

European Commercial - Q2 2025

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SPOTLIGHT
Savills Research

European Office Investment



● Inflation ● Yields ● Outlook

Further interest rate cuts expected

Economic overview

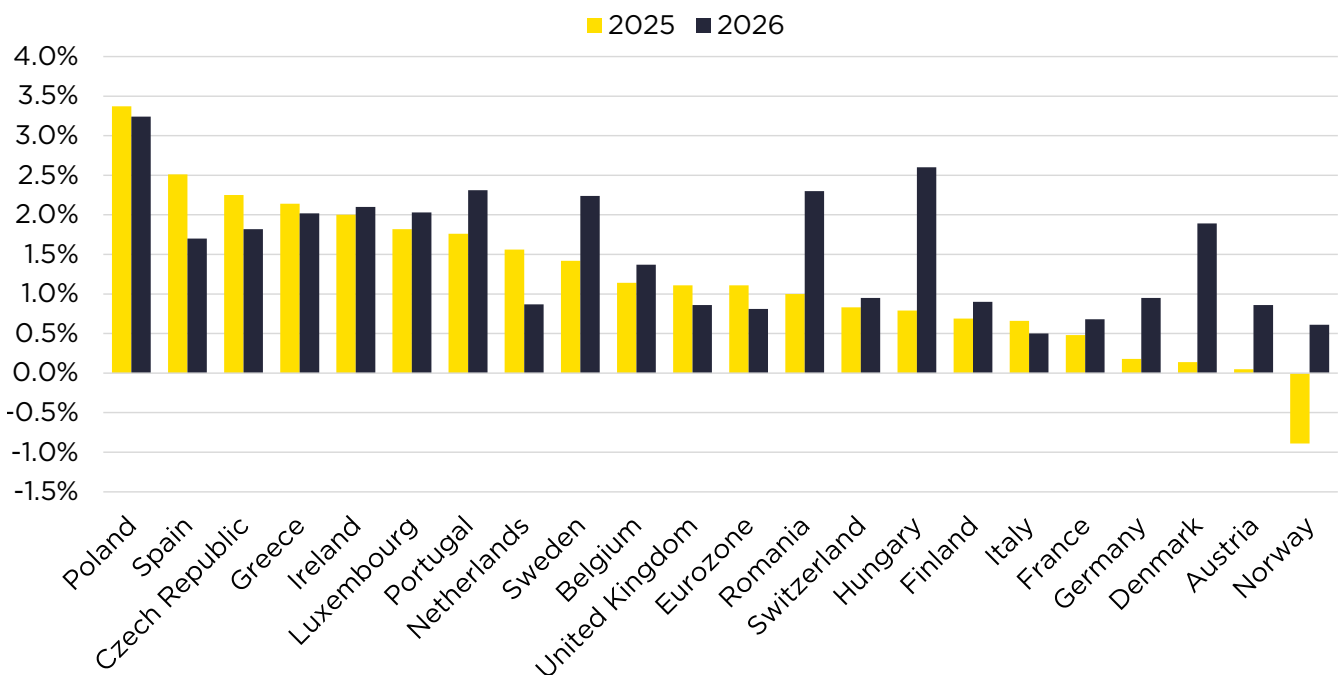
The European economy recorded growth of 0.6% during Q1 2025 and is forecast to have fallen to -0.1% during Q2 2025, following higher base effects. Service sector output is still in growth territory, and Eurozone GDP growth is expected to average 1.1% during 2025, followed by 0.8% in 2026.

Eurozone inflation rose marginally to 2.0% during June 2025, given slowing energy price increases, whilst food prices fell, with further disinflation expected throughout H2 2025. Oxford Economics now expects Eurozone interest rates to fall to 1.50% by end 2025, before rising to 1.75% in 2026 and stabilising at 2.00% in 2027. German government bond yields fell back 20 bps to 2.6% during Q2, after an initial spike following the German fiscal expansion plans. In the UK, inflation currently stands at 3.4% and in its latest meeting, the Monetary Policy Committee chose to hold interest rates at 4.25% to maintain

a “gradual and careful” approach amid persistent inflation, global trade tensions, and heightened geopolitical uncertainty.

Sentix’s Eurozone Investor Confidence index rose to pre-tariff highs during June, with investors more positive around the current and future economic situation, despite the looming uncertainty of the trade relationship between the EU and the US. German finance minister Lars Klingbeil warned that the EU stands ready to impose retaliatory measures against US goods if the two parties fail to reach a “fair” deal to resolve their trade dispute. However, weaker domestic growth, rather than global trade disruption will remain a more significant concern for Europe’s larger economies.

Chart 1: European GDP growth forecasts by country (% pa)



Core European yield compression

European average yields compress by 5 bps during Q2 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 Helsinki.

