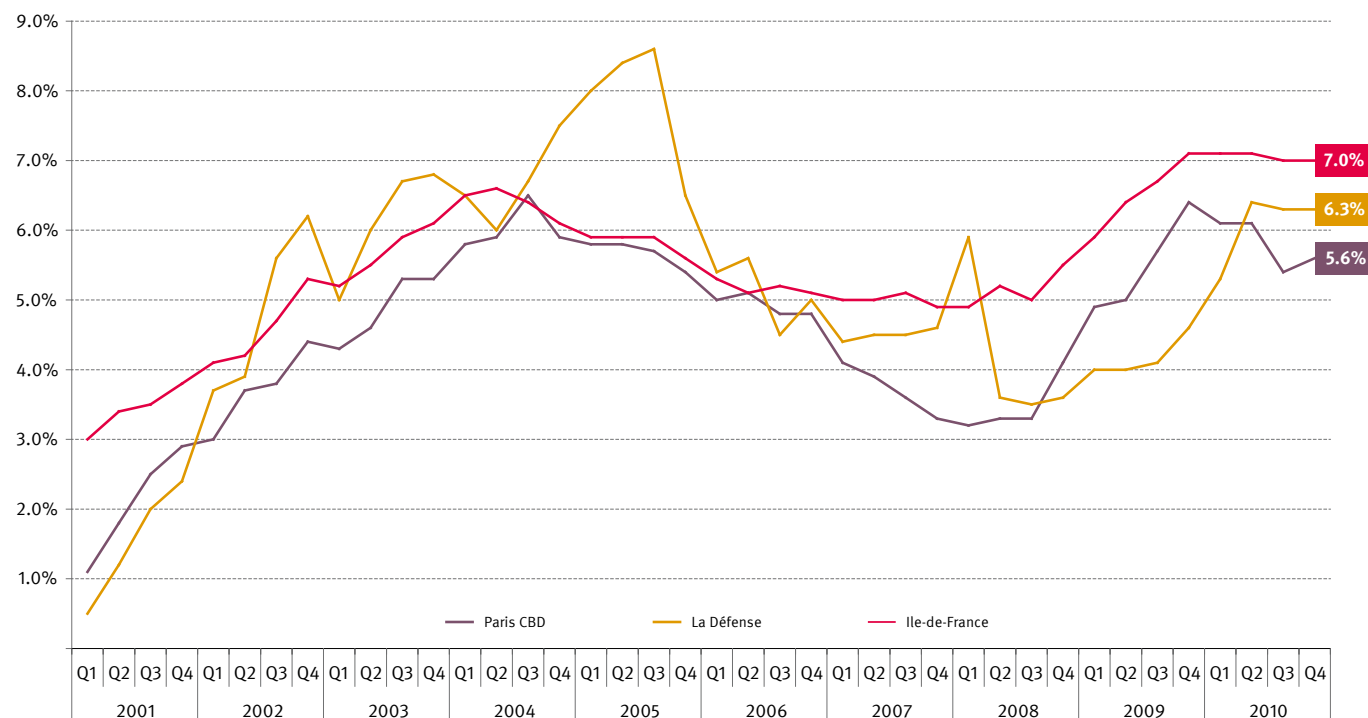
The fact remains that a trend towards stabilisation and even decline can be established in emerging sectors as well. The advantage clearly remains at the start of 2011 with more established markets, headed by the central business quarter and La Défense. Companies took advantage of lower rents from as far back as the start of 2010 to confirm their entrenchment in prime locations. Some have even gone back to them. One of the most noteworthy examples of this trend is AON. After an excursion to Colombes, AON announced its return to Paris in a building located in the seventh arrondissement. This means the contraction in supply is more evident on "historic" markets where the vacancy rate is the lowest. The Central Business District, for example, had a vacancy rate of 5.6% at the end of December 2010. La Défense posted 6.3%.

Just as users took advantage of positive trends to "indulge themselves" in geographic terms, they also focused on high-quality property. When combined with the drastic fall in new or restructured deliveries in 2010, this propensity led to new supply practically disappearing in some sectors.

There is now a blatant shortfall in the central business district, where only 17% of available office space at the end of 2010 was first-hand, new or similar. The situation can be seen throughout the Paris region, albeit to a lesser extent. New or restructured items accounted for 22% of available supply (compared to 25% in mid-2010).

Vacancy rate in Ile-de-France

Sources: Knight Frank, Orié



Office rents: the window is closing for users

Inertia in medium-scaled rent in the Paris region has emerged as one of the main features of the market, with 2010 offering no exception to the rule. At € 307 on average between January and December 2010, the average rent in Ile-de-France was very close to figures for the previous year (€ 313). The average rent amount therefore varied only very slightly and remained relatively decorrelated from the economic situation and the performance of the rental market. The extent of the fluctuation over ten years has contracted by more or less 10% around the median value at € 295.

