

WATLING 

PROPERTY MARKET REVIEW

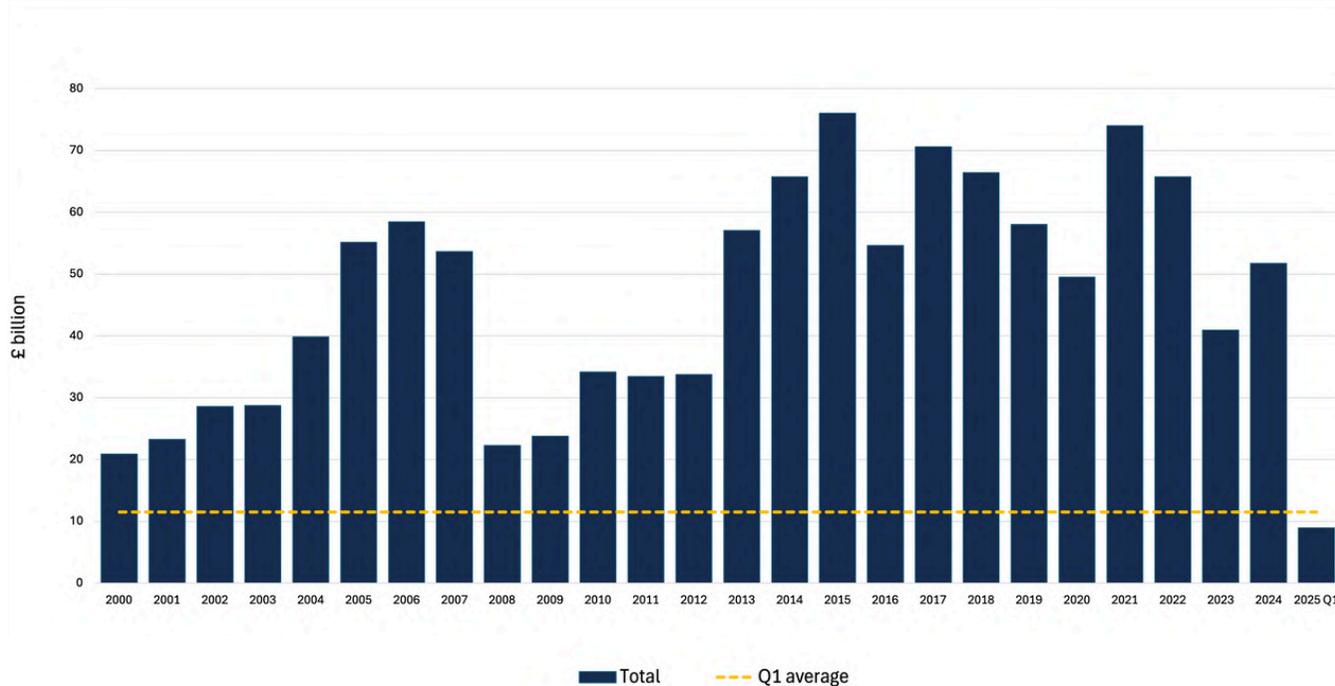
Focused for Insolvency Practitioners and Business Support professionals dealing with Real Estate assets across the UK

Q2 2025

MARKET OVERVIEW

More realism about valuations is needed as the property market improves

UK Commercial Real Estate Investment Volume



Source: MSCI Real Capital Analytics

- Occupier demand is broadly in line with longer term averages, which coupled with constrained supply is driving healthy rental growth across many markets and sectors – albeit typically confined to better quality properties and locations.
- However, wider geopolitical and economic concerns continue to overhang investment sentiment. Mainstream investors lack the confidence to enter the market, while opportunistic buyers are holding out for deeper discounts on pricing. Transaction volumes are around 30% below the five-year average.
- Investment transaction activity is likely to improve through the second half of 2025, and could accelerate sharply as investors gain confidence from seeing others enter the market. Equally, any further deterioration in the economic and political environment will damage confidence and push the true recovery back to 2026 and beyond.

WATLING VIEW

This is the time when the property market should offer good buying opportunities, but investors are still holding back. With banks keen to lend and interest rates falling – albeit slowly – it shouldn't take much for the investment cycle to kick back into gear.

When it does, we expect that the flow of distressed property onto the market will rise significantly. A recovery in values may help some borrowers, but it also encourages those lenders adopting a “watch and wait” strategy to take action once they see more options to resolve problematic loans. Typically, the early stages of any upturn are when we see a surge in repossessions and distressed sales.

