

An aerial photograph of the London skyline, featuring prominent skyscrapers like the Gherkin and the Shard. The image is overlaid with a semi-transparent blue filter. In the top left corner, the word "WATLING" is written in white, bold, sans-serif capital letters, followed by a white circular icon containing a lowercase letter 'i'.

**WATLING** 

# PROPERTY MARKET REVIEW

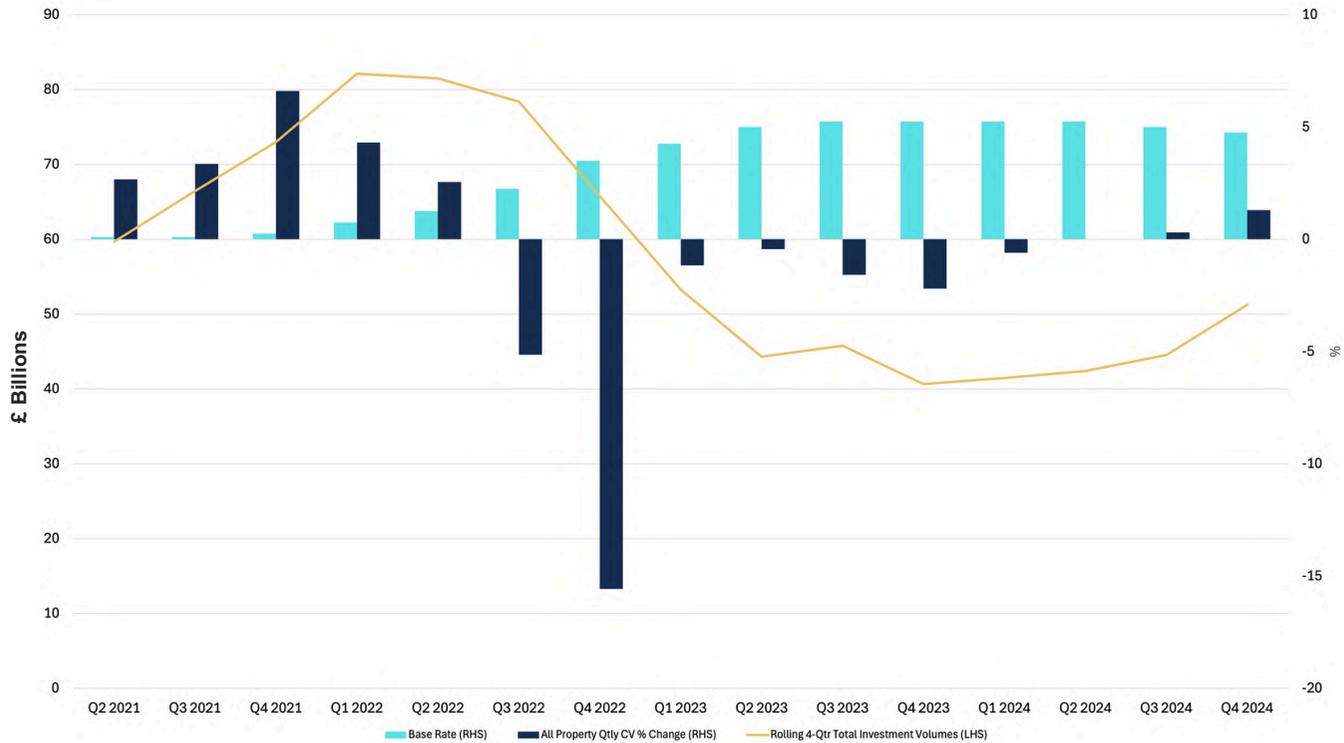
Focused for Insolvency Practitioners and Business Support professionals dealing with Real Estate assets across the UK

*Q1 2025*

# MARKET OVERVIEW

Improving market data suggests the bottom of the market has passed

Rolling 4-Quarterly Investment Volumes vs Base Rate vs Capital Value Change



Source: Bank of England, Avison Young, Various

- Towards the end of 2024, with expectations of base rate cuts growing, investment volumes and capital values turned a corner. Positive rental growth is seen across all main market sectors.
- However, 2025 has seen the Trump presidency create significant volatility in the financial markets, with US tariff imposition and counter tariffs from several countries generating global economic uncertainty. The geopolitical situation in Russia / Ukraine and the middle east only exacerbates matters.
- There is an acceptance amongst most commentators that while 2025 will see some UK market recovery, it will remain particularly challenging, with some segments of the market facing extreme pressures from high costs and weak business confidence.