Everything would indicate that users attempt arbitrage depending on the face rent (based on the quality of the surface areas or the location, for example), which acts as a stabilising factor. Rents for premium new or restructured property have varied to a much more marked degree as a result of the economic environment of the companies using them. 2010 accordingly hinted at an improvement in the balance sheet and outlook of many companies.

Companies' interest in central districts and more efficient products, combined with an increasingly tight supply, has had an effect.

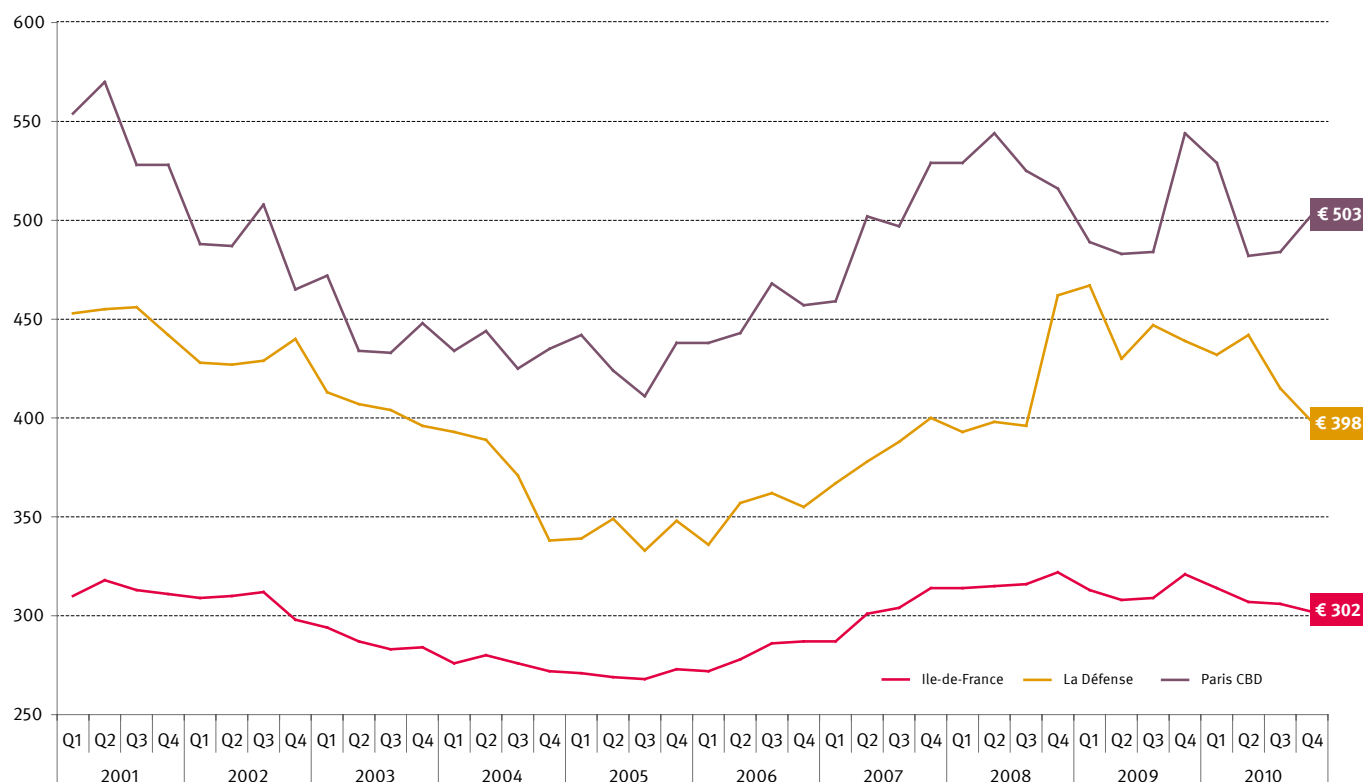


Rents for high-end products considered representative of the market rose to € 750, compared to € 710 at the start of 2010, with a margin for improvement still possible. It is also important to note that some transactions have taken place at even higher figures. Two examples are Origami, in avenue de Friedland (Paris 8th arrondissement), at face values of € 830, and the lease signed for 52 avenue Hoche (Paris 8th arrondissement) by the legal firm Allen & Overy.

Other established markets are taking the same route with a time lag of a few months compared to the central business district. One example is La Défense, where high-end rents returned to € 580. As we have stated for several months, the window of opportunity for users on the market for the regional as a whole is starting to close.

Average rents in Ile-de-France (in € net/sq. m./annum)

Sources: Knight Frank, Immostat



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OUTLOOK: SILENT STRENGTH

A new cycle on the rental market in Ile-de-France began in 2010. Everything points to the satisfying results booked last year being the first step in a period of transaction growth. Users' real estate streamlining requirements remain huge. This driver has been vital for several years and will remain dynamic for as long as the market offers companies opportunities to improve efficiency and cut global occupancy costs. This means it will lessen only if commercialisation rents surge at short notice. Even so, a further proof of the subsequent dynamism of rental business can be seen in another factor, which has made itself felt again in recent months: the growth in office space requirements. Net absorption was positive in 2010 with a volume of 515,000 sq.m. The economy of the greater Paris region stopped destroying service jobs at the start of 2010 and is now beginning a tentative phase of job creation. More significantly, there are increasing numbers of companies working in the belief that the horizon is clearing despite persistent and widespread uncertainty. They are planning for medium-term growth in their need for office space.

