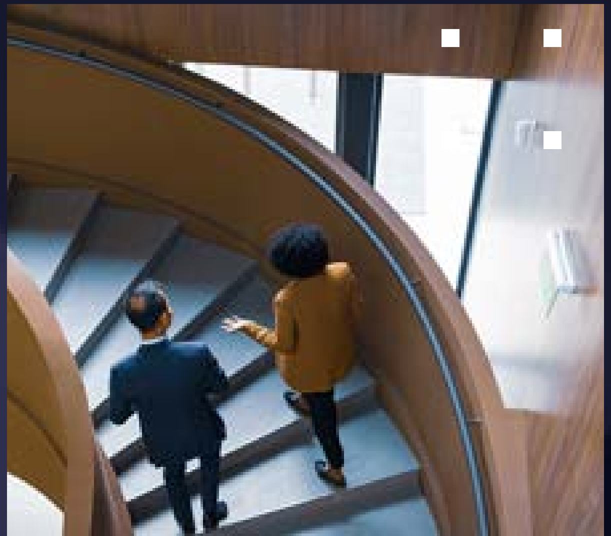
Savills Takes Stock

Global Capital Markets Offices Q1 2025



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Savills Takes Stock: Q1 2025

Global outlook

Oliver Salmon

Director, World Research

Taxing times as global economic outlook deteriorates

The current global economy as we know it can be divided into two states of being; pre- and post-'Liberation Day'. In the first, growth was steady, if unspectacular, as falling inflation and robust labour markets supported rising household real incomes, creating a virtuous cycle in activity. In the second, volatility and uncertainty are the prevailing characteristics, following a series of tariff announcements from the US Administration, disrupting a status quo that has persisted for the last 80+ years.

The extent of the economic impact remains highly uncertain, not least because the tariffs are changing on an almost daily basis. The IMF expects a hit to global economic growth of around 0.5%, incorporating tariff announcements up to mid-April (and so not including the deal with China), with the US economy seeing the most significant damage. But the initial hit to sentiment data could lead to a more severe downturn. In the US, for example, consumer confidence has fallen sharply since the tariffs were first announced.

What we do know is that President Trump has now blinked several times due to various external pressures, first providing a 90-day reprieve to most trade partners from his 'reciprocal tariffs', and then exempting some consumer electronics and automobiles from the most punitive of duties. This would indicate that he does indeed have a pain threshold, which should rule out the most extreme downside scenarios. But tariffs are also ideological to the President, which means that while he remains in power, they are here to stay. Even with a temporary deal with China, the average US import tariff has risen from 2.5% at the end of 2024 to nearly 18%, according to the Budget Lab at Yale. So we are not returning to the pre-Liberation Day steady state either.

Until there is some clarity over where we land in the wider spectrum of possible scenarios, a period of caution will grip global real estate capital markets.

> "Discretionary vendors have a tried and tested gameplan from recent years: sit tight and wait for better times ahead"

Real estate is a GDP-linked asset class, so it stands to reason that many investors would prefer to sit on their hands, and their cash, rather than deploy into this economic environment.

Ultimately, weaker global growth will feed into the outlook for occupational demand and rents across all sectors. Investors underwriting new deals will need to consider the impact on their tenants. This will impact expected returns, and therefore yields may need to rise. But real estate is not a liquid market, and with few motivated sellers to support turnover and price discovery, discretionary vendors have a tried and tested gameplan from recent years: sit tight and wait for better times ahead. In the interim, expect more deliberation over the prevailing 'bid-ask' spread.

This comes at an inopportune moment for the real estate market, after finally showing signs of emerging from a two-year period of malaise, underpinned by a surge in global interest rates. Global real estate investment rose by nearly 20% in the second half of last year, compared with the with same period in 2023. The first quarter of this year, while not quite hitting the same heights, was encouraging in other ways, for example, there was continued growth in the market share of domestic institutional and cross border investors.

There may be some solace for investors, in the form of lower interest rates and less development. Outside of the US, where monetary policy is conflicted by the dual mandate of full employment and price stability, this is a deflationary demand shock. The major global central banks are expected to cut interest rates at a faster pace than in the pre-Liberation Day world. This could provide a mechanical boost to risk premiums and negate the need for any further yield adjustment. Meanwhile, if it is a risky environment in which to acquire a stabilised asset, then it is even riskier to break ground on speculative development. Scarce assets, with natural-monopoly characteristics in their location, or high quality of amenities, will be well placed to outperform. As the proverb goes, 'fortune favours the brave'.

