MONTAGU EVANS PRESENTS...

INVESTMENT MARKET UPDATE 2025

ECONOMIC BACKDROP

THE TARIFFS AND POTENTIAL TRADE WAR UNLEASHED BY DONALD TRUMP HAVE CAUSED PROFOUND DISRUPTION TO THE GLOBAL MARKETS. PROPERTY'S ILLIQUID NATURE MEANS IT IS SLOW TO REACT TO THESE WIDER SHIFTS BUT WILL UNDOUBTEDLY SEE TURBULENCE TOO. THIS WILL – AS WITH OTHER MARKETS – LEAD TO OPPORTUNITIES AS WELL AS RISKS, BOTH OF WHICH THIS PAPER WILL OUTLINE.

The immediate impacts on the UK are macroeconomic. Oxford Economics' GDP forecast for 2025 has been held steady at 1.0%, partly as a result of the strong readings for the first few months of the year. But the 2026 forecast has been cut back from 1.5% to 0.9%.

GDP GROWTH

2024	1.1%
2025	1.0%
2026	0.9%
2027	1.3%
2028	1.8%

Source: Oxford Economics

The forecasting house also expects inflation to rise slightly over the next few months, ending the year a little above 3.0%. But this should fall back in 2026 and beyond, moving into the 2.0–2.35% bracket. Despite higher inflation recently, two more base rate cuts are pencilled in this year, meaning it will enter the New Year at 3.5%, after which cuts may be more infrequent. Gilt rates should also fall as a result, although not as quickly as central bank rates, falling below 4.0% towards the end of 2026.

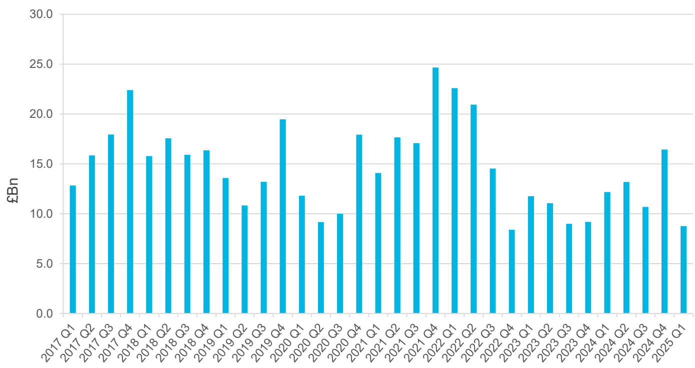
This will create far more supportive conditions for both investment and development markets, and in particular the residential market. Mortgage rates should continue to drop, albeit slowly, which given the imbalance of supply and demand in UK housing, will lead to significant upward price pressures and an improvement in transaction volumes. The recent increase in planning application activity, while not yet strong, may be a sign that this is filtering through to developer confidence.

This will also promote greater investment in real estate, although the economic risks may push investors towards the least risky assets. Investors will also be influenced by second order economic effects on the leasing market resulting from both tariffs and the wider slowdown. These are more likely to impact the manufacturing sector, and regions more exposed to it, than the services sector. This after all is more important in the UK, reflects the larger part of exports to the US and is the key driver of the office market. Retail (and logistics), aside from the wider economic issues, could become more impacted if a full-on trade war develops, although at present the situation looks to be easing.

THE UK INVESTMENT MARKET

The final quarter of 2024 saw the highest level of investment activity – £14.7bn – for over two years. However, Q1 was very subdued, with £7.8bn recorded as a provisional total. It remains to be seen whether this is an anomaly, although it is worth noting that the 12-months to March saw a total of £44.3bn. Although this is 17% down on the 10-year average, it is 21% higher than the previous 12-month period, a significant recovery. This demonstrates that an anticipation of falling risk-free rates and greater confidence in pricing is restoring confidence. Yields have barely moved over the year, although there has been some mild compression in certain retail segments and in multi-let industrial.