At this stage it is critical that lenders make sure they are well informed about the true state of the local market, and don't get misled by averages and headlines. Investor and occupier demand, and thus value recovery, are currently highly differentiated, with better quality stock doing well but many poorer buildings almost unlettable.

In most cases, any valuation assuming “typical” void periods with a reletting at the current rent is likely to be materially higher than what can be achieved in practice. Make sure you have a realistic, locally-informed valuation before deciding how to move forward in dealing with an existing borrower.

4.25%

UK base rate (vs 4.75% in January 2025)

0.7%

UK GDP growth Q1 2025 (vs 0.1% Q4 2024)

+12.8%

Construction insolvencies, Q1 25 vs Q4 24

RESIDENTIAL DEVELOPMENT

Recovery in house price growth hasn't offset the numerous other headwinds

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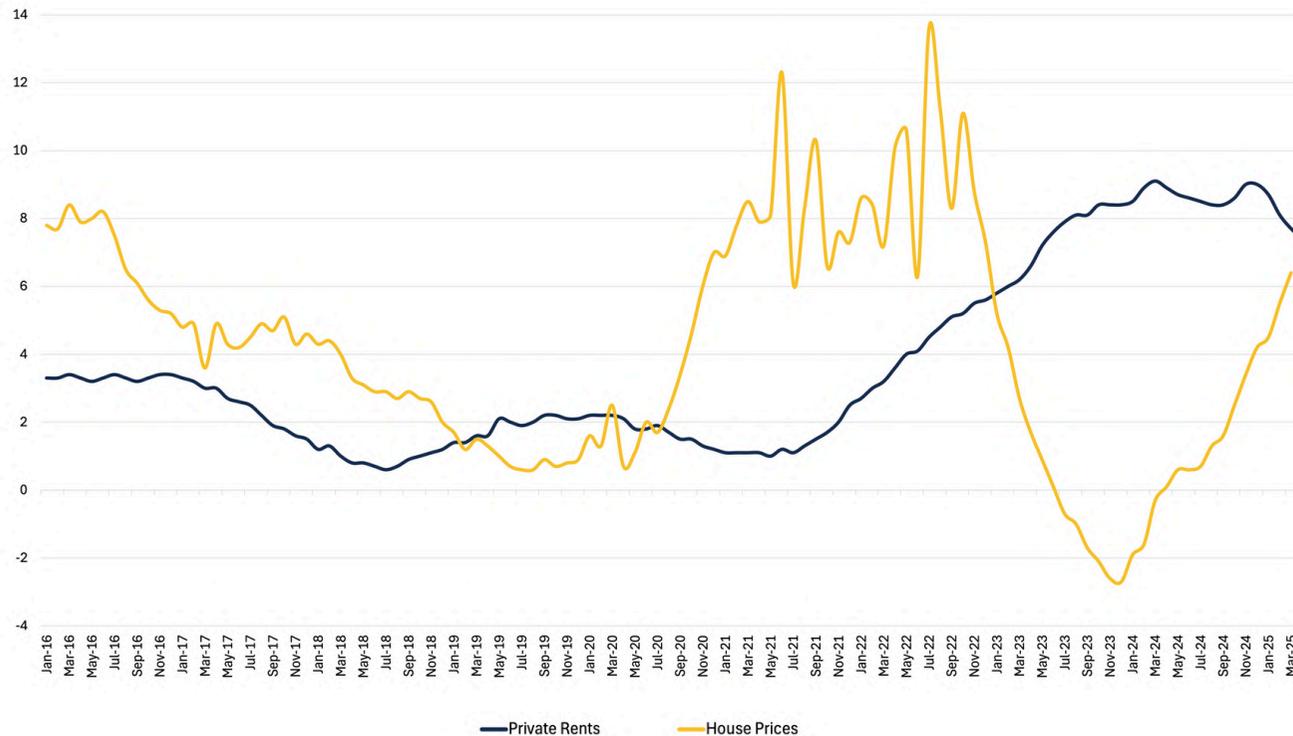
We continue to see significant levels of distress coming through in the residential development sector, which has now been the primary source of problem loans for some time.

The 50bps of interest rate cuts and continued recovery in house prices seen so far this year have helped some developers, but significant headwinds remain. Construction costs are still far higher than they were at the start of the decade, challenging the fundamental viability of schemes that have taken time to get through the UK's tortuous planning regime, or were delayed by falling values in 2023/4.