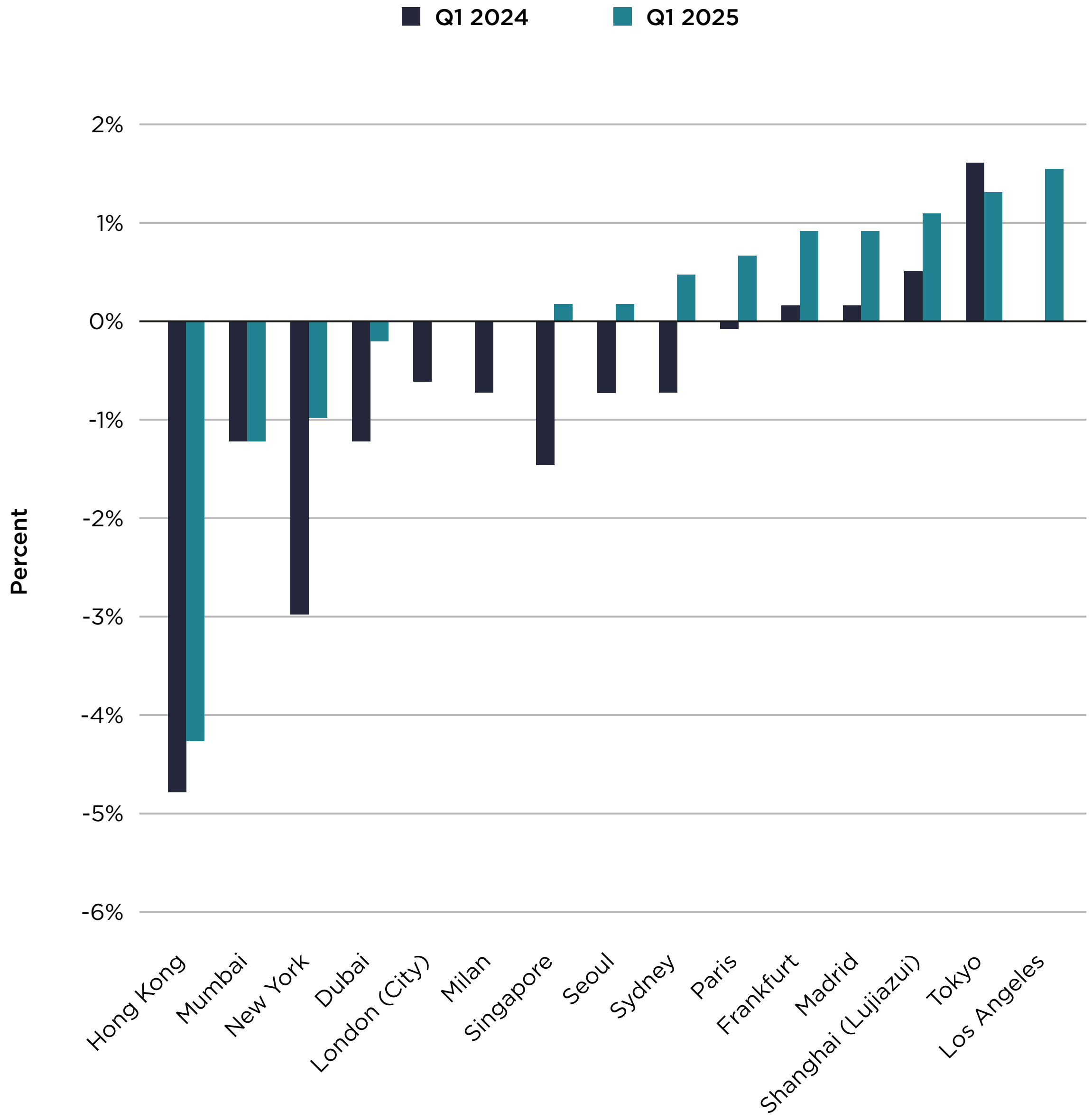
The economics of scarcity supporting offices

The global office sector is in recovery, or at least it was, before 'Liberation Day'. This view is not necessarily reflected in the transactional data, with investment totalling US$35bn in Q1 2025, representing a 20% fall on the year. But it is reflected in the pricing data. Benchmark prime yields are now stable or falling across most markets, with the average yield across the 15 global markets that we track unchanged this quarter for the first time in three years.

Shanghai and Mumbai are the only markets where we see some upward pressure in yields over the next 12 months. The former, due to an oversupply of office space and weak leasing activity, and the latter due to past increases in interest rates (although the recent trend is favourable in this regard, with the RBI cutting rates twice since the beginning of the year). By contrast, a number of European markets, including London City, Madrid and Milan, are expected to see some inward movement over the course of this year.

At the same time, the cost of debt has continued to fall, from a peak of 5.7%, based on the average of the markets covered in this report, to 4.9% this quarter. This is not only driven by policy easing by the major global central banks, but also due to private debt becoming more attractive to investors, driving competition to lend against the best assets. In 2024, global debt funds secured over US$32bn in new capital commitments, 16% more than in 2023. In many markets, investors can now leverage their returns using debt financing. This is an important development that may encourage more core investors to transact, given relatively attractive cash-on-cash returns.

GLOBAL: PRIME OFFICE YIELD SPREADS TO COST OF DEBT



Source: Savills Research. Spread shows the difference between the benchmark prime yield and the total cost of debt

