

MARKET PULSE: UK PROPERTY INSIGHTS

YEAR-END 2025:

UK AUTUMN BUDGET, MARKETS AND ECONOMY

11 DECEMBER 2025



THE BUDGET

The UK budget finally took place on 26th November. After what felt like months of speculation, leaks, denials, U-turns and rumours, it felt like a genuine anticlimax. There had been suggestions – some reversed - that it could contain some radical measures, including an increase in the basic rate of tax, the imposition of national insurance contributions on rental income, and significant changes to the council tax system, among others.

In reality, it changed little (at a time when it could be argued that something significant *is* required, if not exactly those trailed). There were no radical changes to the UK tax system; the primary additional revenue-raising measure was the retention of the existing income tax bands until 2030/31. These are actually the bands set in 2021, which were originally frozen to 2026 and then 2028. The effect of these freezes is to bring more people into higher tax bands as their income rises naturally with inflation, a process known as 'fiscal drag'.

Other announcements relevant to property include:

- A 2pp increase in the tax rates applicable for rental income from property (for individuals).
- A High Value Council Tax Surcharge (HVCTS) for residential properties worth £2m or more. This will be £7,500 for homes worth £5m or more; £2,500 for the remainder.
- The ability for mayoral authorities to charge an overnight levy ('tourist tax').

Some in the industry were disappointed that there were no further measures to make residential development easier (as are being consulted on in London), although an extra £48m is being made available to recruit planning staff.

The new rating list (for business rates) and the new multipliers were announced. There are some significant increases for certain properties, especially in the hospitality sector, reflecting a combination of changed circumstances and the expiry of reliefs dating back to the pandemic. These will have impacts on the market in the longer term and will be dealt with in an upcoming note.

The bond markets reacted calmly to the budget, even though the fiscal consolidation is kicked into the medium term. 10-year gilt yields fell by around 17bps around the day of the speech and have remained roughly at that level since. However, the UK's fiscal situation remains poor and further turbulence is possible, especially if growth disappoints and borrowing overshoots. Given the internal politics of the Labour Party, this could be complicated by political turbulence.

The National Minimum Wage (for 18–20-year-olds) will increase by 85p to £10.85 per hour from April 2026, with the Living Wage (for those over 21) will rise by 50p to £12.71. This will have a slight inflationary effect, although this will probably be offset by price falls in other areas.

More importantly, it could impact the wider economy as firms will be less likely to take on new staff. This could be particularly felt in the hospitality sector given the other challenges, not least the increase in business rates outlined above. Indeed, this sector is likely to see more than its fair share of headlines over the coming year.

In summary, the budget does not have any radical impacts on the larger-scale real estate sector; nor does it contain any major growth-enhancing measures that might improve markets indirectly. Private residential ownership and investment is a different matter though.

Changes to council tax will have a marginal impact on the high-value residential market, while the tweaks to property income taxation will further discourage landlords. They have been hit by a variety of measures in recent years, not least the Renters' Rights Act, which comes into force on May 1, 2026.

This will have indirect impacts on the wider residential market, decreasing the supply of rental homes, which in the long term will push up rents. This will help to support the argument for build-to-rent property of all types, as well as increasing the demand for homeownership. The reduction in capital requirements (and potentially new entrants) will, at the same time, help to ease conditions in the mortgage market for first time buyers, albeit over a longer time scale.

Back to the budget, though: this wasn't a terrible set of policies, but it wasn't great either. Putting aside the political questions around tax-and-spend and the benefit bill, it kicks the wider issue of the sustainability of UK government finances into the long grass. All the 'consolidation' is in the future, close to the next election (politically unfeasible in reality), or based around vaguely defined 'efficiency gains'. The hope must be that some decent economic growth comes along and saves us.

Where that is coming from is the big question, of course. The budget documents make a lot of references to ongoing planning reform – implying that while there were no new measures announced in the budget, more reforms are to come, or at least more pressure to properly enact what has been put in place so far. (There were a few more details on various initiatives aimed at stimulating regeneration in the big city-regions, such as Mayoral Revolving Growth Fund) The overall conclusion is that development of all types is (a) going to be enabled and (b) expected to do a lot of economic heavy lifting.

