

European Commercial - Q4 2024

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SPOTLIGHT
Savills Research

European Office Value Analysis



● Inflation ● Yields ● Outlook

European growth to remain sluggish

Four further ECB rate cuts expected for 2025.

Economic overview

The eurozone economy returned zero growth during the final quarter of 2024, although this understates the underlying momentum of the European economy, given that volatile Irish figures, and a post-Olympic Games blip in France pulled the aggregate figure down. The headline eurozone figure also masks wide differences between countries. Spain and Portugal continue to outperform and will lead growth again this year, but Germany, France and Italy all had either flat growth or contractions during Q4 2024 as employer hiring sentiment remains weak. The Eurozone economy is expected to grow by 0.9% in 2025 and 1.1% in 2026, and outside the bloc, CEE economies are expected to record the fastest economic growth.

Eurozone inflation eased back in February from 2.5% to 2.4%, as core inflation dropped to 2.6%, remaining above expectations. The stagflationary nature will put the European Central Bank in a dilemma, but growth concerns will ultimately prevail, and the policy rate is expected to be cut to 1.75% by end 2025. Bond yields remain relatively

volatile, rising following US inflation data.

Oxford Economics has cut its UK GDP growth forecast for 2025 by 0.3 ppts to 1.1%, following recent weak business survey data. Despite UK inflation being expected to average 3% this year, around 75 bps of further interest rate cuts from the Bank of England are expected, reducing rates to 3.75% by end 2025.

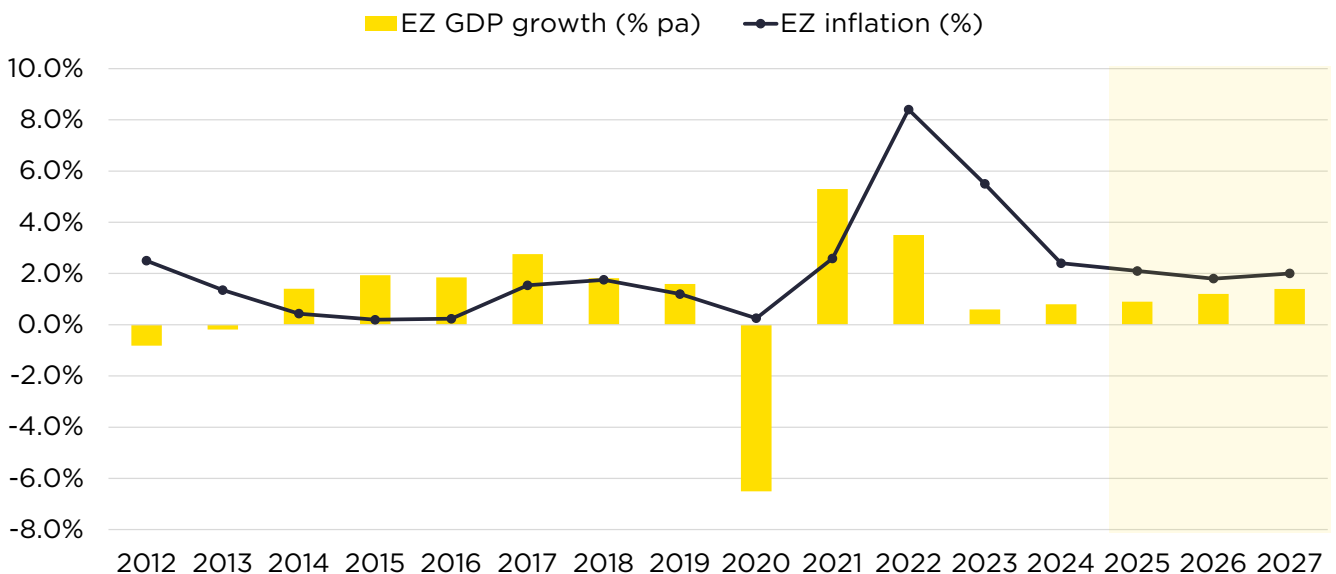
Savills data indicates that 2024 European office investment volumes reached approximately €41 billion, an 18% increase YoY. The annual increase was observed across several markets, particularly Norway, Sweden, Italy and Spain, albeit from a historically low base.

European office take up reached 7.6m sq m during 2024, an 8.4% YoY increase, outperforming expectations. Southern Europe, London and CEE markets delivered the strongest growth against five year averages- Prague, Lisbon and London City all performed in excess of 20% against this metric. On the other hand, an upcoming federal election and a weaker economic

environment in Germany hampered leasing activity across the top 6 cities. Over the course of 2025, we expect European office take up to rise by 1% YoY.