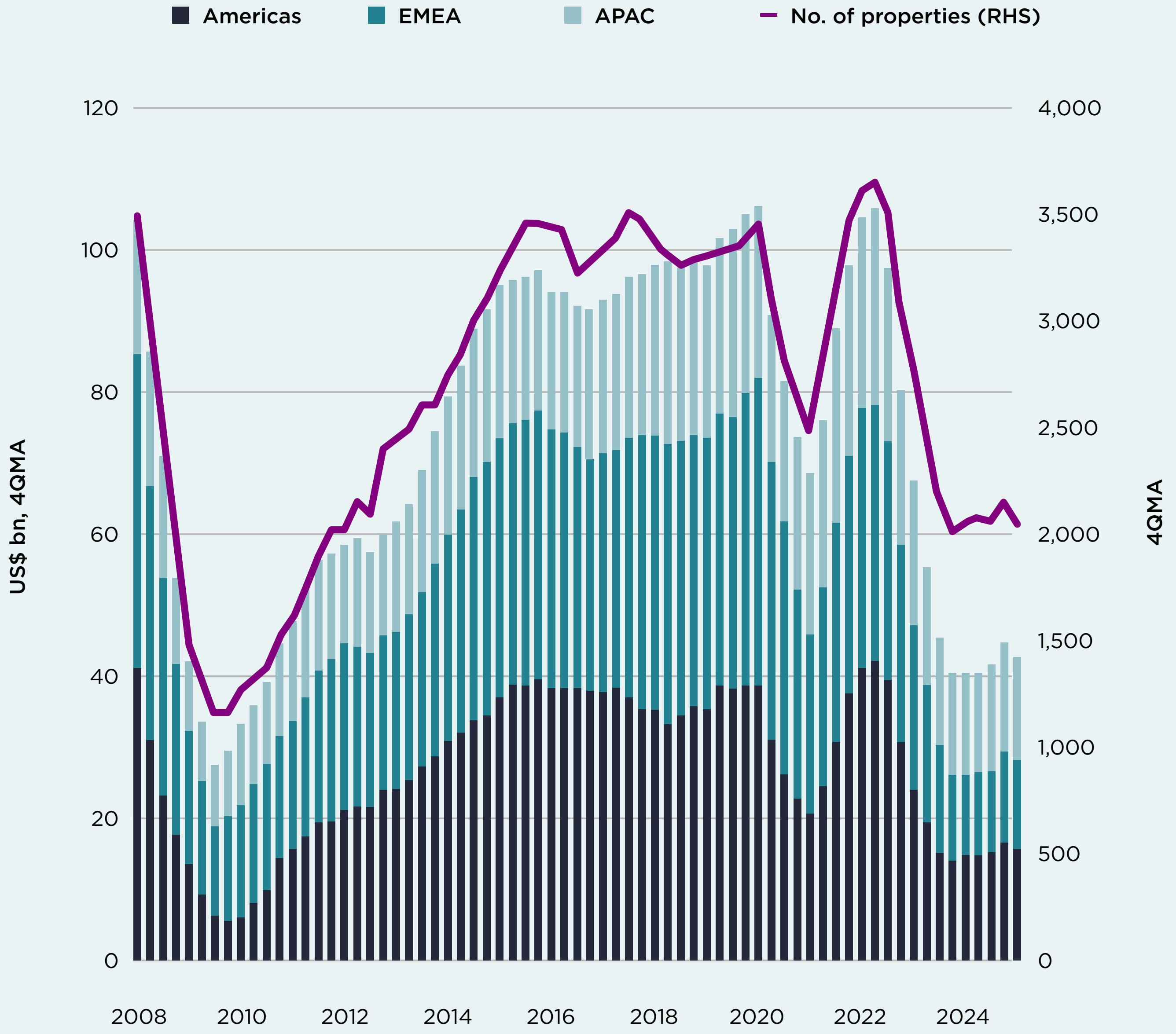
This dynamic is already supporting an increase in interest from larger institutional and cross-border capital. Combined, they have increased their market share in transactional activity to nearly 50% in early 2025, up from around 40% last year. Liquidity for larger deals is gradually coming back as a result, and this has encouraged more vendors to bring forward listings that were perhaps postponed in recent years due to adverse market conditions.

Looking ahead, the ongoing fallout from President Trump's 'Liberation Day' tariffs threatens to disrupt the fledgling recovery in the office market. Occupational demand is largely driven by the services sector – in Europe, around two-thirds of take-up in the first half of 2024 was underpinned by banking and finance, professional services, and technology. These sectors are not directly targeted by tariffs, and there is no indication that they will be, given the focus is squarely on the US goods-trade deficit.

Clearly, however, there is some spillover from a wider slowdown in economic activity, and in the short term rising uncertainty will have an impact on leasing activity. There is a direct correlation between uncertainty and business investment more generally, which includes decisions related to new office requirements. This favours lease renewals and extensions over long term commitments or wholesale moves. If hiring activity slows in line with the early survey data, then businesses will be less inclined to commit to new space.

However, there is every chance that some of these sectors may benefit from an increase in trade and policy uncertainty. A number of major global banks reported strong earnings in Q1 2025, for example, underpinned by trading revenues earnt during the recent market turbulence. Furthermore, uncertainty will feed into weaker development activity – compounding the shortage of good-quality office space in most global markets. Owning a prime central CBD office with a good covenant and long lease might just be the one of the more attractive real estate investments in this environment.

GLOBAL: OFFICE INVESTMENT TURNOVER



Source: Savills Research using MSCI RCA. Based on independent reports of properties and portfolios. Excluding development sites.

Savills Takes Stock: Q1 2025

Regional outlook

EMEA (Europe, Middle East, and Africa)

Total office investment in Q1 across EMEA of €8.5bn (US$8.8bn) represented a fall of 14% on the year. This disappointing transaction data was reflected in the atmosphere at MIPIM, which was more muted than many may have hoped for after a strong end to 2024. This was largely due to the unfulfilled expectations of available capital and product, as buyer and seller expectations have still not quite met.

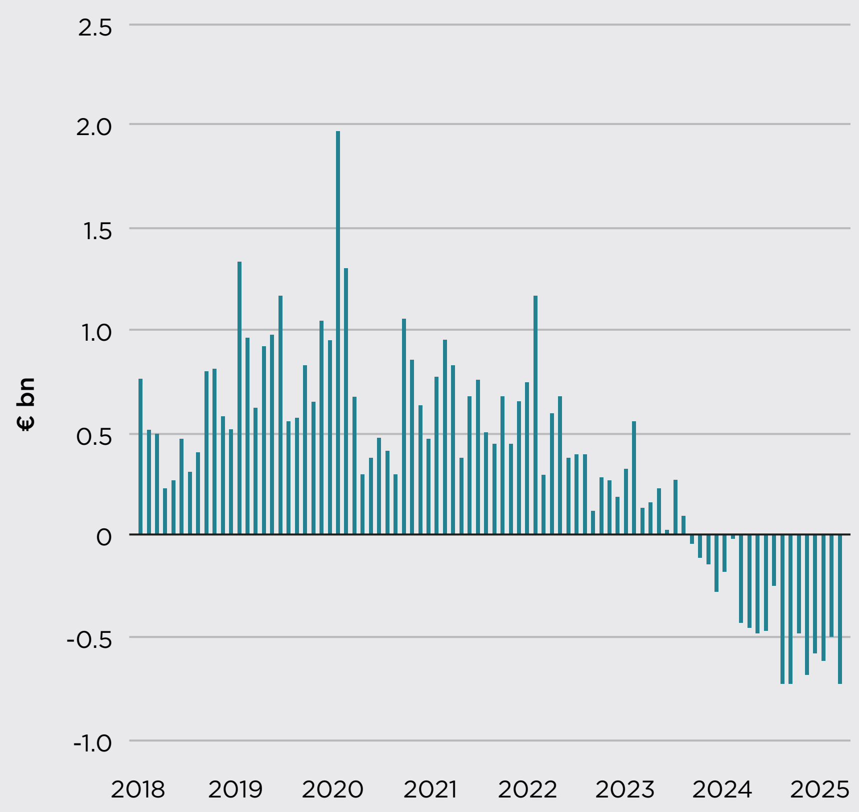
Domestic and short-haul capital remains prominent, including insurance funds – who are active in the core and core+ space – as well as the French SCPIs, which continue to target higher yielding submarkets, diversifying into CEE and regional markets in Western Europe. Long-haul cross-border investors remain more absent by comparison, as they have done since late 2022. US private equity and some Canadian institutions are slowly returning to the market, mostly focused on the UK, but starting to show interest for income-producing assets on the continent. But this is yet to show up in the aggregate transactional data.