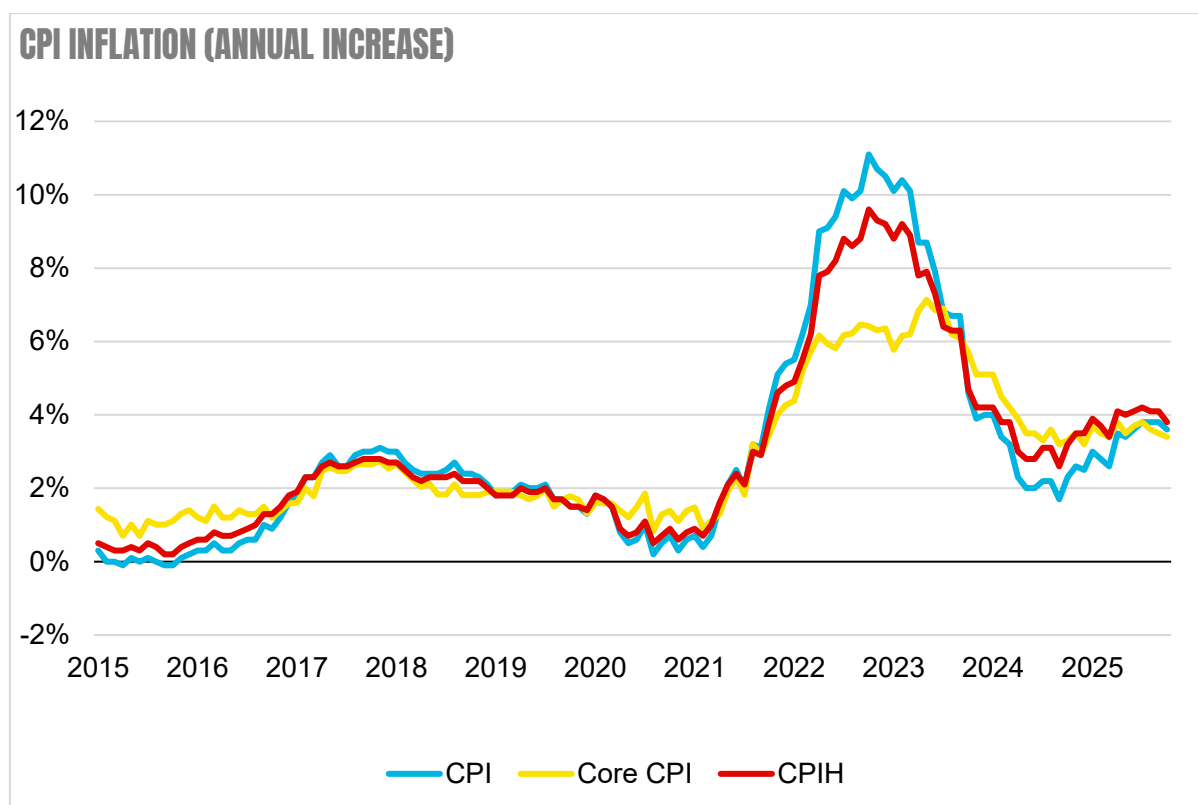
THE WIDER ECONOMIC BACKDROP

The recent economic news has not been overwhelmingly positive. GDP shrunk in September (by 0.1%), meaning that growth over the third quarter came it at just 0.1%, somewhat below expectations of 0.2%.

So far, so gloomy. But dig beneath the (recent) headlines and the picture looks a *little* better. Firstly, despite Q3 disappointments, GDP is 1.3% higher than a year ago. This is mediocre by historic standards, but compared with France's 0.9%, Australia's 0.8%, Canada's 0.8% and Germany's -0.2%, it looks pretty good, the second highest in the OECD. (The US of course is well ahead of the pack at an estimated 4.0%, although much of this is a result of huge investment in AI which may or may not be a bubble).