Furthermore, amendments to the Building Regulations mean that from September 2026 any new residential building above 18m in height (ie 6 storeys) will be required to have a second staircase. This is leading many schemes to be replanned at lower height, leading to further delays and increased costs. With the Building Safety Levy (see opposite) also set to hit many developers next year, these pressures are impacting the viability of schemes that were already marginal when sites were purchased at the height of the market.

Affordable housing "Registered Providers" have previously been active buyers of sites seeing little demand on the open market, but are currently finding it difficult to make purchases. This further limits the options for lenders looking to dispose of sites taken back from borrowers in default.

House Price and Private Rent Growth (%pa)



Source: ONS

- ▶ The recovery in house prices seen in 2025 continued through the start of this year. Volumes will have been boosted by buyers looking to complete before the Stamp Duty Land Tax increase at the start of April. London saw the slowest rate of growth in the country, suggesting that pricing is already stretched in the capital.
- ▶ According to Savills, urban land values fell by 1.9% in the year to March 2025, whilst greenfield values rose by 1.3%. Concerns over the economic outlook, regulatory environment and construction costs are making developers cautious.
- ▶ The Building Safety Levy, being introduced in the autumn of 2026 to help fund remediation of cladding issues on unsafe buildings, will add further pressure to housebuilders in England. It will be payable by developers of all new residential developments of more than 10 units, including houses and flats, build to rent schemes, PBSA and conversions to residential use. This could be challenging for some schemes where lower house prices have already impacted viability.

6.4%

ONS Annual house price growth, March 2025

-1.9%

Savills Urban Land Value change, March 2025

£3.4 billion

Target revenue for the Building Safety Levy

PURPOSE BUILT STUDENT ACCOMMODATION

Increasing construction costs to continue impacting the development sector

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UCAS Undergraduate Student Acceptances by Domicile



Source: UCAS

The Purpose Built Student Accommodation (PBSA) sector has expanded rapidly across Europe to take advantage of a historic undersupply of affordable housing, growing student numbers and, particularly in the UK, a rise in international students.

Student numbers are broadly stable, but the strong growth recently forecast has failed to materialize. The composition is also changing. The sharp post-pandemic decline in EU students has been partly offset by increased demand from other countries, but this is moderating. Universities are now forecasting a short-term decline in foreign students, who are a vital source of tuition revenue. They are also important to PBSA providers, particularly those operating at the premium end of the market where the product is almost entirely aimed at international students.

PBSA competes with other private landlords letting houses, particularly for UK students who are typically more price-sensitive. With overall university room bookings for 2025/6 lower than usual so far this year, we will see pressure on rents and more students agreeing 42-week rather than full year deals. We are already seeing more HMO (houses in multiple occupation) schemes in default. This could also spell trouble for some PBSA providers in second tier markets where demand is weaker or there is now an oversupply, with both occupancy levels and rental competition putting income under pressure.

- ▶ Historic rates of growth in student numbers have been exceptionally strong, and the UK is a key destination for overseas students. Further growth is likely with Canada and Australia tightening policies on foreign students, but OfS report entrant numbers to the UK being 21% lower in 2024/5 than previously forecast.
- ▶ A recent study of 180 European cities by Patrizia ranked London top for PBSA investment attractiveness. Five other UK cities including Manchester, Bristol and Edinburgh made the top ten, and in total nine UK cities were classed as “prime established” markets.
- ▶ £744m was invested in the UK PBSA sector during Q1 2025, broadly in line with last year, according to Knight Frank.