The combination of these two factors prompts us to plan ahead for an increase in transaction activity. Rising rents and increasingly rare new supply should not check streamlining as a driving force, at least not before the end of 2011. Net absorption should continue to rise at a gentle pace even if the improvement in the economic environment remains slow and faltering. Our cautious assumption for 2011 is therefore an increase in transaction activity at a rate in the region of +10%, i.e., a growth rate in the rental market lower than in 2010. 2011 should therefore see levels in the vicinity of 2.4 million sq.m. of office space transacted by companies in the greater Paris region. Available supply stopped trending upwards at the start of 2010 and is now beginning to fall given the recovery in transaction activities and fewer deliveries. These factors will amplify the phenomenon in the next few months. The vacancy rate for the Paris region as a whole fell just under the 7% level at the end of 2010 and should gradually sink to 6% some time in 2011. The lack of new and restructured supply may well become increasingly marked. Companies with leases looking for property solutions will therefore be forced to adopt a very early position ahead of real estate to be built. Pre-commercialisation transactions at over 24 months ahead of delivery have already been noted.

Users will therefore have to deal with very limited choices, which may discourage some from implementing even decisions that would be preferable for them.

Early signs of pressure forcing rents upwards took form in the central business district in the third quarter of 2010 as a consequence of the increasingly rare new or restructured supply, with high-end rents rising from € 710 to € 750. Although no change was noted in the fourth quarter, the upward trend should continue with the € 800 bar probably cleared in the near future. Such pressure has already been felt in the other major established market in the Paris region – La Défense – where high-end rents now amount to € 580. A premise can be felt in other sectors, especially where there are exceptional and landmark buildings. Rising face rents should be progressively more widespread depending on the varying pressure on supply for high-quality products. A sudden rise can probably be discounted before the end of 2011, however, as the economic situation is unfavourable and support measures granted by owners when signing leases ensured a margin for manoeuvre in advance. Accommodations currently range between 10% and 15% of the face value. A contraction in such should curb any upward pressure on rents. It should also be noted that high-end rents may appear to be something of an abstraction in some parts of the greater Paris region, as the lack of supply entails a lack of transactions and presentation values.

In contrast, upward price pressure has no reason to affect energy-deficient buildings or even second-hand products, which are facing persistently severe competition. Average rents should therefore continue to be stable. The greater Paris market will therefore see the gap between medium and high-end rents continue to widen.



INVESTMENT MARKET: REMISSION ISN'T A CURE (YET)

Volumes invested: a deep breath of fresh air

Investment activity in the service real estate market accelerated sharply in the Paris region in 2010. Nearly € 8.3 billion were invested in twelve months. A comparison with the EUR 5.3 billion recorded in 2009 highlights a 57% increase. The improvement is considerable and does confirm Paris's status as the Europe's Number 2 investment market after London. However, although the increase was higher than the European average (+45%), it was far from exceptional, as Central London posted a 70% increase over the same period, whilst Frankfurt (admittedly a far more restricted market) posted a rambunctious improvement exceeding 150%. The greater Paris market has gradually awoken, a trend confirmed throughout 2010. It could be seen in the fourth quarter of 2009 and continuously expanded throughout 2010, as Ile-de-France rose from a pace of € 900 million invested in the first quarter to nearly € 3.8 billion in the last three months of the year. The € 3.8 billion figure in the fourth quarter was 75% higher than the previous quarter. Such uninterrupted acceleration is indicative of a return to solidity by the Paris region market.

Solidity does not yet mean a cure, but rather a remission. The more obvious symptoms of the recession have disappeared, but we are compelled to note that the rise in investment levels last year were not enough to return to pre-2007 levels. There are still obstacles that are far from being raised and

will continue to hamper the medium-term outlook for an improvement in the market. Buyers are still obsessed with the notion of security, in particular to lock down their financing plans. The search for "zero risk" is one of the main features of the investment market, which is concentrated on a reduced asset segment, property with long leases signed by tenants deemed reliable. One figure alone can be used to measure the extent of this phenomenon: subsequent completion transactions for "blank" developments concerned less than EUR 260 million in 2010, i.e., barely 3% of investment levels in Ile-de-France. The dearth of new supply for the rental market seems here to stay...

The Paris market is still marred by a lack of retail surface areas, which can be transferred despite a reprieve in the fourth quarter of 2010. These products are generally considered among the best refuge assets available.

This means the market is concentrating on office assets, which accounted for over 76% of investment amounts in Ile-de-France.