Average office vacancy rates fell by 10 bps QoQ to 8.3% in Q4 2024 as tenants are now beginning to withdraw 'grey' space from the market, with a view to reutilising the space. Much of the vacant stock is generally of a lower quality, with Grade A vacancy rates estimated to be below 2% in several markets. Development costs remain too high for investors to start undertaking speculative schemes, which will sustain upwards pressure on prime rents in good locations. Indeed, average prime European office rents rose by 4.8% YoY in 2024 and we anticipate average European office rental growth of 2.7% in 2025.

Chart 1: Eurozone inflation and GDP growth



Prime yields turn a corner

Average prime European office yields moved in by 3bps to 4.92% during Q4 2024.

Methodology

Savills European Office Value Analysis compares the fundamental (calculated) yield relative to current market pricing across 20 European markets, covering London-City, Stockholm, Manchester, Lisbon, Oslo, Berlin, Paris CBD, Dublin, Amsterdam, La-Défense, Prague, Hamburg, Madrid, Barcelona, Munich, Brussels, Warsaw, Frankfurt, Milan and Bucharest.

An investor must be compensated for bearing the risk of investing in real estate over sovereign bonds- the risk premium. The calculated yield is derived as the current risk-free rate plus 2017-21 average office risk premium, discounting for nominal rental growth (source: IPF, Savills), inflation (source: Oxford Economics) and depreciation across each market. The fundamental yield represents a hypothetical yield, assuming a fully liquid market and the investor is fully hedged against currency risk.

Given the inverse relationship between yields and capital value, we use the following

definitions for fair pricing:

- Market capital value >10% above fundamental capital value, we consider over-priced
- Market capital value within 10% of fundamental capital value, we consider fairly priced
- Market capital value >10% below fundamental capital value, we consider underpriced

most attractively priced on this metric, given rental growth prospects and pricing relative to historic levels.

What's happened to pricing?

Average prime European office yields moved in by 3bps to 4.92% during Q4 2024. The only inward movements were Oslo (-15 bps) to 4.50% and Stockholm (-10 bps) to 3.90% following strong domestic Nordic buyer demand, along with Bucharest moving (-30 bps) to 7.10%, as all other markets remained stable.

From a fair value perspective, average prime European office yields remain in fairly-priced territory, with a -7% capital value adjustment required, largely reflective of risk-free rates increasing during Q4 2024. Madrid, Amsterdam and Barcelona appear

