

European Commercial - Q1 2025

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SPOTLIGHT
Savills Research

European Office Value Analysis



● Inflation ● Yields ● Outlook

Tariffs dampen growth outlook

Economic overview

Headline inflation across the euro area continues to trend downwards, currently at 2.2%, as services inflation fell to 3.4% in March and wage growth begins to normalise. Eurozone interest rates currently stand at 2.50% and Oxford Economics anticipates that this will fall to 2.00% by June.

US trade policy changes have shaken global equity markets as European stock markets have observed the highest volatility levels since during the pandemic. Tariffs are likely to hit EU export markets, particularly the automotive, aerospace and defence sectors, as consumers and businesses are forced to pay higher prices. Sentix's European investor confidence index has fallen to its lowest level since November 2022.

Focus has now shifted to how global superpowers are responding. On 9th April, Trump announced a 90 day pause for nations hit by reciprocal tariffs, whilst raising the tariff on Chinese goods to 125%. The EU is expected to try to negotiate on

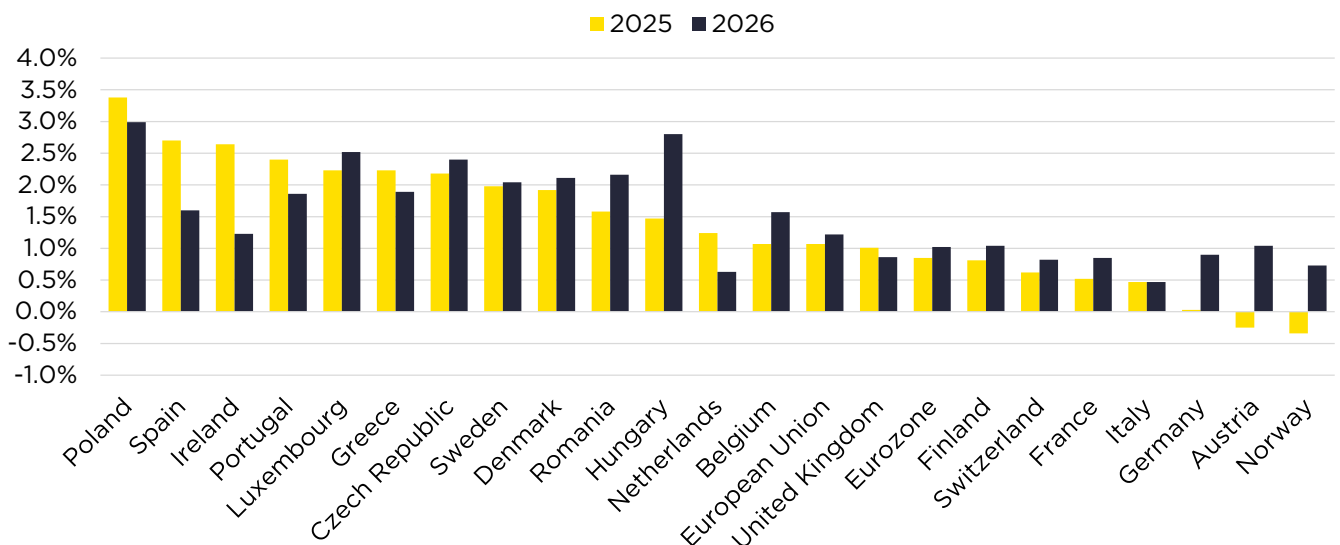
its terms, and if unsuccessful, implement its own tariffs on US goods. Goods remain subject to a minimum 10% tariff (except for China), which has caused disruption to supply chains, although we expect that the services-dependent office sector will be more sheltered to the impact of new trade barriers.

Clearly, trade disruption provides an additional inflationary threat to Europe. US tariffs are expected to impact both the US and European economic growth outlook, with Eurozone GDP growth forecasts downgraded to 0.8% in 2025 and 1.0% in 2026.

Elsewhere, Germany announced a reform of its constitutional debt brake and enacted a large fiscal stimulus. Early surveys have shown an improvement in business sentiment, although the boost to growth is not expected to be realised until 2026/27, given it will take time to allocate spending on defence and infrastructure, according to Oxford Economics.

Total European investment activity is showing signs of resilience, with preliminary data indicating that Q1 2025 volumes surpassed €50 billion—a 28% year-on-year increase. While this signalled a recovery, investment levels remained 45% below the five-year average. Savills expects full year 2025 investment volumes to reach €216 billion, representing a 13% annual increase—down from the 23% previously anticipated.

Chart 1: European GDP growth forecasts (%)



Prime yields begin to compress

London West End compressed by 25 bps during Q1 2025.