Indeed, the UK, and specifically London, stands out from the rest of the region in terms of the depth of investors looking to transact.

In one of the largest deals of the quarter, Norges Bank Investment Management (NBIM) acquired a 25% interest in a mixed-use portfolio of Grosvenor Estate, with a large office component, for £306m (US$410m) – one of several notable London acquisitions by the Sovereign Wealth Fund in the first quarter. And in April, State Street bought 100 New Bridge Street in London City for £333m (US$430m). The asset is for their own occupation, but the pricing was based on a yield of 5%, which will support some downward pressure on the current benchmark yield of 5.25%. More generally, the Australian Superannuation funds, Japanese groups and US private equity are all reported to be active in the UK capital, but are facing a chronic lack of opportunities to deploy.

The concern around the lack of assets may be changing in some markets. In Germany, for example, the open-ended funds continue to face a wave of redemptions, which may lead to more asset disposals in the near term. Net flows have been negative since August 2023, bringing total redemptions to over €7.8bn through this period. We have already noticed an increase in the number of sales processes in Germany, and an influx of stock from motivated sellers may provide some momentum to European office markets more generally.

EMEA: NET FLOWS TO GERMAN OPEN-ENDED REAL ESTATE FUNDS

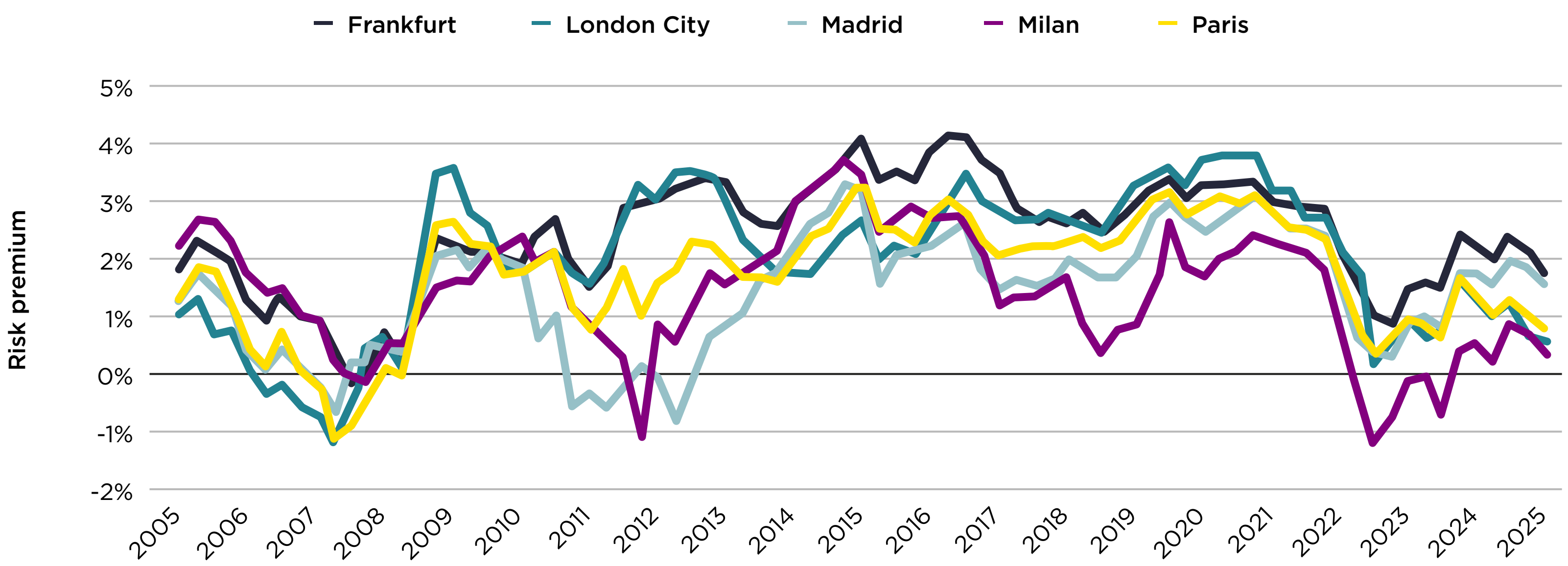


Savills Research using Macrobond

Meanwhile, a deeper pool of capital looking for larger lot sizes of up to €100m will support greater liquidity, as vendors get more comfortable listing their assets. This process is supported by the falling cost of debt. Across the six markets that we track in EMEA, the cost of debt has fallen to 4.5% from its peak of nearly 5.9% in mid-2023. The increase of alternative lending solutions and a lack of deals closing on the equity side has allowed owners to be more aggressive in negotiating terms, with some compression in margins complementing the decline in interest rates.

One downside risk to the outlook is in the volatility in government bond yields. Through the first quarter, long-term bond yields rose by around 30bps, largely following German Bunds after their parliament approved a major fiscal stimulus aimed at infrastructure and defence. This squeezed the prevailing risk premiums, especially in in low-yielding markets such as Paris, impacting the ability of those investors to transact with higher hurdle rates. More recently, US President Trump's tariff announcements have underpinned a decline in European bond yields, easing some of this pressure, but markets remain volatile.