2.08 million

Higher education students, 2023/4

70%

Growth in total non-UK students since 2015

-68%

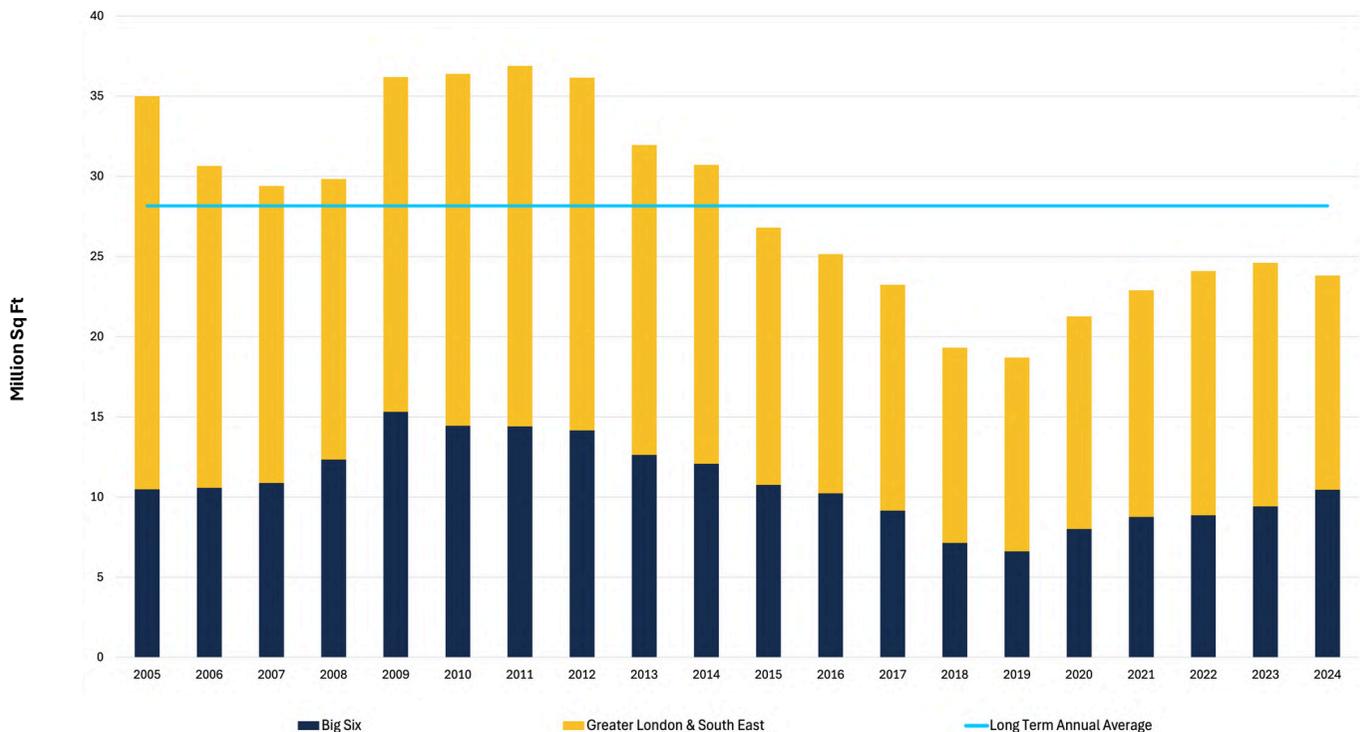
Decline in EU student acceptances 2020 to 2024

REGIONAL OFFICE SECTOR

Occupier markets show surprisingly positive trends, but investors remain wary

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Office Supply Outside Central London



Source: Savills

The office sector has experienced a torrid time since the pandemic. Changing working patterns, environmental pressures and a lacklustre economy have all impacted demand across the market. Add in the dramatic increase in construction and financing costs, coupled with a shortage of skilled contractors equipped to carry out refurbishments, and it's not surprising many office investors have experienced difficulties.

But behind these familiar headlines, the market fundamentals are in surprisingly good shape. Demand is recovering, helped by a number of large companies mandating a more significant return to the office. Various agents report that many more occupiers are looking for space to expand than are "right-spacing" into smaller units. For those lenders with exposure to the sector this will come as a welcome relief after several years where the news has been unrelentingly negative.

However, the recovery is very selective. Shortages of Grade A stock in central city locations mean some occupiers are looking a little further afield, and repositioning of some buildings is becoming more viable, but only where the location and end product will clearly meet current occupier requirements. For now, investors remain extremely cautious about stepping in to buy challenging properties, and lenders should to remain equally wary.

6% pa

Q1 2025 regional office prime rental growth

6.75%

Regional office market prime yield

2%

Fall in regional office availability in Q1 2025

- ▶ Prime rents are rising across most major UK office markets, driven by stable demand and an increasing shortage of supply of good quality buildings. Much older stock has been taken out of supply or is effectively unlettable, and development activity is at historically low levels.
- ▶ As a result, contrary to what might be expected given the negative newsflow about the sector, office supply is well below the long term average, particularly outside Central London.
- ▶ KPMG's latest CEO survey found that 83% of business leaders expect a full return to office working over the next 3 years, up from 63% in 2023.
- ▶ Investment volumes in regional markets totalled just £297 million in Q1 2025 according to Cushman & Wakefield. This is 60% below the previous quarter and the lowest quarterly total since 2012.



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