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

What's happened to pricing?

On a quarterly basis, average European prime office yields have moved in by an average of 3 basis points to 4.89%. The inward movement was driven by London West End (-25 bps to 3.75%), Vienna (-15 bps to 4.85%) and Brussels (-5 bps to 4.75%). London West End is now the most keenly priced office market in Europe, given a number of private cross-border investors who have bid down yields given strong rental growth prospects and increasing liquidity.

Madrid and Paris CBD remain the most attractively priced European office markets,

given positive real rental growth prospects, and a reduction in risk-free rates, increasing prime offices' appeal.

The Investment Property Forum (IPF) also upgraded Brussels' five year rental growth outlook to 3.5% pa, lifting the Belgian capital to the third most attractively priced market. Brussels vacancy rate remains at the 4% mark, among the lowest in Europe.

Chart 2: Average European office market yield and calculated yield (%)

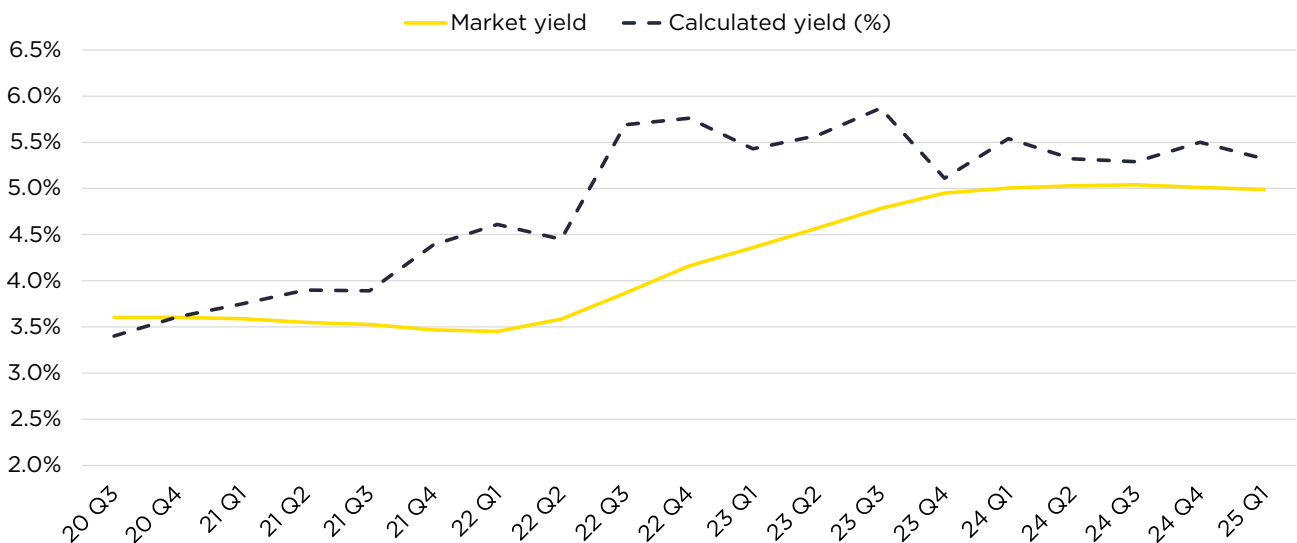
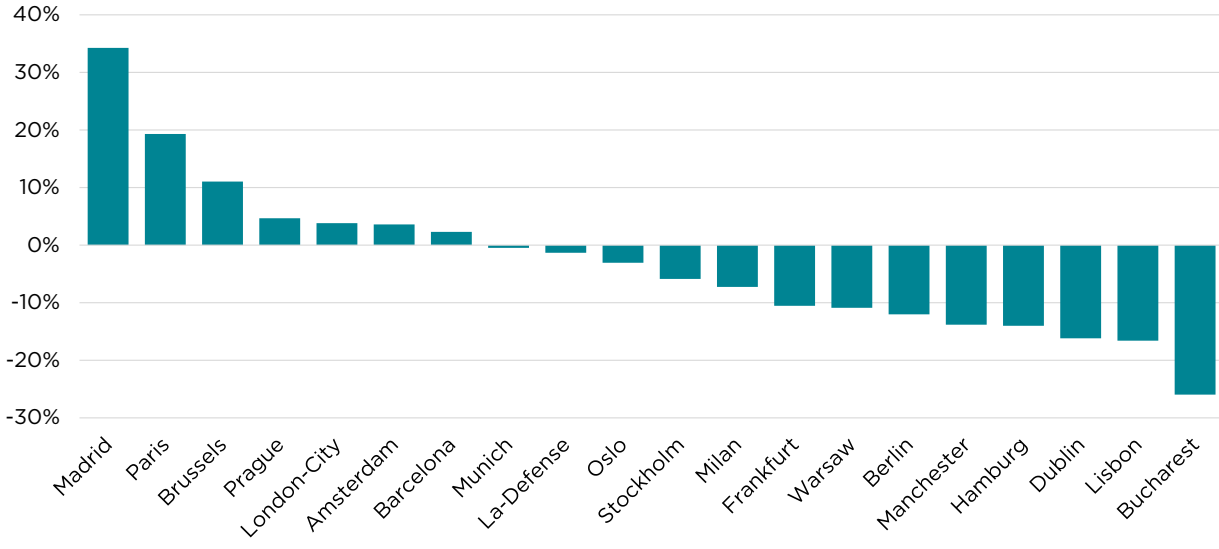
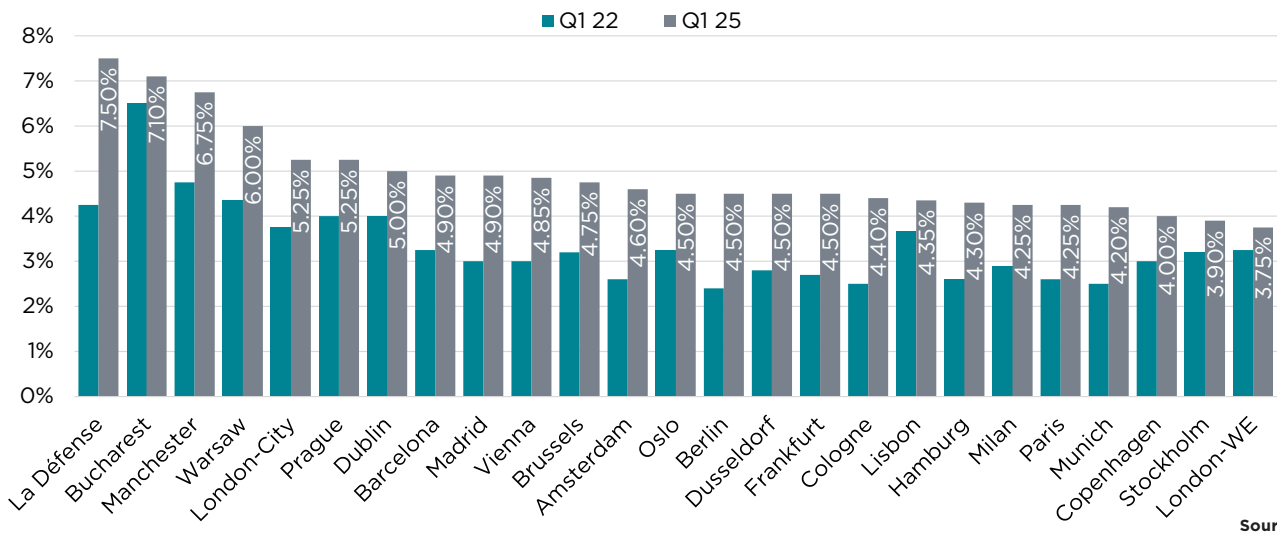