# WATLING VIEW

Whilst both capital values and investment volumes are rising, the changes are modest and overall market activity remains subdued. Moreover, the detail behind the data shows the increases are driven by a small number of “big-ticket” prime property investment transactions. In general, we are seeing a benign market with caution being adopted by most purchaser groups.

Stress continued across all property sectors, most notably in secondary markets where facilities are expiring and investors have limited economic interest remaining as a consequence of the value declines in H2 2022 and 2023 (see graphic). Where forced sales follow, and lending is required to support a purchase, transactions times are increasing and often exceed three to four months due to a general lack of competitive tension in the market and lender and buyer apathy.

The majority of our distressed work over the last six months has involved the residential sector. This has included high end prime London houses (falling values), apartment schemes (mis-management and increased operating costs) and part built schemes (see overleaf). We expect these challenges to continue throughout 2025. Those investors that are active continue to favour the industrial and specialist sectors, including PBSA and hotels.

**4.75%**

UK base rate unchanged in March

**-0.1%**

UK GDP in January (vs 0.4% in December)

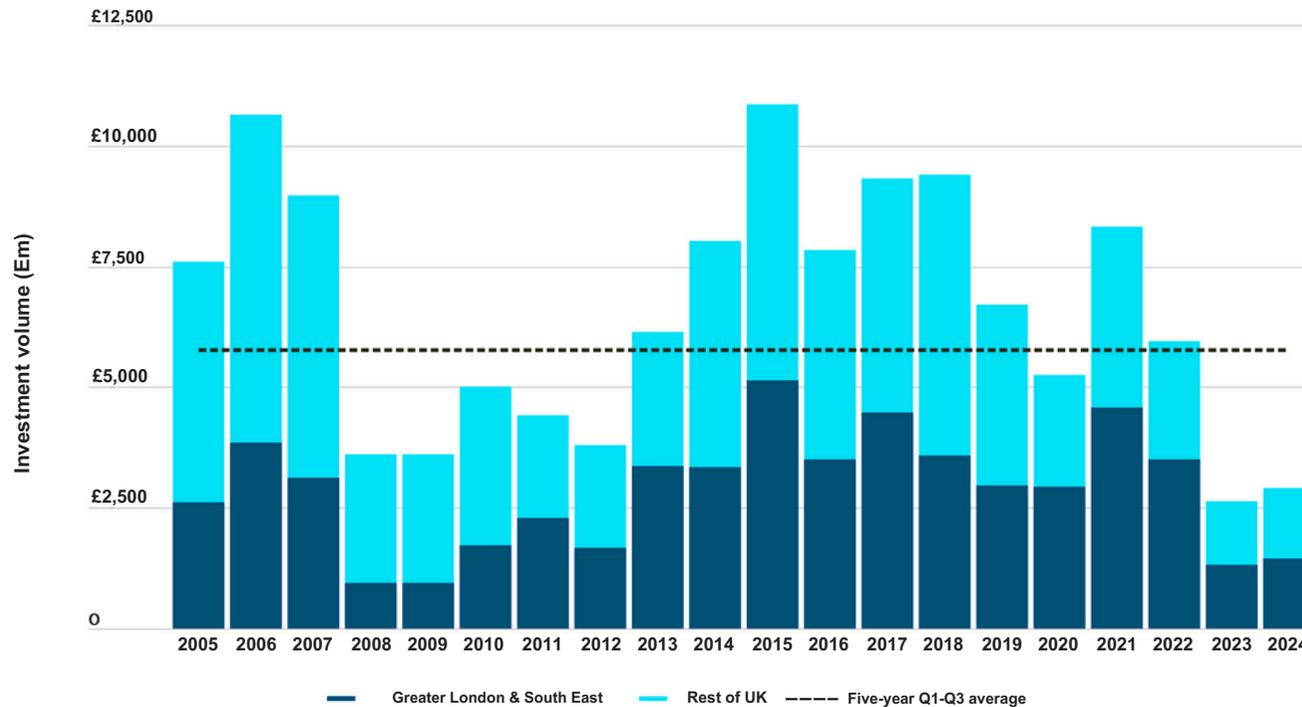
**£2.6bn**

January investment volumes (-27% y/y)

# OFFICES

Have office values bottomed out?