Concentration on a smaller asset segment prompted an increase in the average unit value of transactions, firstly because the imbalance between supply and demand for secure assets encouraged a price hike, but also because a growing number of sales of large complexes took place at high unit amounts close to or exceeding € 100 million.

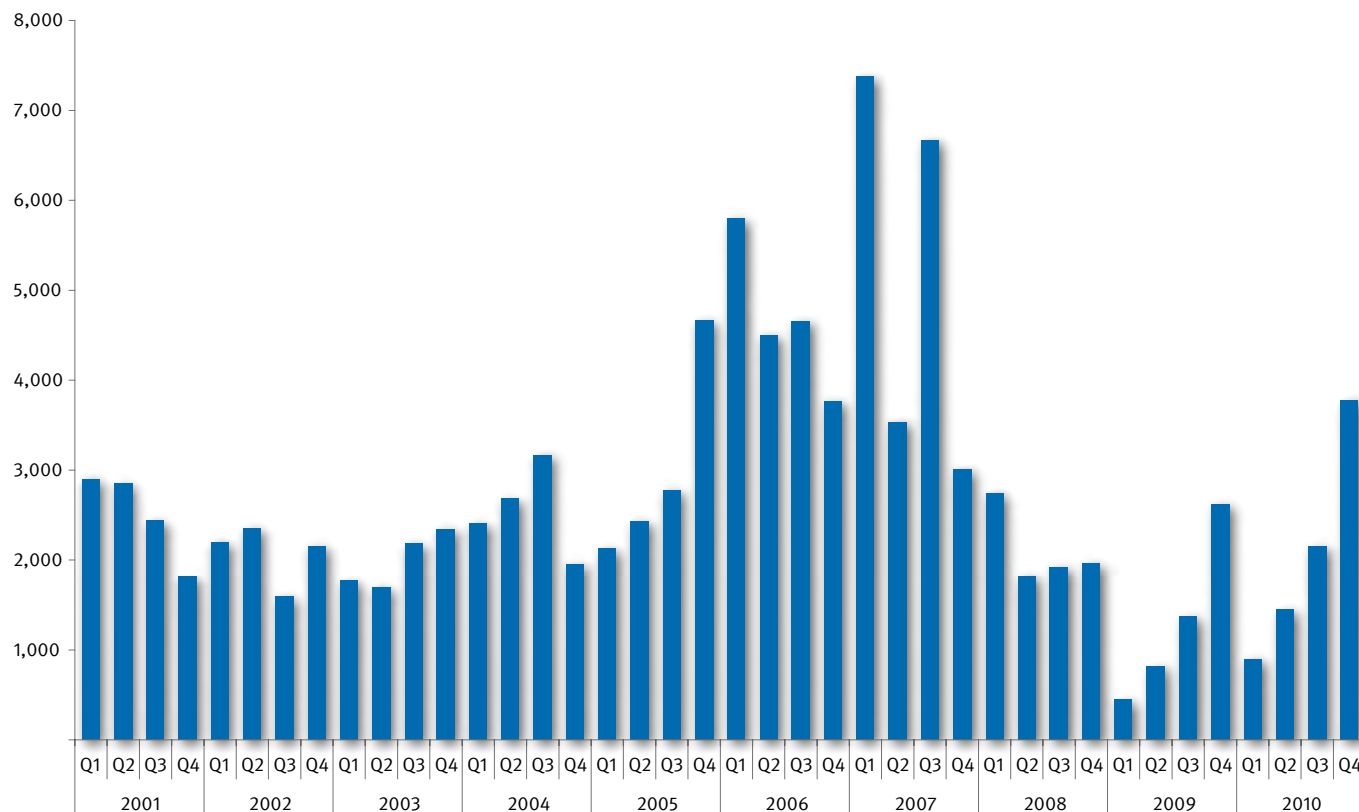
Examples of investment transactions (Q4 2010)

Asset	Area	Purchaser	Size (sq. m.)	Price (€ M)
Europe Avenue - Bois Colombes	Northern Bend	Generali (tête de file)	63,000	400.0
Orange Village - Arcueil	Southern Inner Rim	Gecina	44,700	247.0
31 rue Pierre 1 ^{er} de Serbie - Paris 16 th 88 rue de Rivoli - Paris 1 st	Paris CBD Paris 3/4/10/11	Allianz	12,800	184.0
36 rue Marbeuf - Paris 8 th 25 rue de Marignan - Paris 8 th	Paris CBD	Invesco	12,000	134.5
Urban Green - Joinville-le-Pont	Eastern Inner Rim	Wereldhave	16,700	67.0



Investment volumes in Ile-de-France (€ million)

Sources: Knight Frank, Immostat



This trend became clearly noticeable in the second quarter of 2010. For 2010 as a whole, over 69% of investment volumes focused on transactions with a unit amount exceeding € 50 million (of which 44% in transactions exceeding € 100 million). The change was significant; a year ago, the market was dominated by assets with a unit value below € 25 million. The return of large-scale transactions accounted for the market's sound results to a large degree.