What's more, the 'hacking' issue at Jaguar Land Rover – the UK's largest automotive manufacturer – are partly responsible for the weak reading, with a 28.6% fall in the automotive sector taking place in one quarter. This should bounce back in Q4. But with the leading PMI indicators showing very moderate expansion in services and ongoing weakness elsewhere, it is unlikely to be very strong. The overall picture, then, is positive but sluggish; Oxford Economics expects only 1.0% growth next year.

Inflation readings for September came in rather lower than expected; although the change in CPI was static compared to August (at 3.8%), this was 20bps lower than market expectations. There have also been signs of the labour market weakening, with private sector pay growth slowing and payroll numbers falling slightly. As a result, there now seems to be an expectation that inflation has reached a peak (compared to the trough of mid-2024) and will now fall, albeit slowly. This is clear in the Oxford Economics forecasts shown below.

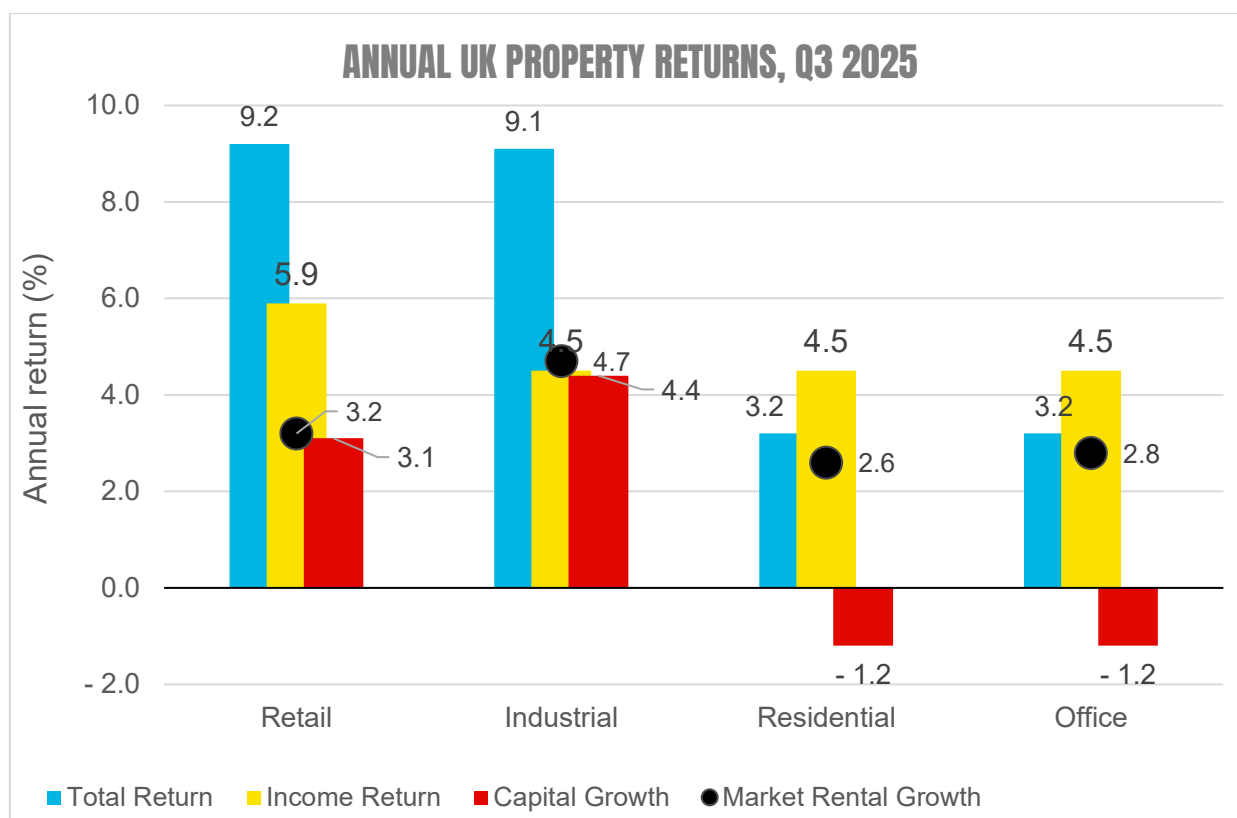


Until mid-November, the markets appeared to have digested this, and the rumour that Chancellor Rachel Reeves was preparing to fill the 'hole' with an income tax rise. 10-year gilt yields fell 30-35 bps since during the middle of October. Although there was some turbulence around the budget – which saw yields rise c. 20bps and then fall again – this is the level at which they have remained. If inflation continues to fall (especially if it surprises