EMEA: PRIME OFFICE RISK PREMIUMS



Savills Research using Macrobond. Risk premium calculated by subtracting the 10-year government bond yield from the prime office yield

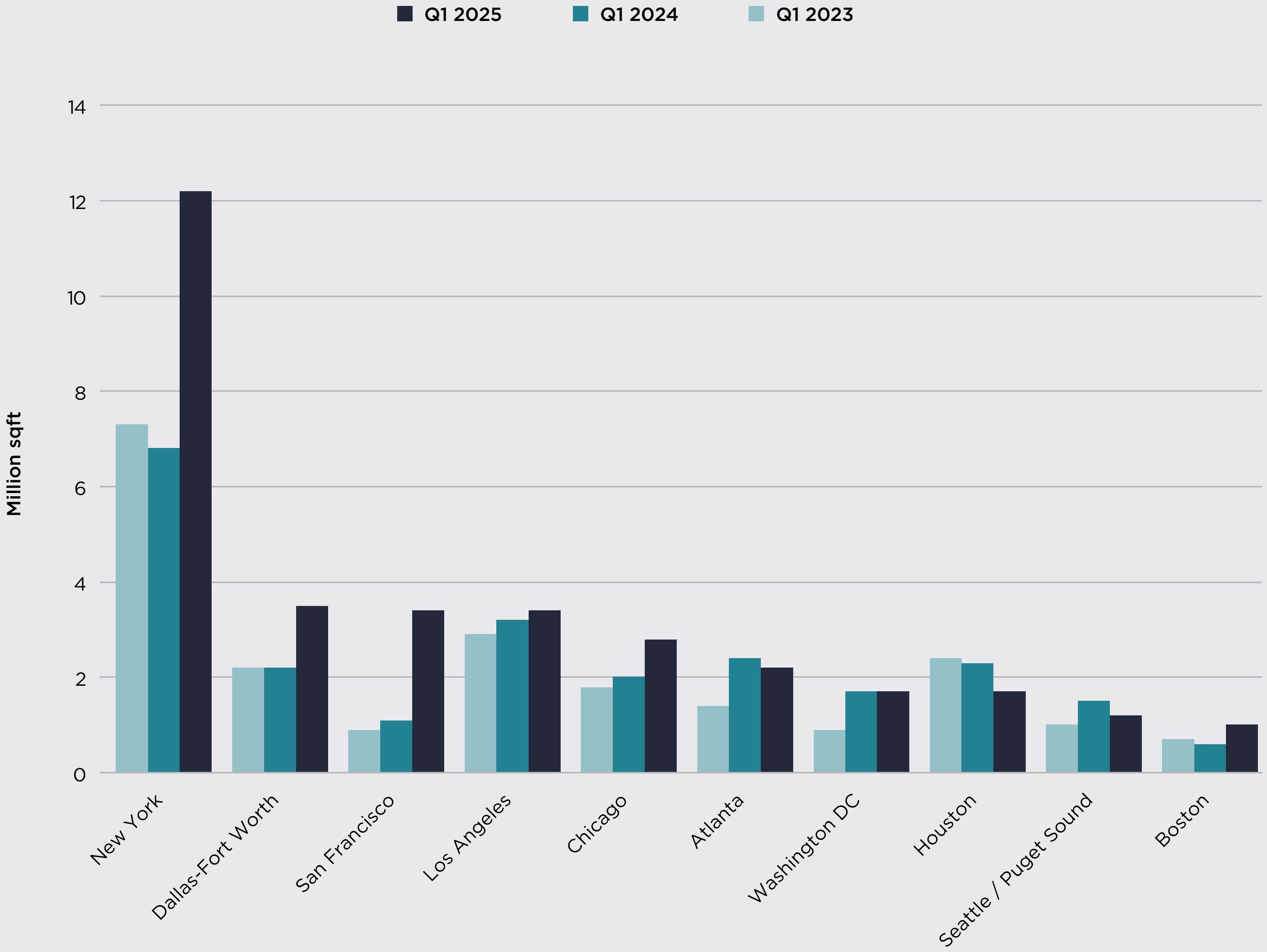
North America

US office investment totalled US$12.6bn in Q1, down by nearly 25% on the year. Towards the end of 2024, investment activity had started to recover, particularly in some of the major CBD markets, underpinned by improved occupational dynamics, and with the Fed on track to deliver lower interest rates and a soft-landing in growth. This optimism was reflected in debt markets, with New York leading a strong recovery in loan origination activity, albeit with a narrow focus on the best-in-class assets.

However, as the economic outlook for the US has weakened – a trend that pre-dates recent tariff announcements – some of the optimism, and the accompanying transactional activity, has also dwindled. This is also underpinned by reduced optimism for further interest rate cuts, with the Fed largely expected to remain on hold for the rest of the year. Our benchmark prime yields, which were expected to fall over the course of this year, are now expected to remain unchanged as a consequence.

Occupational markets have continued to improve at the beginning of this year. Most major cities in the US experienced robust leasing activity in Q1, with San Francisco notably having its best quarter since 2015. This is reflected in falling sublease space and an overall decline in availability rates across most markets. However, in some cities such as Los Angeles, this is primarily driven by an increase in owner-occupier acquisitions, and some conversions to residential reducing inventory levels. Leasing activity is still predominantly driven by renewals, rather than new leases or expansions.