Chart 2: Average European market yield and calculated yield

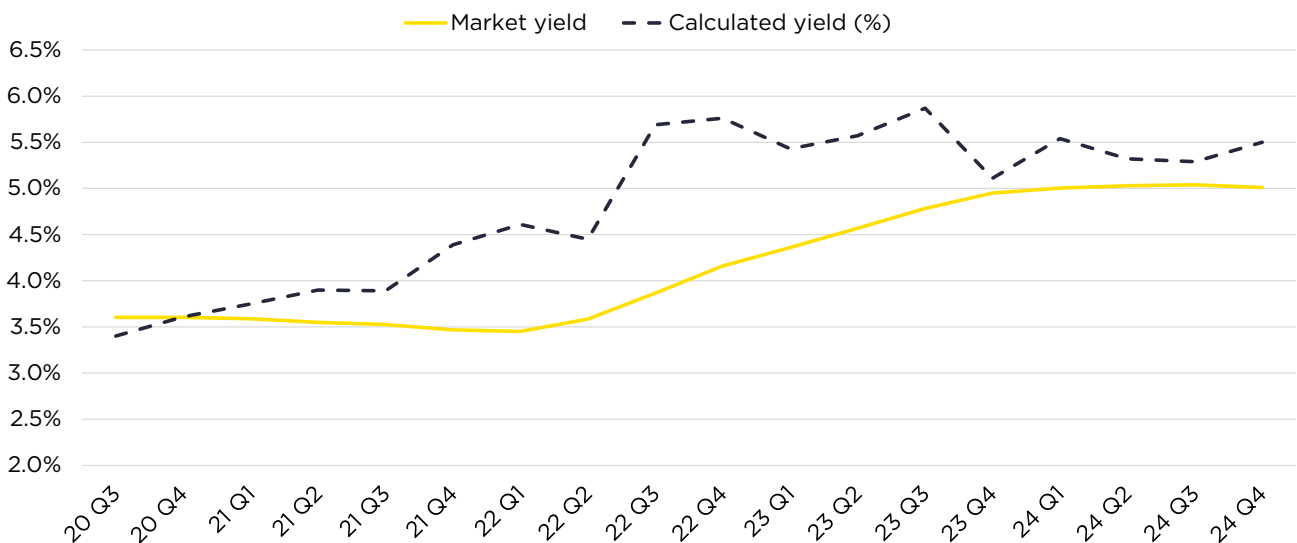
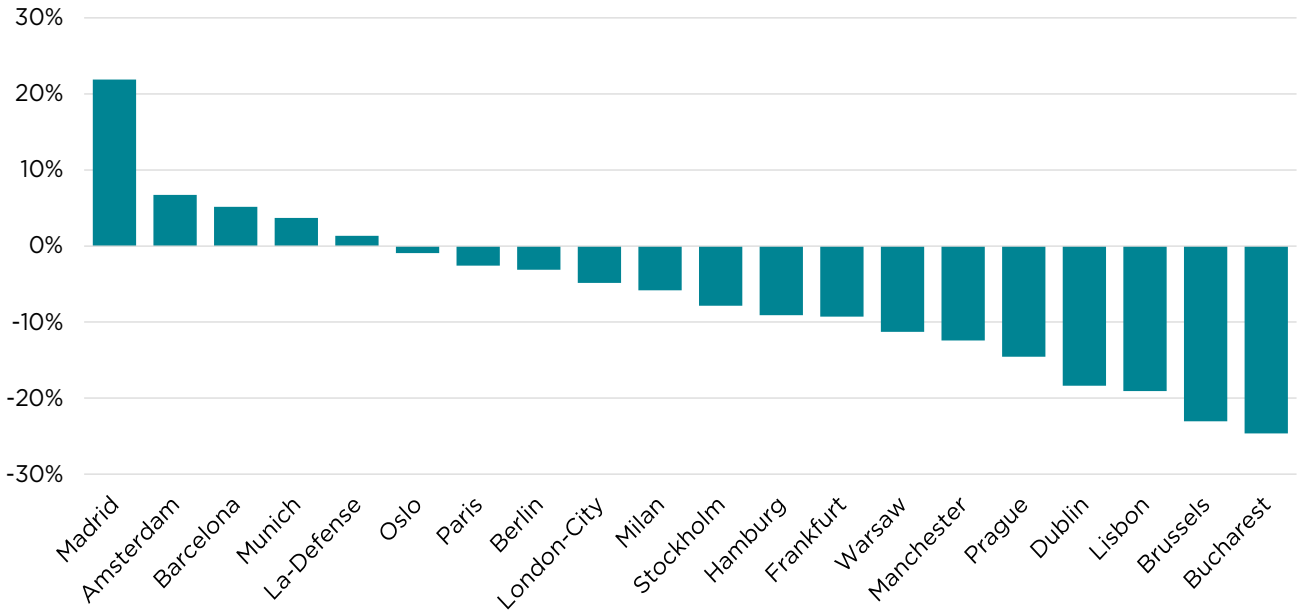
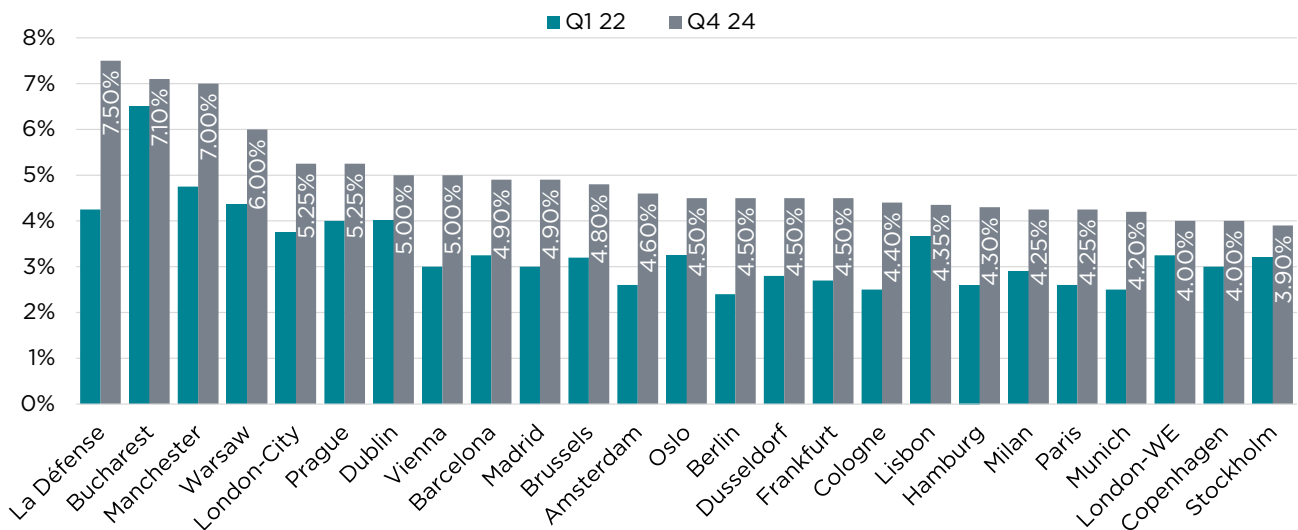


Chart 3: Capital value adjustment required for fair value pricing



Source Savills

Chart 4: European prime office yields



Source Savills

Outlook

Investors navigate geopolitical challenges as yields begin to compress in selected markets.