on the downside), then there could be further mild falls. But as noted above there are also upside risks if concerns over the sustainability of finances mount again. That is why Oxford Economics has gilt yields ending 2026 at only around 10bps lower than today.

STATE OF THE INVESTMENT MARKET

Investment returns have shifted considerably over the past year. All-property returns for the year to Q3 2025 stood at 6.6%, compared to 2.3% at the same point in 2024. This is largely because of capital growth moving into positive territory (1.6% compared to -2.6% at Q3 2024). Yields have generally stabilised – even if there are still complaints that buyers and vendors are not “on the same page”.

However, there are stark differences between the sectors. Retail has taken over from industrial as the strongest performing segment with annual returns of 9.2%. This is predominantly driven by income return (5.9%), partly a reflection of how low retail capital values have fallen. To be fair, though, retail is now seeing some capital growth (3.1%), demonstrating that it is coming back into favour with investors – and indeed the likes of Land Securities, who now see it as a more profitable option for development than residential.. Performance *within* retail is bifurcated, though, with out-of-town segments doing much better than in-town; that might be temporary though, as rental increase in some in-town locations now look pretty strong.



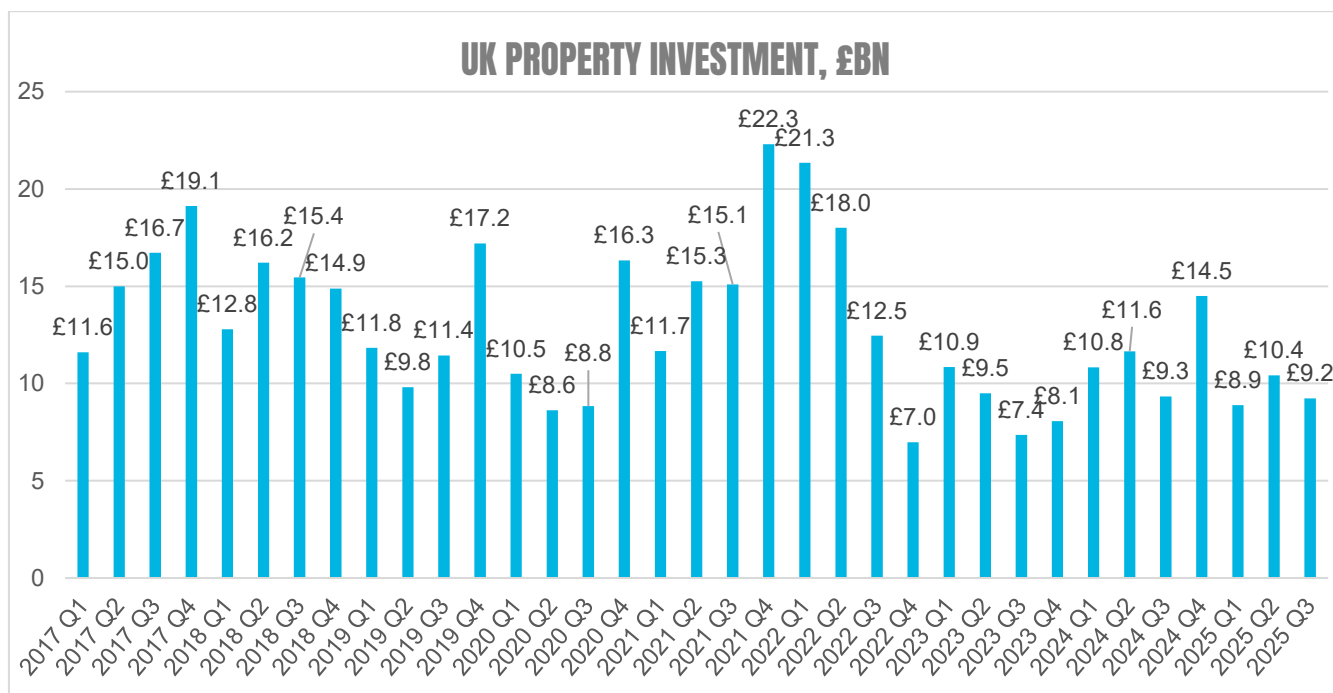
Source: MSCI Quarterly UK Property Index