TOTAL UK INVESTMENT VOLUMES



Source: Montagu Evans / MSCI Real Capital Analytics

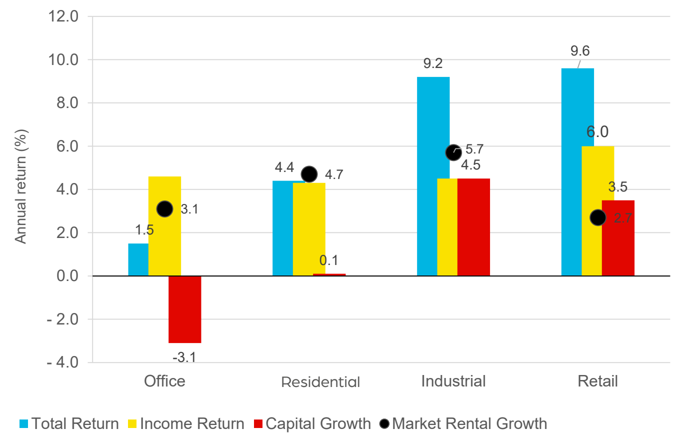
Sectoral differences persist. While the 12 month totals for most sectors are down compared to the long-term average, residential transactions were 12% ahead of the 10-year trend, while retail is only just below it. This reflects different trends, however. The residential sector continues to attract the most intense investor interest. For retail, outside of retail warehousing and a few prime spots, the story is more one of reinvention – the market recovering after years of price turbulence.

SECTOR	Y-O-Y	C/TO 10-YR AVERAGE
OFFICES	11.7%	-49.3%
RETAIL	37.4%	-1.0%
INDUSTRIAL	10.7%	-5.55%
RESIDENTIAL	11.6%	11.9%
ALL	18.6%	-17.1%

Industrial is just over 5% below an average skewed by the unusually large volumes seen after the pandemic, but it is offices that are the real standout. Transactions here are around half the trend level. It is clear that many investors still have reservations about this market. This headline fact obscures two important points. The first is that there is a huge variation by quality and location. London, for example, has robust leasing volumes and rental levels. Secondly, recent quarters have seen a slight improvement in office activity, perhaps reflecting the 'return to the office' trend.

The performance of the various MSCI segments over the past 12 months reflects the office story; it has by far the lowest returns at 1.5%, dragged down by the fact that office pricing is still falling overall (–3.1%). This investor aversion is strong enough to cancel out healthy income returns and rental growth. Digging into the subsegments shows that there is, again, huge variation in capital growth between London and other city centres and a more struggling out of town market (with some exceptions). This does not always reflect variation in rental growth. If the negativity around the segment does gradually dissipate, and the fundamentals are better understood, parts of the market may well be on the verge of a recovery.

MSCI (IPD) QUARTERLY INDEX Q1 2025



Source:MSCI

The strongest returns, however, were actually for retail (9.6%), largely driven by very strong income returns (6.0%). This is partly a result of the extent to which capital values have fallen over the past few years, although they are now recovering from a low base, with 3.5% growth over the year. Total returns for industrial are not far behind on 9.2%, although this is driven more by capital growth (4.5%) – the highest of any segment, evidence that investors are still prioritising sheds. 'Beds' meanwhile have not seen as much movement in pricing, perhaps as yields did not correct as much after the pandemic.

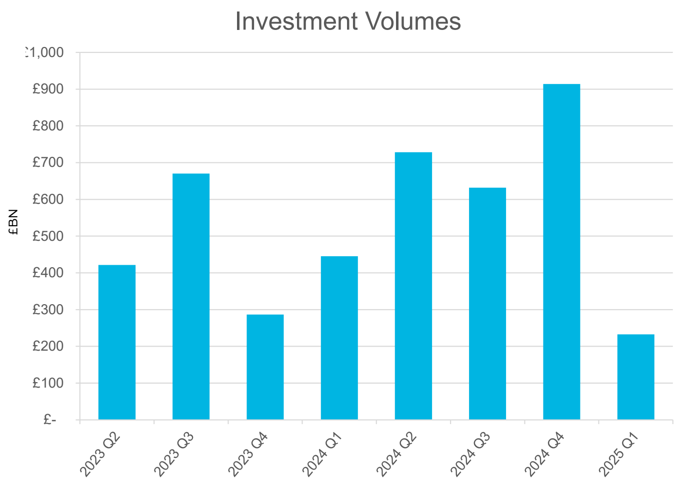
INDUSTRIAL FOCUS

Industrial & Logistics remains the most traded segment, with £10.8bn transacted over the year, although this is significantly lower than in 2021 or 2022 when £15–£20bn was typical. The total is, however, only around 5.5% below the 10-year average, demonstrating that the 2021-2023 period was a blip, and that volumes are returning to their pre-pandemic norm – unlike offices, say, which remain well below that level.

Perhaps more of a concern is the weakness in industrial leasing levels, which fell to a recent low in late 2024 and 2025. Given the wider tailwinds for the sector, and the highly cyclical nature of leasing here, this looks to be a temporary issue, perhaps tied in with global trade tensions.

Those tailwinds – shorter supply chains, larger inventories, the continued growth of online shopping – also explain investor confidence in the sector.