Better liquidity with large properties also explains why the proportion accounted for by the Paris central business district in investment amounts fell sharply. This sector was even one of the few to drop in value.

As the sector is dominated by small or medium-sized properties, it attracted only 22% of the investments made in 2010, compared to 37% in 2009. This confirms the fact that less prestigious sectors and even areas on the periphery returned to favour for buyers. The intrinsic qualities of the property remain predominant – to the detriment of having a good address. The inner and outer suburbs accordingly attracted nearly € 2.8 billion, i.e., 34% of investment amounts in 2010, compared to 19% in 2009

Prices and yields: individualising value

Re-pricing service assets ended in Ile-de-France in the fourth quarter of 2009 when the first drop in "prime" rates occurred after two years of recovery. This was the first of many signals, with conditions for a genuine countertrend falling into place throughout 2010. The contraction began slowly, but was confirmed and grew in the summer.

Prime rates of return for office assets, i.e., assets which might be acquired at the highest prices, now fall in the 4.75% to 5.00% range in the Paris central business district. The symbolic threshold of 5.00% has been breached, primarily by private investors (the institutional market remains above the 5.00% mark). With some trophy buildings offering a high reversion potential, initial yields can be even lower. Overall, the drop was in the region of 100 basis points for 2010.

The CBD returned to mid-2008 levels before the panic that followed the bankruptcy of a major US investment bank.

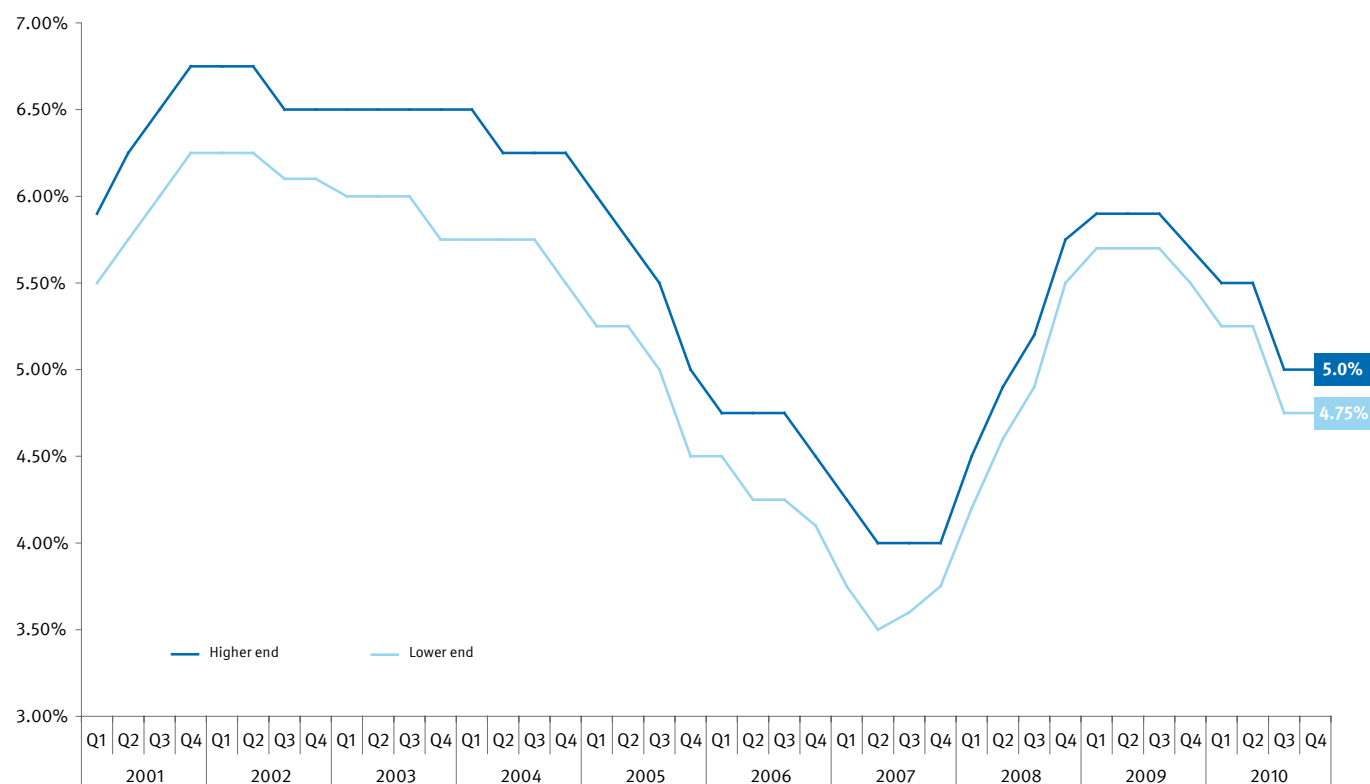
The trend on other Paris markets is the same, although at times academic given the scarcity of references in property transactions.