Bond markets have begun to stabilise following a volatile first few weeks of 2025. Investors are adopting a wait-and-see approach as they calculate the impact of US protectionist measures on inflation, the speed of interest rate cuts and European real estate returns.

Higher US interest rates have strengthened the US dollar, which should support US investor demand to Europe throughout the course of the year. Much of this demand is currently concentrated on the Central London market, although we expect this to filter through to continental Europe throughout the rest of the year.

Of course, higher interest rates have hit global real estate fundraising, which fell by 26% YoY in 2024, whilst European open-ended fund redemptions remain in the red. Fundraising for the office sector remains difficult given investor concerns around remote working. However, Trump's push for higher office attendance from government departments and agencies follows an increase in the number of return-to-work mandates from private sector companies, and we anticipate a further increase in occupancy rates for US headquartered companies located in Europe throughout 2025. On the whole though, we feel the European office physical occupancy rate trend has generally stabilised at the 60% mark.

A further change has been the US pulling out of the Paris Climate Agreement, which raises the question of how investors' attitudes to ESG could change over the next five years. What is clear is that European occupiers are increasingly looking for better quality office space to attract/retain employees, and reduce carbon emissions, amid a dormant speculative development market, so we believe prime rental growth prospects remain strong.

Although office fundamentals remain attractive...

On a more positive note, Savills latest investor sentiment survey shows improved investor confidence in the office sector, as investors are increasingly willing to deploy a) beyond the beds and sheds sector and b) into traditionally non-core geographies. Following falling real estate values and rising equity prices since 2022, many multi-asset investors are now underallocated to real estate which we expect will support increased bidding activity through the year.

Occupier demand also remains strong, with an average 8% YoY increase for European office take up. Many occupiers have found that they no longer have enough desk space, supporting an upsizing trend. Occupiers are after good quality space but are not necessarily willing to pay headline rents, and as a result, are now beginning to look 3-4 years ahead of their lease events given the shortage of good quality stock. Indeed, average European prime rents grew by 4.8% during 2024, well ahead of forecasts, which is presenting asset managers to bring good quality stock back to the market.

What does this mean for pricing?

The lack of liquidity in the market is largely down to the shortage of distressed sellers. Banks are well-positioned with capital reserves and they have lent at lower LTVs, so are less exposed to losses. What's more, positive, albeit, underwhelming, economic growth has meant that business insolvencies are lower than post-GFC and tenants have continued to pay rent on time. As such, the number of forced sellers is low, which has maintained a bid-ask spread on pricing.

Lenders are also more open to new opportunities than 6-12 months ago, as debt margins begin to contract, which is supporting a recovery in the number

of buyers. Upon refinancing, banks are particularly selective on the quality of stock, as they seek to reduce their exposure to non-EPC compliant office stock. As banks see more transactional evidence through the course of the year, we expect them to apply more pressure on landlords who have extended debt terms upon upcoming refinancings.

From a global perspective, Europe is forced to compete against the buoyant level of private investment in the US markets and the organic economic growth in the APAC markets. Europe faces a number of structural challenges including ageing demographics, government uncertainty and sluggish productivity growth. Intra-European investment will remain more dominant during H1 2025 as APAC buyers remain sensitive to European inflation and growth prospects.

European offices, however, offer accretive returns amid repricing, against a backdrop of low vacancy rates and rental growth outperforming expectations. With an expected further 100 bps of interest rate cuts to go from the ECB in 2025 at the time of writing, we believe this will kickstart buyer activity for larger lot sizes during the second half of the year, and apply gradual downward pressure on yields in selected markets.



Savills Commercial Research

We provide bespoke services for landowners, developers, occupiers and investors across the lifecycle of residential, commercial or mixed-use projects. We add value by providing our clients with research-backed advice and consultancy through our market-leading global research team.

Research

Mike Barnes

European Offices

+44 (0) 207 075 2864

mike.barnes@savills.com

Investment

James Burke

Global Cross Border Investment

+44 (0) 207 409 8874

jburke@savills.com