LONDON INDUSTRIAL



Source: Montagu Evans

More interestingly, while vacancy rates have risen in line with the 2021-2023 construction boom (a response to a frenzied marketplace), rents continue to increase, albeit at a slower rate. This unusual combination suggests that the market is seeing some polarisation and that many occupiers are focussed on the best quality space and see logistics efficiency as increasingly central to their business.

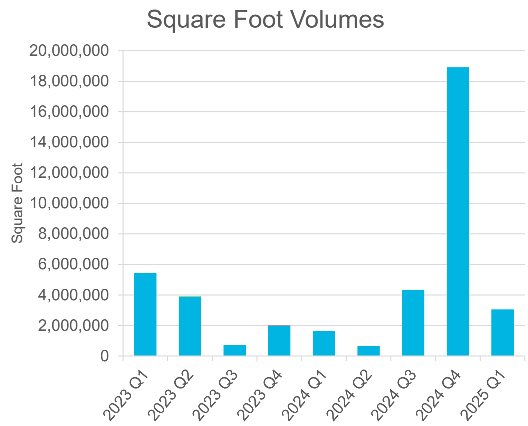
The market also needs to be separated into big box and multi-let logistics. The supply of the former is more elastic, given the amount of consented land in the key locations. The latter is more constrained, particularly in London and other big cities, given the historic loss to residential and the lack of new sites. This explains why there has been some yield compression here. It is perhaps also unsurprising that – while Q1 has been a quiet quarter – 2024 saw a pick-up in London industrial investment activity, a trend that should continue as 2025 unfolds.

RETAIL WAREHOUSING FOCUS

The bifurcation in MSCI performance is evident in the retail sector too, with out-of-town segments generally outperforming. Retail warehousing parks actually have the highest returns of any class, with 12.8% recorded over the 12 months to the end of March 2025, driven by strong capital growth and healthy income, closely followed by out-of-town shopping centres (11.7%). The appeal and convenience of such locations is clearly still strong, although the extraordinary rental growth seen in Central London (9.4%) may be a sign of shifting priorities to come.

The 12 months to March has been a busy period for the sector, with £2.8bn traded, more than double the £1.3bn recorded over the same period a year earlier. Some £1.9bn of those transactions took place in Q4 2024 and Q1 2025 alone. Realty Income remain the most active buyer, accounting for £440m. As a result of the activity of a few major players, just five – Realty, British Land, Columbia Threadneedle, Aberdeen and Ikea – owned almost a quarter (22.6%) of the market by floorspace at the end of 2024, up from 19.6% at the end of 2023. With strong activity from Realty in Q1, this has likely increased even more.

OUT OF TOWN RETAIL



Source: Montagu Evans

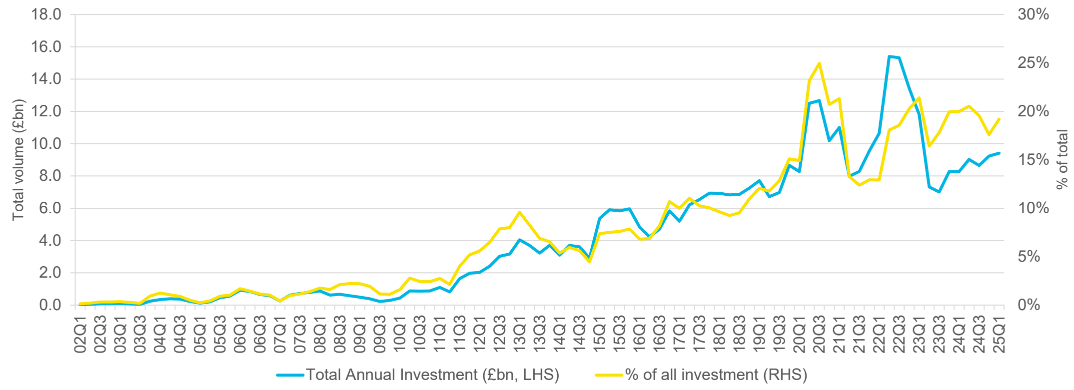
The prospects for retail look relatively robust, although obviously there are risks from global trade disruption and economic weakness. Lower inflation will support the market, with real sales growth of 1.0%, 1.6% and 1.7% forecast for the next three years respectively. It remains to be seen whether this will disproportionately benefit the out-of-town market, given its recent outperformance – or whether a 'return to the office' could be accompanied by an improvement in city centre retail.

RESIDENTIAL

The residential sector has become a far more important part of UK real estate investment. Over the past year, some £9.4bn has been invested in the segment, around 19% of the total – compared to a 10-year average of £8.4bn or 14%; before 2015 the figure was below 10% or £4bn. Much of this, however, is still comprised of forward funding deals rather than the sale or purchase of stabilised stock.