Scarcity arose from the low number of core assets offered for sale and has prompted another major change in the investment market in 2010: questioning of the notion of "flagship markets" with the importance of the address knocked off its pedestal in favour of the building's intrinsic qualities and tenant. Investors give preference above all to the technical performance of the asset, the solidity of the tenant and the terms of the lease commitments. Location is now only one among other criteria. This means that the gap between prime and other rates on various markets is starting to narrow.

Accordingly, the strongest contraction in rates can be seen in specific emerging sectors in Paris and the periphery, in particular for those facing the boulevard périphérique with a drop in the region of 125 basis points in the past year.

Prime yields band in Paris CBD

Source: Knight Frank



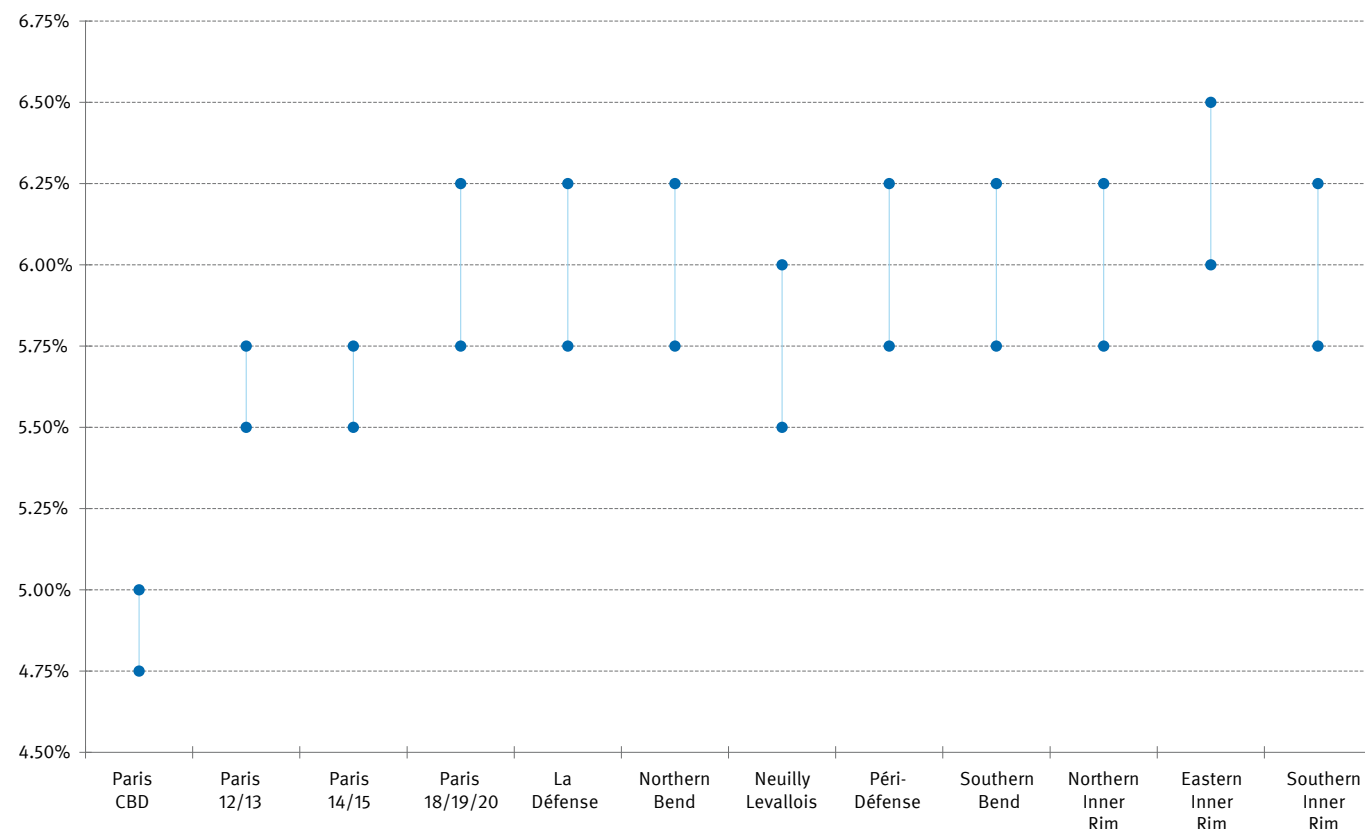


Inversely, the gap is widening between core assets and others within each market. Whilst competition remains strong for the best properties, it is now much harder to find a taker for those with handicaps. One increasingly considered way out of these constraints is to sell to the user.

The phenomenon is estimated at between 8% and 10% of invested demand, but has not yet been translated into figures, although it could become increasingly important, especially if the investment market cannot significantly reinvigorate "blank" sales in a future state of completion (VEFA).

Prime yields in Ile-de-France

Source: Knight Frank



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OUTLOOK: A MARKET STILL WITHOUT DIRECTION

A recovery in investment activity beyond core assets, especially in blank developments, will be one of the key factors in ensuring that the recovery that began in 2010 is not a flash in the pan because, although the next few months appear promising, the medium term remains uncertain. At present – and in contrast with the rental market – we are unable to assert that Ile-de-France has begun a new phase of growth.