US: LEASING ACTIVITY IN MAJOR OFFICE MARKETS



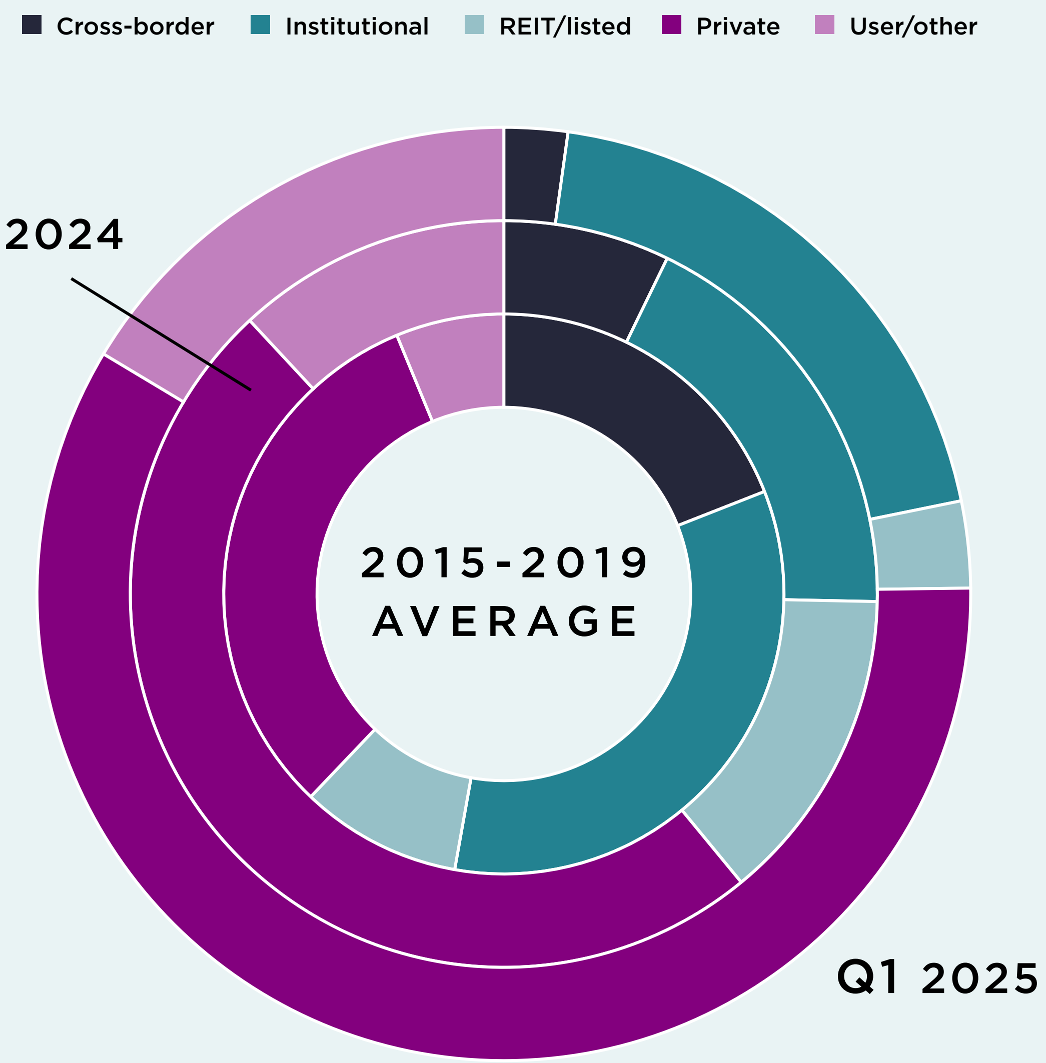
Source: Savills Research

The bifurcation of the office market remains a key theme. While the major cities are seeing overall rents plateau or fall, grade A rents have continued to rise, albeit that rental concessions across all grades of office remain high, as landlords aggressively compete for occupiers. Vacancy remains elevated, providing significant leverage for tenants in negotiating terms. This bifurcation is seen in the premium that newly-built offices can command. The constrained pipeline in Miami and New York is creating a significant uplift for new properties, further driving up prime rents. This trend is mirrored in Silicon Valley.

Private investors continue to be active buyers of US offices, accounting for nearly 60% of deals so far this year. Valuations of CBD offices have fallen by nearly 50% peak-to-trough, according to MSCI data. This repricing is attracting private investors into the market – total investment by privates in Q1 2025 rose by 44% on the year. For similar reasons, end-users are also taking the opportunity to acquire buildings at discounted prices, especially considering rents have not seen a significant repricing.

Institutional investors, both domestic and cross-border, remain cautious. However, the reported listing of 590 Madison Avenue in New York indicates that there is growing appetite to trade, with an apparent price tag of US$1.1bn. Should it successfully trade - with RXR Realty reported to be close to a deal - it would represent the first deal in excess of a billion dollars in two years. New York is however perhaps the only market in the US where an asset of this scale could transact at the moment.