Industrial is not far behind however, with annual returns of 9.1%, supported by both the highest capital growth of any segment (4.4%) and decent income (4.5%). The former demonstrates that this is still the segment most in demand among investors, even if the leasing fundamentals appear to have deteriorated somewhat over the past year or so (see below). This probably reflects a long-term perspective that sees demand for logistics space growing, given consumer and trade patterns and forecasts, and jackpot alternative use values in the form of data centres.

The office sector, while just in positive returns territory, is still struggling, mainly because capital growth is still negative at -1.2% y-o-y. This is despite a relative robust leasing market (at least in core locations such as Central London) and a 'return to the office' that is evident both anecdotally and in transport data. My theory is that global investor sentiment on the segment remains tepid, partly because of the shocks of recent years, partly because of the much worse US experience dominating investor mindsets, partly because there are genuine concerns around obsolescence and associated capital requirements. To be fair, Central London and Regional Office Parks (high returns, like retail) are outperforming.

The wider quandary, according to CoStar at least, is that regional construction volumes are at the lowest level this century, while rental growth is at the highest level. This is explained by the fact that rents are not yet high enough to make development viable, but when that changes, it will be against the backdrop of a market that has been starved of stock. The situation is arguably not so different in London, with construction now slowing and rents still healthy. The supply of grade A space here could also soon start to look insufficient. The office market could have a lot more vim a couple of years, then, but investors are not listening, yet.

Transaction volumes are a different story. Across all segments, some £9.2bn changed hands in Q3 – down 11% on Q2 albeit roughly in line with the same quarter in 2013. The total for the year so far is £28.5bn, compared to £31.8bn at this point last year, so there is no sign of a recovery, at least in the figures, even though sentiment is slowly improving.