There are many factors prompting a belief that financing conditions could remain Malthusian. There are persistent economic uncertainties and fears of a sovereign defaulting and banks breaking, which prevent a return to the peace of mind that favours risk-taking in investment terms. In addition, the Basel III agreements^[1], although less extensive than planned, will encourage prudential measures and limit banks' exposure to risks. Banks will therefore tend to continue giving priority to core assets and investors providing solid equity guarantees. It would be hazardous to plan ahead for a further loosening of the "loan to value" (LTV) ratio beyond current margins (between 50% and 70% for the more secure acquisitions). Looser credit conditions in 2010 do not provide an assurance that the trend will continue. Further, the policy pursued by the European Central Bank (ECB) remains uncertain. Most analysts are counting on a major hike in the cost of accessing financing, especially from the second half of 2011 onwards. In this light, the failure by Bundesbank chairman Axel Weber to secure his appointment as Jean-Claude Trichet's successor at the head of the ECB may well reshuffle all the cards. Axel Weber is considered an inflation "hawk" and a vocal opponent of the program for the ECB to buy back sovereign debts.

Although a long-term favourite, his profile seems to have built up too much hostility outside Germany to secure the appointment. The ECB policy in leading rates may therefore be more moderate than planned, which will limit the rise in long rates that has been observed for several weeks and is threatening the investment market. However, this is still pure conjecture...

The risk of a gradual drying up of the investment market therefore exists. Other hypotheses may, however, counterbalance it. Many investors, for example, will face major repayment maturities in 2011 and 2012 for acquisitions made up till 2007. Some of them will have to deal with a drop in the market value of their assets to below the debt amount in some cases. Credit institutions will attempt to prevent their clients defaulting by providing further financing. It is also possible, however, that this wall of debt leads to more extensive asset sales than planned, which will ensure a further investment volume.

Furthermore, it is not inconceivable that budget streamlining programs and current prudential reforms achieve their key objectives: to reassure markets and ensure short-term visibility. In this case, the resilience of the French rental market will ultimately justify taking slightly more risks in real estate investment decisions. This notion of acceptable risk will determine the recovery of blank construction or restructuring developments and therefore a new cycle in the investment market. Even so, we will continue to project an investment level in 2011 close to 2010 levels until these hypotheses are substantiated, i.e., around € 8 billion in Ile-de-France.

One obvious fact is clear in an environment dominated by uncertainty: core assets' will to steal the limelight for potential buyers. This type of market configuration should result in increasingly determined competition for the best secure assets and should further help prime rates of return to compress in the region of 50 basis points. Inversely, yields from less easily financed assets, starting with specific "distressed" ones, could rise. These trends should remain minor, but they will further two other trends that began in the last two months: a less marked difference in location between core assets and, inversely, a wider spread in yields between sound and less attractive property in the same market.

[1] The Basel III banking reforms stipulate an increase in "solid" equity (reserved shares and profits) at 7% of a bank's market or credit activities. Implementation will be gradual, starting with an increase in the Core Tier 1 solvency ratio from 2.0% to 4.5%, followed by a further 2.5% increase by 2019.