US: OFFICE INVESTMENT BY BUYER TYPE

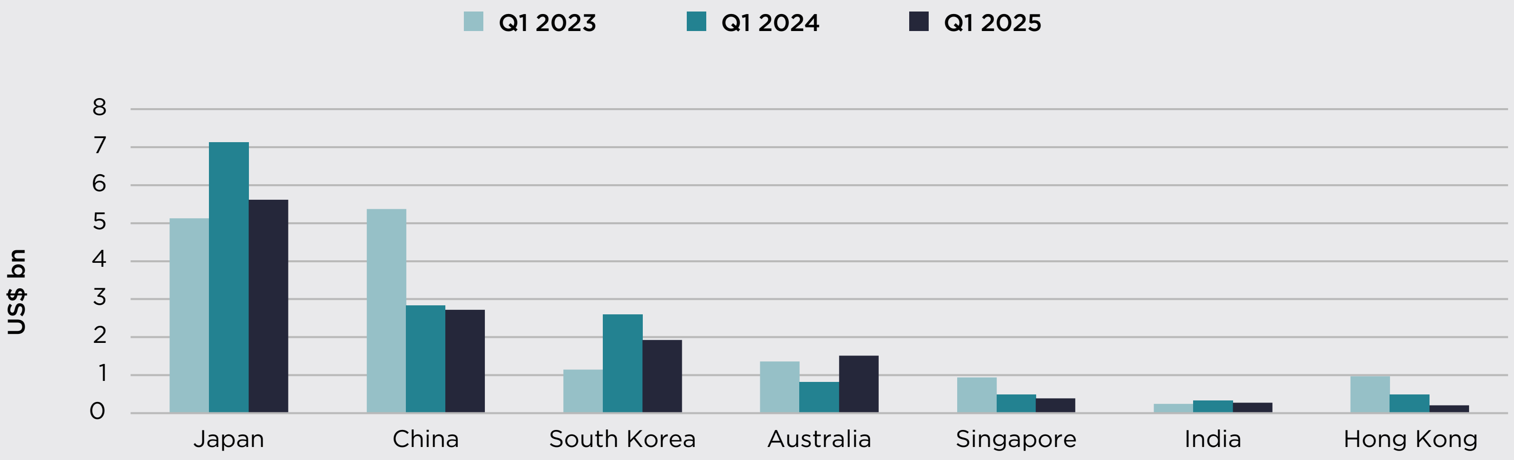


Source: Savills Research using MSCI RCA

APAC (Asia Pacific)

The US$12.9bn invested in offices across the APAC region in Q1 2025 represented an 18% decline on the year. This was largely due to falls in South Korea and Japan, although the latter was underpinned by base effects following an exceptionally strong start to last year. Deal activity in Singapore was also down, with very little of note transacting in the quarter. By contrast, the AUD2.4bn (US$1.5bn) of completed office transactions in Australia was more than 95% higher than Q1 2024, underpinned by several large deals in Sydney, all in excess of AUD500m, including 388 George Street and 10-20 Bond Street. Investment in China was broadly unchanged, potentially a sign of stabilisation in the market, despite zero recorded acquisitions from cross-border investors.

APAC: TOTAL OFFICE INVESTMENT



Source: Savills Research using MSCI RCA. Based on independent reports of properties and portfolios. Excluding development sites.

Throughout 2024, Seoul was one of the hottest office markets globally. However, there is some investor caution creeping in at the beginning of this year, due to a weaker economic outlook and increase in unsold asset listings. Leasing fundamentals have deteriorated since late last year, with both net absorption and rental growth slowing. With buyer appetite fading, there is a concern that vendors may have missed the window to transact, leading to an increase in unsold properties. Total office investment in Q1 of KRW 2.8tn (US$ 1.9bn) represented a near 20% decline on the year.

Sydney has seen a number of new completions, such as Martin Place and Parkline Place, both located in the heart of the CBD. Tenant demand for similar premium offices remains strong, however the onboarding of new supply of premium buildings is further exacerbating a bifurcation between the ‘best’ and ‘rest’, allowing tenants to trade up in quality. Overall, the prime CBD vacancy rate rose from 11.9% to 13.3% this quarter, underpinned by negative net absorption in grade A space, with premium vacancy remaining relatively stable. Investor sentiment remains robust, largely thanks to the RBA cutting rates in February for the first time since 2020. Asset prices appear to have bottomed out, with the prime yield expected to stabilise at 5.85%.

The Tokyo office market is expecting a large number of completions throughout the year, but much of this new supply is already pre-leased. As such, vacancy is expected to remain low, allowing rents to rise. These fundamentals continue to attract investors. While total investment of JPY866bn (US$5.6bn) in the first quarter was 18% down on the year, this comes off a very strong base – excluding Q1 2024, it was the strongest start to a year since 2018. The marquee deal was Blackstone’s JPY400bn (US$2.6bn) acquisition of Tokyo Garden Terrace Kioicho, a mixed-use development, which would value the offices there at US$2.3bn.

In Shanghai, there was one notable deal in the quarter, with China Merchants Bank and China Post Life Insurance acquiring 60% of One Museum Place from ADIA and Hines. The transaction, which valued the asset at CNY10.9bn (US$1.5bn), a 20% discount from the asking price, is reflective of a wider trend of domestic buyers acquiring assets held by foreign owners, who are generally looking for an exit. A high proportion of deals are underpinned by distressed or motivated sellers, as occupational markets remain very weak, with rising vacancy and falling rents. The benchmark prime yield in Shanghai of 4.75% is expected to move out further over the next 12 months as a consequence.

Hong Kong faces a similarly poor occupational market, and office values have fallen by more than 50% over the past five years. One recent deal was notable, with a strata office floor transacting for the lowest price per square foot since 2008. Banks are reluctant to lend against office assets, which means that cash-rich privates or end-users, including local universities, remain the only active buyers in the market. There is potential for a recovery in market liquidity, fuelled by a rise in distressed sales, as more landlords face financial challenges, and banks call in existing debts.

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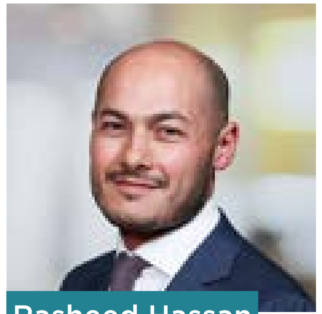
Market view



Rasheed Hassan

Head of Global Cross Border Investment

shares his view on the market

Are we on or are we off?
We remain in a start-stop market, struggling to recover the momentum we had pre-interest rate hikes. However, despite the various macro challenges, I believe that we are currently more 'on' than 'off'.

Unsurprisingly, 'Liberation Day' has been unhelpful and provided further justification for caution and procrastination, as well as driving some opportunistic, albeit largely unsuccessful, attempts at price adjustments.

Despite this, the market is being supported by rental growth, the falling cost of debt, and a dearth of truly actionable transactions. Pricing is improving for the best assets, and not just in the darling sectors.