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?

During Q2 2025, European average prime office yields compressed by an average of 5 bps to 4.96%. Core Western European markets recorded the strongest yield compression, including Madrid (-25 bps to 4.65%), Barcelona (-25 bps to 4.65%), Amsterdam (-20 bps to 4.40%), Munich (-10 bps to 4.10%) and Paris CBD (-25 bps to 4.00%). In our previous iterations of the model, we had indicated how Madrid and Barcelona appeared attractively priced from

a fair value perspective, and the country's service sector continues to outperform other major European economies.

The IPF's May 2025 European office rental growth forecasts remain in line with previous estimates of 2.4% per annum over the next five years, with London City, London West End and Madrid expected to record the strongest rental growth. Oxford Economics has marginally cut its five-year annualised inflation forecasts to 2.1% per annum, supporting real rental growth.

As such, the majority of European office markets remain in fair value territory, as the gap between market yield and fundamental yield closes, and we see buyers' and sellers' expectations on pricing align. Madrid and Milan now appear the most attractively priced European markets, given strong real rental growth prospects, according to the IPF forecasts.

Chart 2: Prime office yields by city (%)

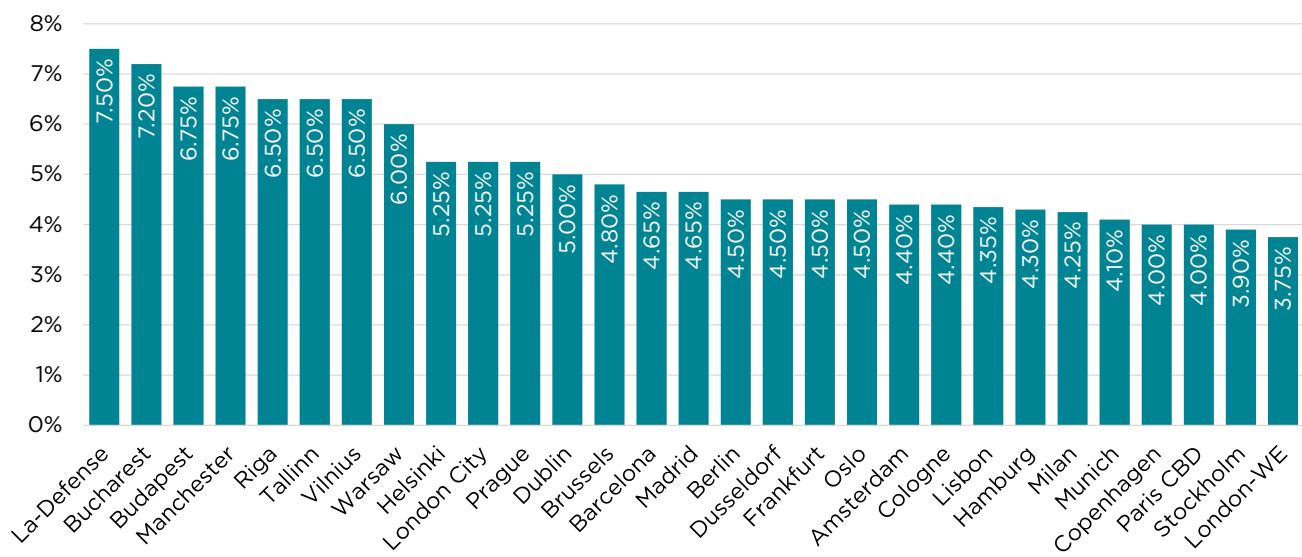
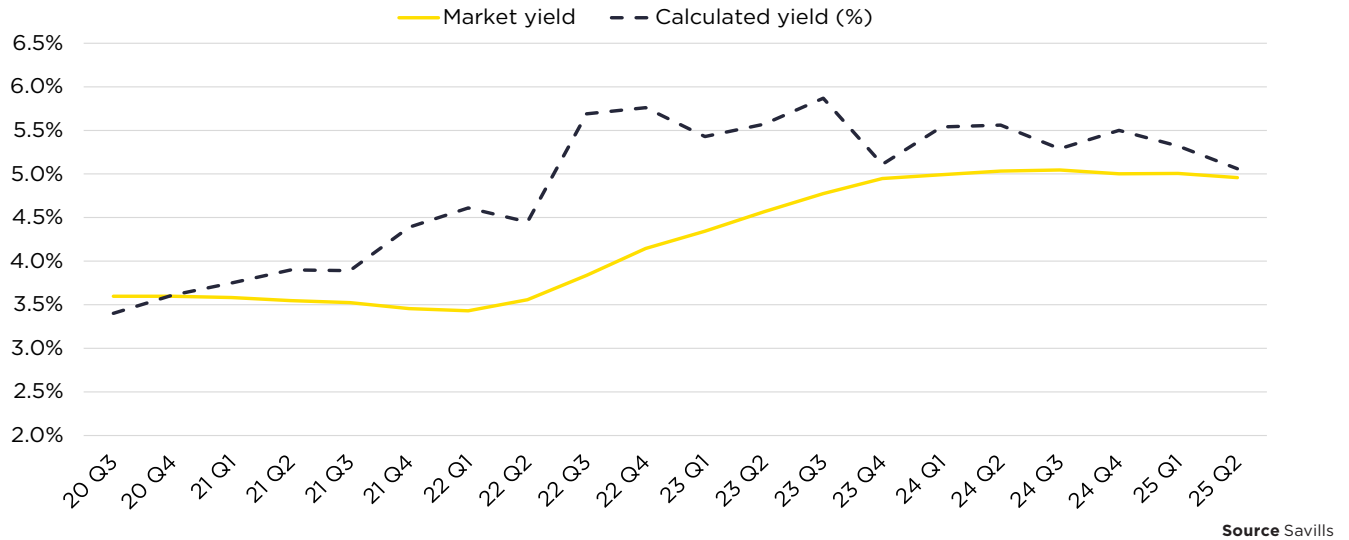
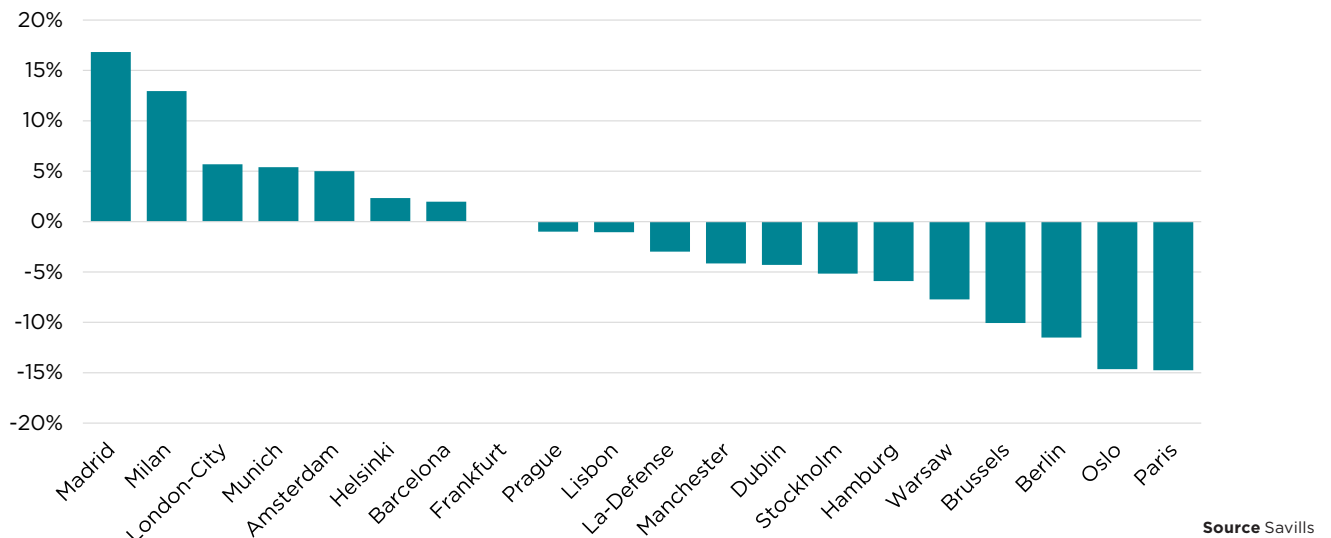
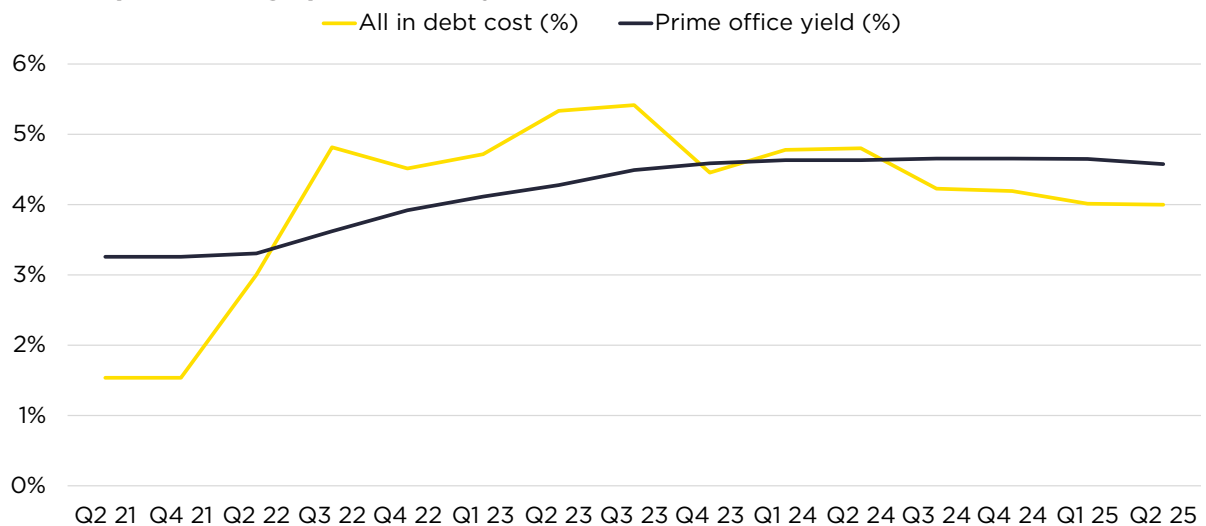