## Office transactions excluding Central London



Source: Savills Research, MSCI

- ▶ Prime regional office yields have stabilised at 6.5%. Between June 2022 and November 2023, prime regional office yields softened by c.190bps and secondary regional city yields moved out by c.400bps.
- ▶ 2024 office transaction volumes (excluding central London) totalled £2.9bn. While this figure is 10% above the 2023 level, transaction levels remain subdued at 49% and 61% respectively below the 5-year and 10-year averages.
- ▶ With base rates expected to fall throughout 2025 and the prime yield gap between regional and central London offices at well over 200bps – the widest spread in 30 years – combined with healthy occupier demand, 2025 looks set for an escalation in regional office market activity.

# WATLING VIEW

We are currently seeing a polarisation between the lacklustre office investment market and the strong occupier market, particularly for Grade A assets. Take-up across the six major regional cities reached 4.6m sq ft, 15% above the five-year average and at its highest level since 2019.

An increasing number of corporates are mandating a “return to office”, including Tesco, Asda, Barclays, HSBC, Amazon and Salesforce. With many companies having downsized post-covid, this is not only driving the demand for additional space, but the demand is very much for “best in class” to encourage staff to return and to aid staff retention.

Savills reports that 16m sq ft of office space was taken out of the market and repurposed last year. Combined with the fact that several regional office markets have limited new build or refurbished Grade A options due to pre-letting and development lag, rental growth in the prime market is almost guaranteed. BNP Paribas Real Estate is forecasting rental growth in regional office markets of between 20% (Manchester) and 28% (Leeds and Birmingham) over the 2025 to 2029 period.

The question remains as to whether the strength of occupier demand for Grade A space filters down to Grade B quality stock. In cities where the demand / supply imbalance is acute, and tenants have very limited options, we would anticipate that the best located Grade B premises will benefit. However, there will remain a raft of stock edging towards distress and obsolescence.

**6.5%**

Prime regional city office yields

**11.0+%**

Secondary regional city office yields

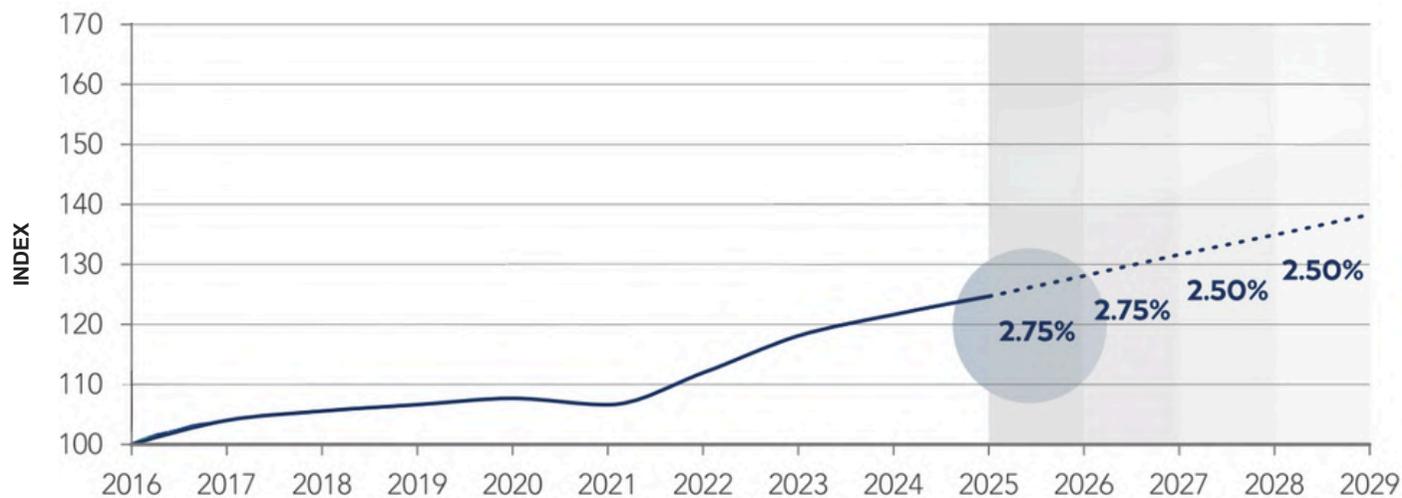
**£41.50 to £48.00 per sq ft**

current prime rental range for the top six regional markets

# DEVELOPMENT

Increasing construction costs to continue impacting the development sector

Tender Price Trend - All UK TPI



Source: Gardiner and Theobald

- ▶ The chart illustrates how tender prices plateaued during covid / lockdown in 2020/2021 and then increased sharply in the following two years as construction activity regained momentum.
- ▶ Construction inflation is expected to continue to impact development activity, driven by labour cost pressures, ongoing sticky inflation in the wider economy, and high financing costs. Higher tenant and investor expectations for ESG-compliant buildings are raising base specifications, further adding to cost pressures.
- ▶ Gardiner and Theobald describe the market as being caught in a cycle of high costs, limited supplier capacity and increased risk aversion. Market uncertainty is being shaped by UK fiscal policy, the global geopolitical situation and regulatory challenges.