Chart 3: Capital value adjustment required for fair value pricing (%)



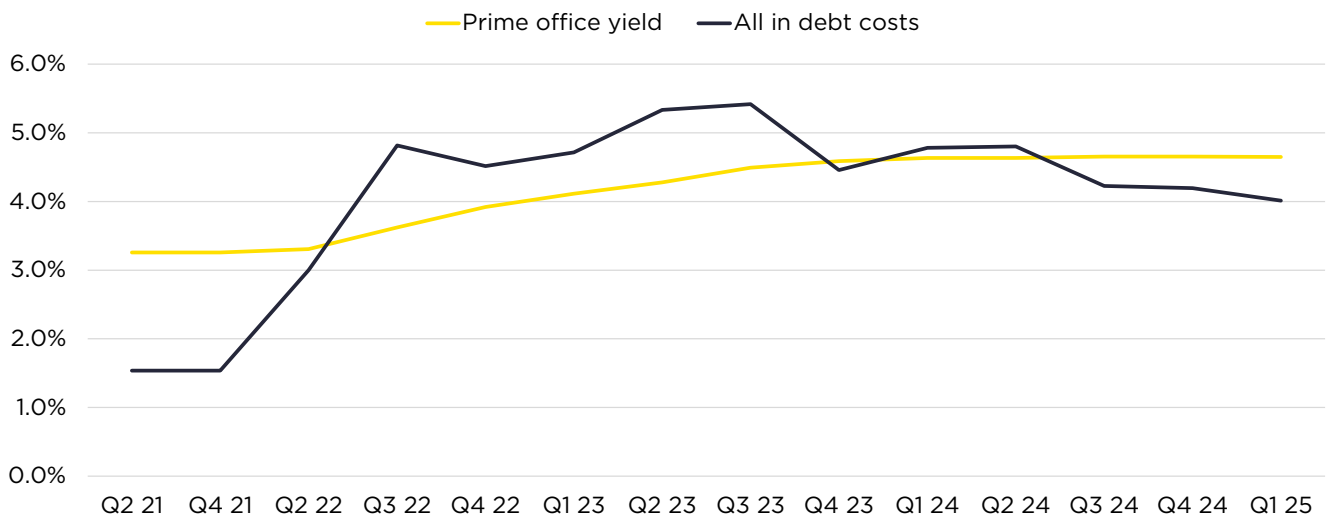
Source Savills

Chart 4: European prime office yields (%)



Source Savills

Chart 5: European average prime office yield and debt costs (%)



Source Savills

Outlook

Falling interest rates will support prime yield compression through 2025 across selected markets.

Amid stock market volatility following Trump's tariffs, non-listed real estate pricing remains relatively unchanged. Yields remained stable on a quarterly basis for the majority of markets, with most European markets anticipating up to 25 bps inward yield movement throughout the course of 2025.

Some investors will treat the current market turbulence as a reason to pause real estate investment decision making, but more generally, deals continue to progress and buyers are motivated to complete deals at attractive pricing.

European open-ended real estate funds are still reporting net outflows on a quarterly basis, which has led some institutions to return stock back to the market to appease redemption requests. However, we are observing very few forced sellers, as we see more lenders return to the market, which has re-engaged buyer interest.

Lenders

Across selected European office markets, we continue to see debt margins fall, against a backdrop of lower swap rates, reducing all-in-debt costs by an average of 20 bps QoQ.

Lenders are increasingly willing to lend to prime standing stock, whilst for non-prime assets, banks remain selective, and alternative lenders are becoming more creative in their solutions, forming joint ventures with asset managers to undergo a change of use. Banks are also now willing to lend at a 60% loan-to-value across many jurisdictions, whereas they were previously comfortable in the 50-55% range.

Data from the European Central Bank's Risk Dashboard indicates that non-performing commercial real estate (CRE) loans as a percentage of total CRE assets remained stable on an annual basis, at 4.3%. Whilst

German banks' non performing loan (NPL) exposure increased, NPL exposure in Southern Europe and CEE fell, as tenants continue to pay rent and investors manage higher interest payments, so any distress remains limited.

Buyers and sellers

Insurance funds remain active for core/core plus stock on a pan-European basis, whilst SCPIs are still active following resilient inflows and are targeting higher yields, increasingly across CEE, and Western European regional markets.

Spanish and German private buyers continue to target core European offices, amid attractive pricing.

Non-European capital generally remains more cautious, although pockets of US private equity, and increasingly, Canadian buyers are enquiring, following improving sentiment towards the office sector. Blackstone, for example, raised €9.8bn of capital for its BREDS VII fund, and is now beginning to explore deals for offices again after a long hiatus, as reported by Bloomberg.

More generally, investors continue to favour the €30-€60m lot size sweetspot, however, we are seeing a deeper buyer pool for lot sizes of up to €100m, given debt costs remain accretive to returns, and banks become more willing to lend on prime stock. Investors are becoming more willing to work on club-deals, or joint-ventures, to gain access to trophy assets.

Savills EME investor sentiment survey 2025 indicates a year-on-year improvement in sentiment towards offices, following repricing in the sector and rising occupancy rates, both in Europe and the US. The key barrier remains a shortage of openly-market stock, and any sellers are those who are

opting to reduce their exposure to the offices sector, rather than those who are being forced to sell.

From an occupational perspective, markets continue to improve. Take up rose by over 8% YoY in 2024, vacancy rates made their first inward movement of the cycle, and as a result, the IPF Consensus average five year European office rental growth forecasts have risen from 2.1% to 2.4% per annum as tenants continue to compete for the best space. There is a belief among investors that real rental growth prospects are back.

Global trade policy concerns are likely to extend investment decision-making periods over the next few weeks, but while pricing remains favourable for buyers, we expect to see domestic players dominate activity. Europe remains a relative safe haven on a global basis given low debt costs, investment liquidity and real rental growth prospects.

We maintain our view that we will see an average 25 bps yield compression across the majority of European office markets by the end of 2025, aided by the return of cross border buyers during the second half of the year.



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.

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