Source: MSCI Real Capital Analytics

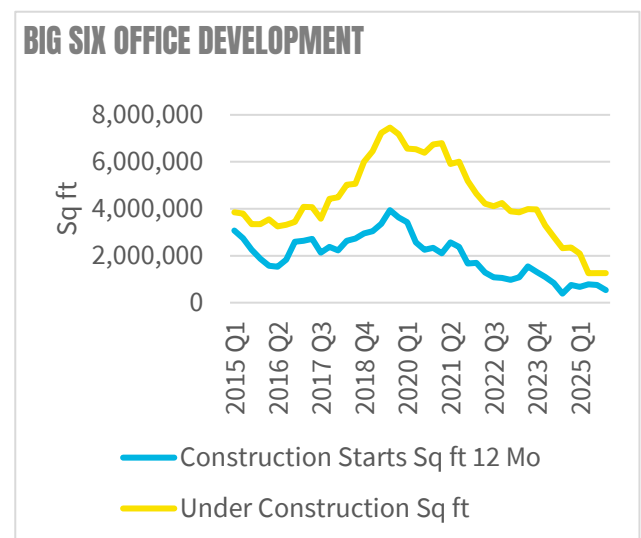
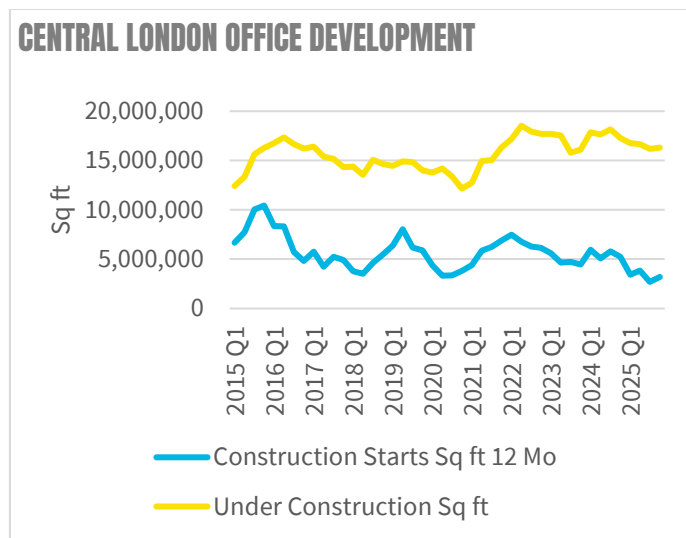
Looking into the detail, it was a strong quarter for residential in recent and relative terms. This was driven by a number of large PBSA deals, including QuadReal's acquisition of the Apollo Portfolio for £550m and KKR's £230m purchase of the Curlew portfolio. Greystar also purchased the build-to-rent Barking Wharf scheme for £180m. Data Centres also saw £1.3m transacted, the strongest for three years. Taking an annual perspective, it is residential and industrial that are up year-on-year (24% and 40% respectively). Offices is up to (19%) albeit from a very low base – driven by Central London investment, recovering after a remarkably poor 2024, which plumbed depths not even explored in the GFC.

SECTOR	Y-O-Y
OFFICES	18.6%
RETAIL	-27.0%
INDUSTRIAL	39.6%
RESIDENTIAL	23.6%
HOTELS	-31.9%

THE LEASING MARKET

The recovery partly results from the strong fundamentals. Unlike regional markets, leasing has recovered to only just below the levels seen before the pandemic (they are well below elsewhere). Vacancy rates, though are substantially higher at c. 10% compared to c. 6%; this reflects the extraordinarily high level of construction in the City in particular. It is not that this space is all now empty, rather that it has generally displaced older, more obsolescent stock which is in some cases now struggling to find a new use.

The charts below show the contrasts between the two markets; construction volumes have been higher than average in Central London – albeit starts have now started to slow – whereas in the regional markets activity collapsed post-pandemic and never recovered. This is obviously related to construction costs, viability and rent levels not just demand. A further question is what the current slowdown in starts means given that letting has remained strong.