Chart 3: European average office market and calculated yields**Chart 4: Capital value adjustment required for fair value (%)****Chart 5: European average prime office yields and debt costs**

Outlook and investment themes

Yields for the very best offices in core locations are beginning to move in, as equity gradually returns to the market. Distress largely remains scarce, as the market is flooded with returning lenders competing at lower margins. Buyers remain sensitive to location, quality of asset and liquidity.

Rising office share of investment

Preliminary investment transactions data from RCA shows that Offices reclaimed its position as the most transacted sector in Europe during Q2 2025, as investors show renewed confidence in the sector and seek to take advantage of attractive pricing.

Returning German appeal

German office investment transactions fell by a further 32% YoY to only €1.86bn during H1 2025, Savills data indicates. However, investor sentiment towards Europe's largest economy is improving, with INREV's mid-year European investor intentions survey showing that the net proportion of investors looking to increase allocations to Germany rose from 5% to 20% over the last six months.

Private investors are among the main buyer types, as certain German open-ended funds are net sellers following over €3bn of net redemptions during the first five months of 2025. Promisingly, the number of emerging sales processes is increasing which is helping to establish price-points.

Debt markets favourable

Arguably, one of the biggest changes in 2025 has been the increased competitiveness among lenders, particularly among debt funds, and with a renewed desire to lend against prime office acquisitions. Borrowers are able to meet loan repayments given strong occupational markets, which has limited the volume of distress taking place across European markets.

Lender margins and swap rates remained stable on a quarterly basis, as debt remains accretive in Europe. Appetite for larger acquisitions is returning, with the proportion of €200m+ lot sizes rising to 24% of total volumes, up from 15% last year. Schoeller Group acquired Signa's €450m Upper West sale in Berlin, Union is selling the Trocadero, Paris, for a price expected to be in excess of €700m, whilst Pontegadea acquired Grupo Planeta HQ in Barcelona. Bidding is becoming more competitive and private equity investors who were previously seeking large discounts from distressed borrowers are finding themselves disappointed.

Buyers and sellers

Real estate fundraising remains difficult, although dynamics have improved YoY, according to data from Realfin. Capital raised for European real estate strategies in H1 2025 rose by 118% to €34bn, whilst US fundraising fell by 44% over the same period as global investors seek to increase exposure to Europe. We expect the stronger euro will postpone the recovery of US investment back to Europe, with European capital expected to dominate during H2 2025.

SCPIs remain active in the market and are increasingly willing to invest cross-border, predominantly targeting the UK, Spain, the Netherlands, Italy, Germany, Ireland and Poland in search of yield. We have observed a cautious uptick from outbound Middle Eastern investors after a couple of years on the sidelines, whilst insurance companies remain active buyers for core-plus product.

Occupational resilience

Returning investor demand is supported by strengthening tenant demand, with German office take-up rising by 18% YoY and London West End up 29% YoY during H1 2025. Return-to-office mandates are supporting occupier decision-making, with

several banks, law firms and consultancies mandating a minimum number of days in the office, and consequently curtailing any plans to reduce office footprint. Europe's office development pipeline is entering a ten-year low, which is supporting further rental growth.

Entering Q3 2025, there is an acceptance among buyers and sellers that pricing has been established and yields are beginning to compress for prime stock across selected markets. The volume of prime stock returning to the market is limited though, and investors will remain selective on asset quality and location. Based on the fair value dynamics, we believe income return will be the main driver of returns over the next 12 to 24 months. The capital is trickling back into offices and those buyers who were testing sellers' resolve six months ago, are now becoming serious bidders.



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