## WATLING VIEW

With muted occupier / purchaser demand across most property sectors development remains financially challenged in most regions. Without significant uplifts in Gross Development Value (which is unlikely) the forecast increase in build costs will do little to enhance the viability of this troubled sector throughout the next two years.

As we move into 2025, the falls in office values are likely to continue and be more pronounced in regional markets. A lack of debt availability for refinancing office assets is likely to become more pronounced, resulting in further distress and, potentially, crystallising lower valuation points.

Industrial values have increased since March, albeit at a modest rate, and we expect that this sector will continue to thrive, particularly for prime / logistics units. Secondary industrial markets will continue to be threatened by environmental obsolescence, with lenders continually assessing EPC risk weighting across their portfolio.

Growth sectors will include Living, notably PBSA (for the short term, see Watling i Q3 2024), senior housing, co-living, and infrastructure, including data centres, renewables and energy storage. Repurposing obsolete underperforming assets to these emerging sectors may present exits for some stressed cases.

**2.75%**

All UK Tender Price Index Annual forecast for 2025 and 2026

**3.00%**

London Tender Price Index Annual forecast for 2025 and 2026

**6.5%**

UK Construction Wage Growth - 2024

# RETAIL

Vacancy rates remain high. Could High Street Rental Auctions have an impact?

### High Street and Shopping Centre Vacancy



Source: Local Data Company, Green Street

- ▶ Shopping centre vacancy rates have fallen steadily from a peak of 19.4% in Q3 2021 to 17.2% in Q4 2024, with a 50bps fall in Q4 2024.
- ▶ High Street vacancy rates also peaked in Q3 2021 at 14.5%. While the vacancy rate has improved, it remains persistently high at 13.8%. The October budget induced higher retailer costs are yet to fully filter through but will likely temporarily reduce demand and stall any further short-term improvement in vacancy rates.
- ▶ MSCI data suggests that high street retail has seen extremely modest annual headline rental growth since mid-2023, with shopping centres remaining in negative growth territory. With substantial incentives often required to lease units, growth at a net effective rent level is likely to be flat at best for high streets and firmly negative for all but the very best shopping centres.

# WATLING VIEW

In December 2024, the regulations enabling compulsory high street rental auctions (HRAs) came into effect. This empowers local authorities to enter into contracts and grant leases as if they were the landlord on “qualifying high street premises”.

The government has allocated just £1m of funding to local authorities to support the process – which equates to just over £3k per authority. With local authorities already experiencing resourcing and financial constraints, and with many higher priorities, one wonders how strong the appetite to pursue this complex initiative will be. We cannot point to any examples to date.

Units may be vacant for a variety of legitimate reasons, but it may simply be that there is a lack of occupier demand. In a particular location, even if the rent is nominal, retailers are unable to trade at a level that covers other costs, such as business rates, utilities and staffing. The HRA process will not change this.

However, there will be instances where landlords are unwilling to let a unit at below what they consider to be the market rent because to do so will have a negative impact on the value of the unit and any other units in proximity. The HRA process will, in many cases, have the effect of forcing a lower rental tone in a particular pitch of the high street, in turn impacting values and potentially causing landlord distress. The law of unintended consequences.

**1.3%**

All Retail Rental Growth 2024

**3.5%**

All Retail Capital Growth 2024

**4.2%**

All Retail Capital Growth forecast 2025

## LONDON

60 Cannon Street, London, EC4N 6NP

## BIRMINGHAM

75/77 Colmore Row, Birmingham, B3 2AP

## LEEDS

One, The Embankment, Neville Street, Leeds, LS1 4DW

## MANCHESTER

Tootal Buildings, 56 Oxford Street, Manchester, M1 6EU

## BRISTOL

17-19 Berkeley Square, Bristol, BS8 1HB

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