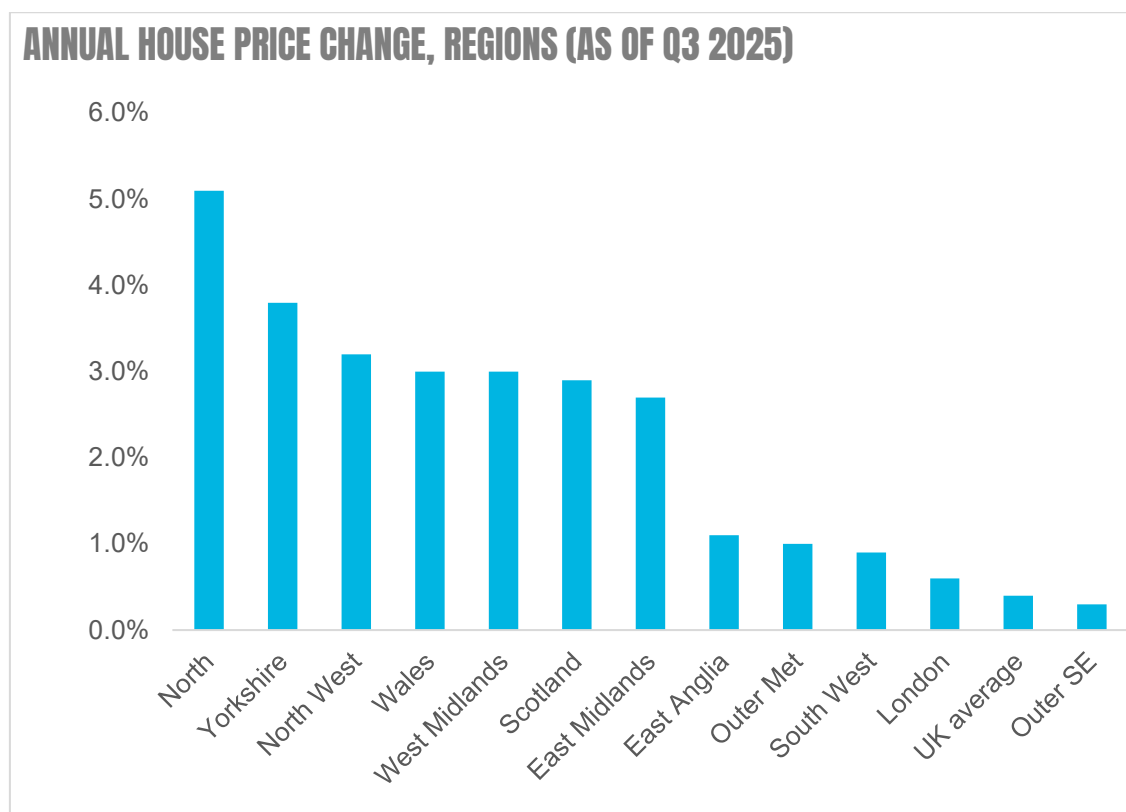


Source: CoStar

The industrial market is rather more puzzling. Gross leasing (on an annualised basis) is the lowest since the pandemic started; vacancy rates have increased from circa 3% to almost 6%; and net absorption of space has been negative since the start of 2024. Yet the appetite of investors remains strong. This must be a combination of the wider story around logistics growth, and potentially the fact that providers need new space, and that there is a similar story to the office market – i.e. vacancy is concentrated among older stock.

RESIDENTIAL

Annual UK house prices growth has been just over 2% over the past few months, somewhat below inflation, although there is a big difference between London and the South (1% or below) and the North of England (over 3%), which surely reflects the lower affordability pressure in the latter.



Source: Nationwide

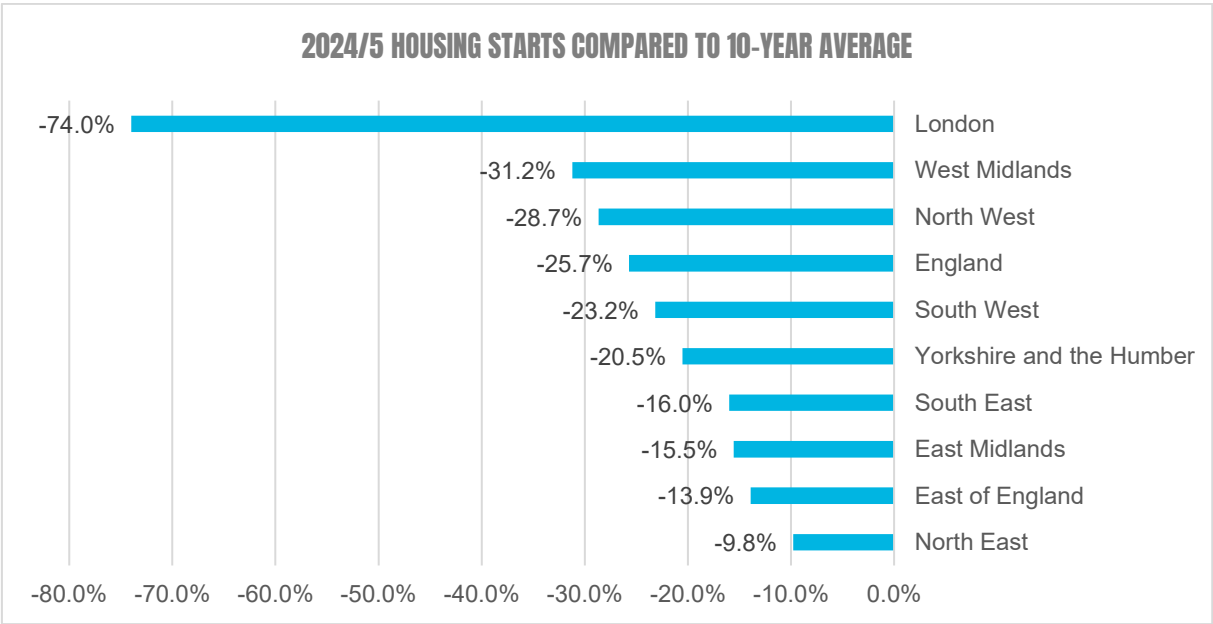
Rental increases show a similar, if less marked, divergence – according to Hometrack, they are down at 1.7% in London, but at 3.8% in the North West; quite the change, still, from a year ago when all regions outside London were seeing rents rise at the equivalent of 5% per annum. With mortgage rates gradually falling, these figures should bump up slightly over the next 12 months.