In some cases where owners haven't liked pricing holding firm has borne fruit and buyers have come to them. Where this hasn't been the case, the debt market is offering better than expected pricing in many instances, providing motivation to extend hold periods in the hope of better bids in the next 12-24 months.

There's definitely a market out there, and I'm pleased to say that it feels like it's growing. Transaction volumes may not be showing positive growth in all areas, but the breadth of opportunities that investors will consider is certainly improving in terms of sector, geography and risk profile.

There is no let-up in the appetite for 'beds' of all types. The test for investors, however, is their willingness to underwrite the necessary rental growth and exit pricing to be competitive. Industrial and logistics, for the first time in a long time, has shown some signs of vulnerability. But this doesn't seem to be turning investors away. Instead, they are approaching the sector with a little more discernment. Office demand is strengthening, even in the US where it feels like things are finally turning a corner. Yes...US offices. We are also witnessing a similar story in retail.

In recent years, the combined impacts of rising inflation, higher interest rates, falling property prices and Covid-19 (working from home and increased online shopping) have underpinned a major slowdown in development activity, either because of a lack of confidence or financial viability, or both. The resultant positive impact on rents is providing investors with the necessary assurances to both buy standing assets and re-start developments.

Rents are now growing at such a rate that it's increasingly difficult to use initial yields as the benchmark for comparison. Instead, the 'stabilised' yield is the metric that investors with conviction to buy are scrutinising.

The credit opportunity remains one of the biggest competitors for more equity into real estate. Many investors are being presented with returns that seem more compelling, on a risk-adjusted basis, than those available in the equity. If the interest rate trajectory remains downward (perhaps with the current exception of the US and Japan) and occupational markets hold up, then this narrative will continue to tilt towards the equity. However, the size of the current market opportunity also favours credit. Lenders like new transactions with greater clarity on market values, but they can also participate in refinancing, which the equity can't.

The fall in transaction volumes does not mean there is less real estate, just less of it changing hands. The growing book of pent-up stock not being sold will be a test for the market. Right now, this is holding back fundraising as equity needs to be released to reinvest and/or investors would like to see some round trips on existing commitments before investing more. Time will tell how this story plays out.

Will market dynamics continue improving to support more selling at improved pricing? Will there be enough capital to absorb the volume and keep prices elevated? Will we see more IPO attempts to help liquidity? Though there are still plenty of questions and an absence of clear answers, for now the resilience of the market continues to not disappoint.

PRIME OFFICE YIELDS, Q1 2025 (AS AT END-MARCH)

City	Prime net initial yield	Outlook for yields, next 12 months	Typical LTV	Total cost of debt	Cash-on-cash yield	Risk premium
Hong Kong	1.97%	→	40%	6.3%	-0.9%	-1.5%
Tokyo	2.60%	→	60%	1.3%	4.6%	1.1%
Singapore	3.75%	→	55%	3.6%	3.9%	1.1%
Seoul	4.25%	→	60%	4.1%	4.5%	1.5%
Paris	4.25%	→	55%	3.6%	5.0%	0.8%
Milan	4.25%	↓	55%	4.2%	4.3%	0.4%
Frankfurt	4.50%	→	55%	3.6%	5.6%	1.8%
Shanghai (Lujiazui)	4.75%	↑	50%	3.7%	5.8%	2.9%
Madrid	4.90%	↓	55%	4.0%	6.0%	1.5%
London (City)	5.25%	↓	60%	5.2%	5.3%	0.6%
New York	5.50%	→	55%	6.5%	4.3%	1.3%
Sydney	5.85%	→	53%	5.4%	6.4%	1.4%
Dubai	6.75%	→	50%	7.0%	6.5%	2.5%
Los Angeles	8.00%	→	55%	6.5%	9.8%	3.8%
Mumbai	8.25%	↑	60%	9.5%	6.4%	1.6%

Source: Savills Research and Macrobond
Note: Yields may be different to quoted values in markets where the convention is to use a gross rather than net value. Values based on end-of-quarter data. See Methodology for details.

Methodology: Net initial yields are estimated by local Savills experts to represent the achievable yield, including transaction and non-recoverable costs, on a hypothetical grade A building located in the CBD, over 50,000 sq ft in size, fully let to a single good profile tenant on a long lease. The typical LTV and cost of debt represent the anticipated competitive lending terms available in each market. Cash-on-cash returns illustrate the initial yield on equity, assuming the aforementioned LTV and debt costs. The risk premium is calculated by subtracting the end-of-period domestic ten-year government bond yield (as a proxy for the relevant risk-free rate of return) from the net initial yield. Data is end-of-quarter values.

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Key transactions

Tokyo Garden Terrace Kioicho

Tenant:	Multiple, including LY Corporation, MetLife Insurance, Dai-Ichi Life Insurance.
Lease length (WAULT):	Undisclosed
Area:	2.4m sqft
Price / NIY:	JPY400bn (US$2.6bn)/ Undisclosed
Vendor:	Seibu Holdings
Vendor nationality:	Japan
Purchaser:	Blackstone
Purchaser nationality:	United States
Other comments:	Mixed-use asset, comprising two grade A offices, 135 residential units, a hotel and exhibition space, and retail space. Reported to be the largest recorded foreign investment in the Japanese real estate market.

One Museum Place, Shanghai

Tenant:	Guotai Junan Securities, Pfizer, Tencent, Gensler
Lease length (WAULT):	Undisclosed
Area:	1.7m sqft
Price / NIY:	CNY10.9bn (US$1.5bn)/4.5%
Vendor:	Abu Dhabi Investment Authority (ADIA) and Hines
Vendor nationality:	United Arab Emirates and United States
Purchaser:	China Merchants Bank and China Post Life Insurance
Purchaser nationality:	China
Other comments:	ADIA and Hines have sold a 60% share in One Museum Place, LEED Platinum building, at a value that is reported to represent a 20% discount from the original listing price more than a year ago. The deal was the first billion dollar real estate transaction completed in Mainland China in 2025.

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