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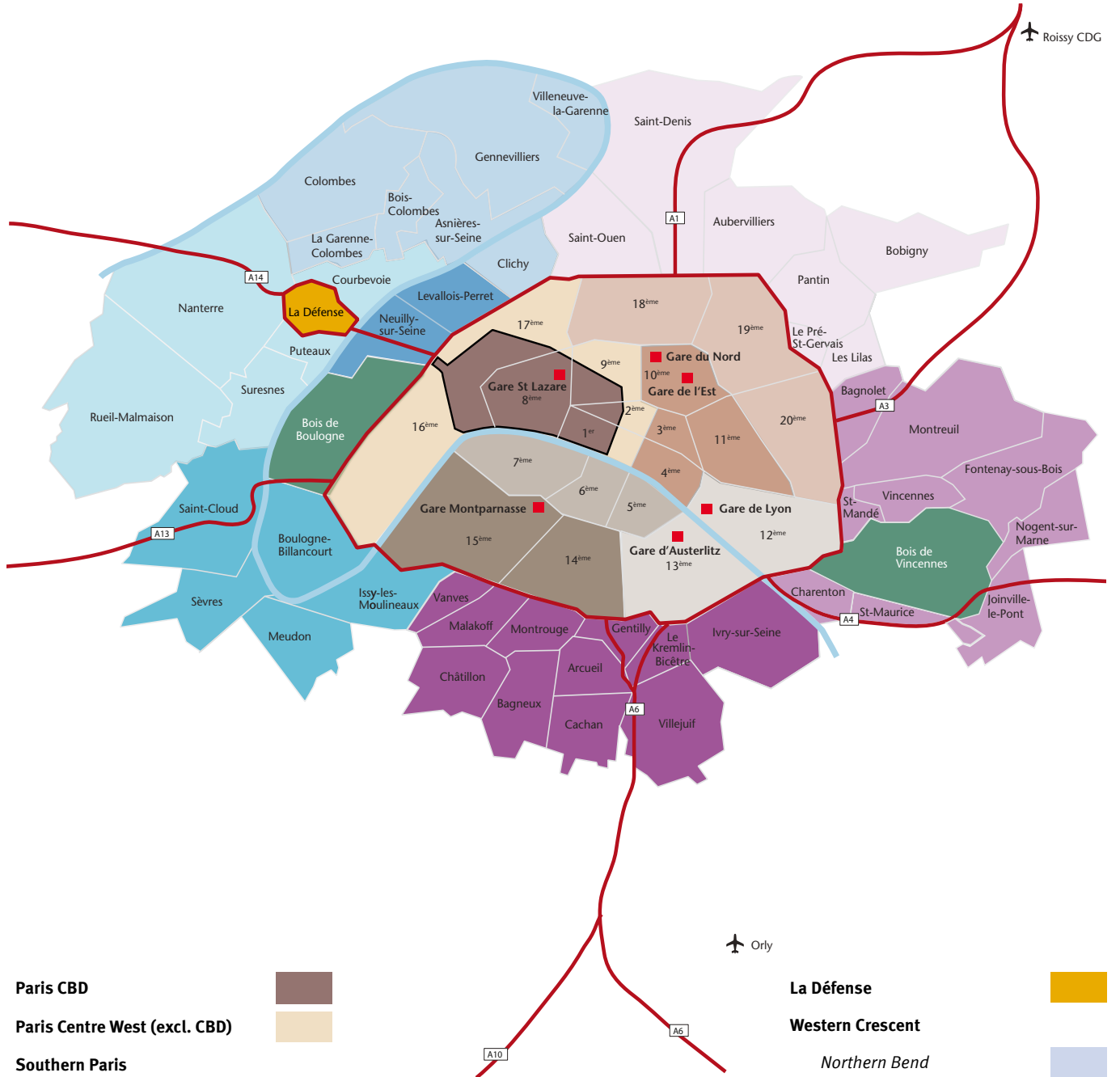
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Market breakdown as at Q4 2010

Area	Prime rents (€/sq m/annum)	Average rents (€/sq m/annum)	Take up in 2010 (sq m)	Estimated stock (sq m)	Vacancy rate	Prime yields band
Paris CBD	750	503	423,600	6,693,000	5.6%	4.75% - 5.00%
Paris Centre West (exc. CBD)	440	380	77,100	1,814,000	6.1%	-
Southern Paris	-	378	283,700	5,034,000	5.8%	-
Paris 5/6/7	650	411	36,900	1,234,000	4.0%	5.25% - 5.50%
Paris 12/13	450	380	113,700	1,900,000	5.8%	5.50% - 5.75%
Paris 14/15	500	365	133,100	1,900,000	6.9%	5.50% - 5.75%
North Eastern Paris	-	280	137,300	2,788,000	3.6%	-
Paris 3/4/10/11	350	310	53,900	1,617,000	4.5%	5.50% - 6.00%
Paris 18/19/20	320	233	83,400	1,171,000	2.5%	5.75% - 6.25%
Total Paris	-	-	921,700	16,329,000	5.4%	-
La Défense	580	398	154,200	3,077,000	6.3%	5.75% - 6.25%
Western Crescent	-	280	407,200	7,568,000	10.9%	-
Northern Bend	350	192	45,100	1,716,000	13.6%	5.75% - 6.25%
Neuilly Levallois	500	339	85,100	1,381,000	6.7%	5.50% - 6.00%
Péri Défense	420	244	119,800	2,060,000	14.8%	5.75% - 6.25%
Southern Bend	500	306	157,200	2,412,000	8.2%	5.75% - 6.25%
Inner Rim	-	221	313,100	5,546,000	8.8%	-
Northern Inner Rim	350	218	139,800	2,206,000	8.9%	5.75% - 6.25%
Eastern Inner Rim	320	188	40,000	1,217,000	10.2%	6.00% - 6.50%
Southern Inner Rim	350	242	133,300	2,124,000	7.9%	5.75% - 6.25%
Outer Rim	-	136	364,300	18,655,000	6.5%	-
Ile-de-France	-	302	2,160,500	51,175,000	7.00%	-

Sources: Knight Frank/Orie/Immostat



- Paris CBD**
- Paris Centre West (excl. CBD)**
- Southern Paris**
 - Paris 5/6/7*
 - Paris 12/13*
 - Paris 14/15*
- North Eastern Paris**
 - Paris 3/4/10/11*
 - Paris 18/19/20*

- La Défense**
- Western Crescent**
 - Northern Bend*
 - Neuilly/Levallois*
 - Péri-Défense*
 - Southern Bend*
- Inner Rim**
 - Northern Inner Rim*
 - Eastern Inner Rim*
 - Southern Inner Rim*



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