The bigger story in residential, though, is the ongoing lack of construction activity. Housing starts rose again in Q2, to 31,430; the highest since Q2 2023, but still low, certainly well below the 300,000 per annum government is aiming for. It's not as if the planning pipeline is filling up' the number of units in all outstanding residential applications fell again in Q2.

The situation is not uniform everyone. In some regions – the North East, East of England – starts are only 15% below the 10-year average. In the most urbanised regions outside London, the North West and West Midlands, starts are circa 30% down. In London, though, the figure is 74%. The reasons for London's problems are probably shared by other cities to some extent, but they don't occupy the whole of their regions. A disproportionate number of London's delivery is in flats, which are (a) out of favour with buyers (b) more expensive to deliver (c) require more upfront investment and most of all (d) are being held up enormously by the building safety processes for buildings with over 6 storeys.

The reasons are explored more thoroughly in our report on London's Homebuilding Crisis at <https://www.montagu-evans.co.uk/research/londons-homebuilding-crisis-policy-challenges-market-pressure-and-solutions/>. Since then,

the government has announced a set of measures – reduced affordable housing requirements and Community Infrastructure Levy (CIL) and higher levels of housing grant – which look set to significantly improve viability.



Source: National Statistics

The problems extend to other cities too, even if the scale – and impact on the national picture – is much less significant. The wider issues with urban regeneration are discussed in another of our recent reports, *Unlocking Urban Potential: The Next Phase of UK Regeneration* at <https://www.montagu-evans.co.uk/research/unlocking-urban-potential-the-next-phase-of-uk-regeneration/>. Circling back to the subtext of the budget, unblocking this will be central to moving the country to a higher growth trajectory over the coming years.

A FINAL NOTE

To conclude, the situation is not hugely changed since the last quarter. A market that (outside development and construction) appears to be very slowly improving. Inflation has surprised on the downside and economic growth on the upside (although the forecast is gloomier). This all rather suggests that – notwithstanding any dramatic events, political or geopolitical – the market will be a *little* better in 2026, but a full-throated recovery may be some distance away.

Residential and Central London are the areas to watch, though. The former is getting all the policy attention, and some investor attention to, with several headlines reporting increased institutional interest. The latter has performed consistently well, and perhaps next year will be the one in which the wider market starts to notice this.

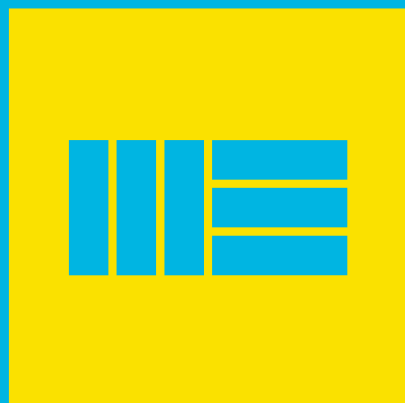
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