Housing construction continues to slow, however. According to National Statistics, work started on just 25,440 units over the last quarter of 2024, one of the lowest figures on record. For the year as a whole, the figure was 107,520, well below the 300,000 per annum needed if the government's target of 1.5m new homes over its parliamentary term is to be met.

RESIDENTIAL INVESTMENT VOLUMES



Source: RCA

The rental increases that have provoked such interest in the sector appear to have subsided in recent months. In the UK as a whole, rents increased by 3% over the year to February 2025, compared to 7.4% over the previous twelve months (Source: Hometrack). The slowdown has been most marked in London, where the figures are 1.1% and 5.1% respectively, although this comes after a period in which the capital had double-digit rental gains. Parts of the North are still seeing rental increases of over 4%, while some cities – notably Birmingham and Bristol – saw rental increases of more than 7%.

A perception that there is a strong pipeline and supply of rental apartments has combined with concerns over the regulatory and planning process and greater demand from families to push the market towards more "single-family" or suburban rental. The availability of unsold housebuilder product has also supported the growth of this market. Compared to three years before, the end of 2024 saw just under double the number of new homes built (14,142 compared to 8,818) and over four times the amount under construction (12,943 compared to 3,146) (Source: BPF). As a result of investor interest, prime yields for single family rental have fallen 25bps-50bps below multi-family.

The planning pipeline is also slowing, with consent given for just 231,000 units over the year to June 2024, the lowest figure for over 10 years. More timely data from Molior in London suggests that consent was granted for just 13,798 units in 2024, down from 21,646 in the previous year, with only 1,210 starts in the first quarter, a remarkably low figure. However, there is some sign of planning application activity increasing, and with the mortgage market slowly easing, the end of 2024 could represent the 'trough' in the residential market.

OUTLOOK FOR 2025 AND 2026 – A SUMMARY

UNTIL RECENTLY, THE MANTRA IN THE INDUSTRY WAS ‘STAY ALIVE UNTIL ‘25’ – BUT THE MARKET IS UNLIKELY TO DELIVER SALVATION FOR EVERYONE THIS YEAR.

While interest and risk-free rates are definitely on a downward trend – and inflation may undershoot expectations – the easing has been much slower than many had hoped for. Economic disruption caused by international political tensions are a further limiting factor.

However, 2025 will almost certainly see an increase in activity and some downward pressure on yields. Property – an unfashionable asset for a few years at global level – will look more appealing generally, although this may be accompanied by a distinct ‘risk off’ approach given events. Even if the fundamentals (and risks) are shifting a little, the evident demographic and trend headwinds for ‘beds and sheds’ will keep them in the limelight as favoured sectors. The appetite for retail warehousing and urban logistics, in particular, has remained phenomenally strong.

The continued – if gradual – ‘return to the office’, and the evident recovery of some parts of the office market suggest that 2025 and 2026 could be marked by a greater, if highly selective, interest. As this would likely be focussed on city cores and high-quality space, it would further polarise an already polarised market. But it is the residential sector where political, demographic and property market fundamentals are converging most favourably. Moderate downward pressure on yields and a stabilisation in build costs should make some projects more viable, leading to an improvement in construction activity – particularly in the residential sector.

While 2025 will be another year of gradual improvement – albeit not one without somewhat heightened risks – those hoping for a full-on recovery may have to wait until 2026.

MUCH DEPENDS ON THE WIDER ECONOMIC TRAJECTORY, WHICH DESPITE THE FORECASTS GIVEN EARLIER, IS PERHAPS MORE UNCERTAIN THAN EVER.

FOR MORE INFORMATION AND INSIGHTS TALK TO ONE OF OUR TEAM...

ED GEORGE
IS A PARTNER AND HEAD OF COMMERICAL AND AGENCY
M 07818 012 489

TOM PATON-SMITH
IS A PARTNER AND HEAD OF INDUSTRIAL AND LOGISTICS
M 07818 012 440

ADRIAN OWEN
IS A PARTNER AND HEAD OF RESIDENTIAL
M 07557 950 456

TIM HAYNS
IS A PARTNER AND HEAD OF RETAIL AND LEISURE SECTOR
M 07717 427 478

JON NEALE
IS HEAD OF RESEARCH AND STRATEGIC INSIGHT
M 07879 113 151

IZZY MILLER
IS A RESEARCH ANALYST
M 07768 310 861

CLICK TO CONTACT

MONTAGU-EVANS.CO.UK