WATLING i

PROPERTY MARKET REVIEW

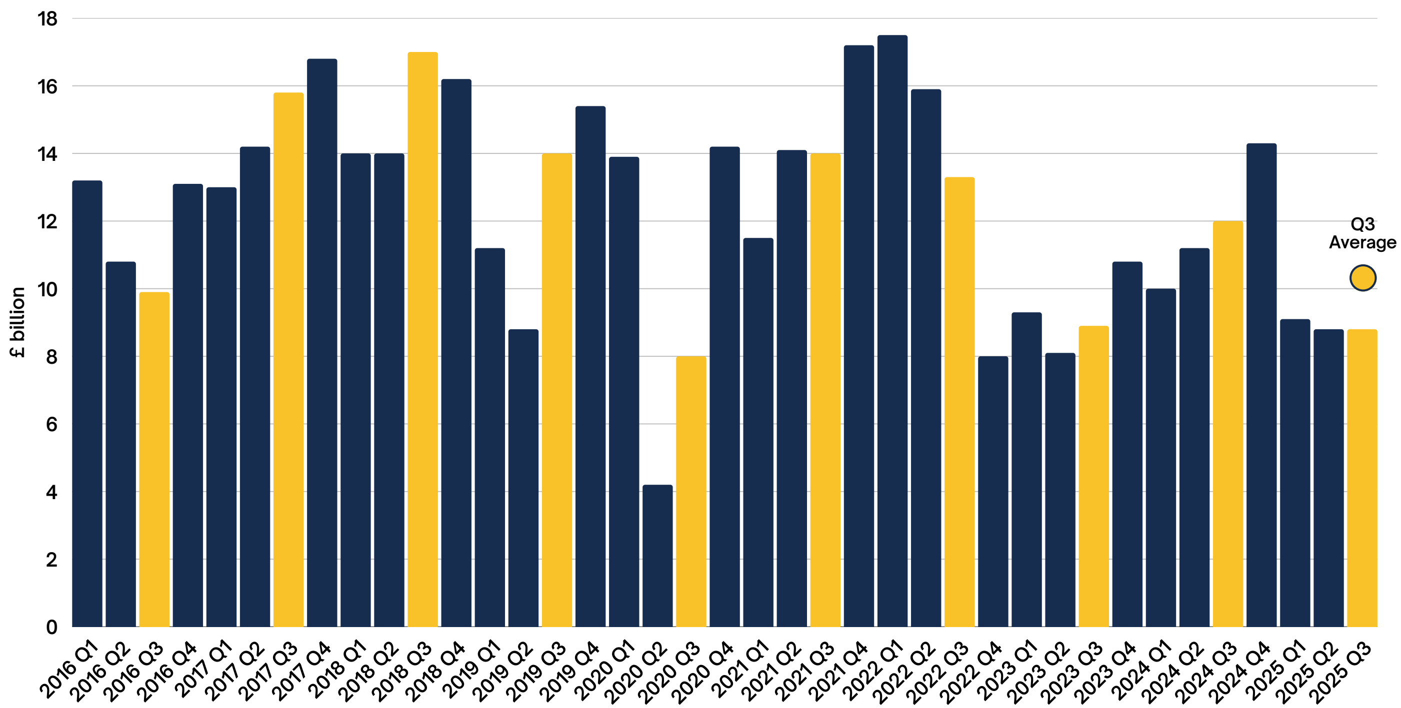
Focused for Insolvency Practitioners and Business Support professionals dealing with Real Estate assets across the UK

Q4 2025

MARKET OVERVIEW

Confidence still the missing ingredient, but sellers need more realism over pricing

UK Commercial Real Estate Investment Volume



Source: MSCI

- Investment transaction activity tends to be highly cyclical, with the second half of the year typically contributing 55-60% of the annual total. Volumes in Q3 2025 were around 30% down on the 10 year average for the third quarter.
- With uncertainty overhanging the market through to the late November budget, transaction volume for the year as a whole is set to be well below the level seen in 2024.
- Living sectors are seeing strongest interest from investors, although activity levels in the office sector are also picking up.
- Opportunistic buyers are prominent in the market but they are looking for a clearer margin between purchase and exit value than currently often exists. Negotiations tend to be protracted, deals are taking longer to complete, and sellers need to be well prepared to avoid giving buyers additional reasons to delay the process or “chip” the price at the last minute.

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After a comparatively healthy start to the year, the UK economy slowed markedly through 2025. Overall economic activity fell slightly in the 3 months to October, with construction activity recording a sharper decline through the autumn. Uncertainty over the Budget was clearly a key factor; the early signs suggest a recovery of sentiment in December but this came too late to provide a meaningful boost to the real estate market.

There remain many reasons for investors to be cautious, and real estate is not the only sector affected. UK government bond yields are now higher than most other advanced economies, reflecting general market skepticism about the government’s financial management. Real estate pricing is sensitive to bond yields and to the related cost of debt, so this does have an impact on property’s attractiveness as an asset class.

With the positive news on inflation and wages encouraging the BoE to finally cut interest rates again in December, we remain of the view that the preconditions for a revival are largely in place. With inflation and interest rates both set to fall this year, albeit slowly, we would expect this to be a period of stronger activity as buyers seek out the value-add opportunities that will take them into the next cycle.

With construction costs remaining elevated, we need to see more realism amongst sellers about the true value of risky secondary assets that require upgrading to make them attractive to occupiers. Lenders on impaired debt may soon start to use their leverage to apply pressure in this direction, as they seek to finally resolve problem loans to create capacity on their books for new lending.

-0.1%

UK GDP growth in the 3 months to October

5.1%

UK unemployment rate, highest since January 2021

3.75%

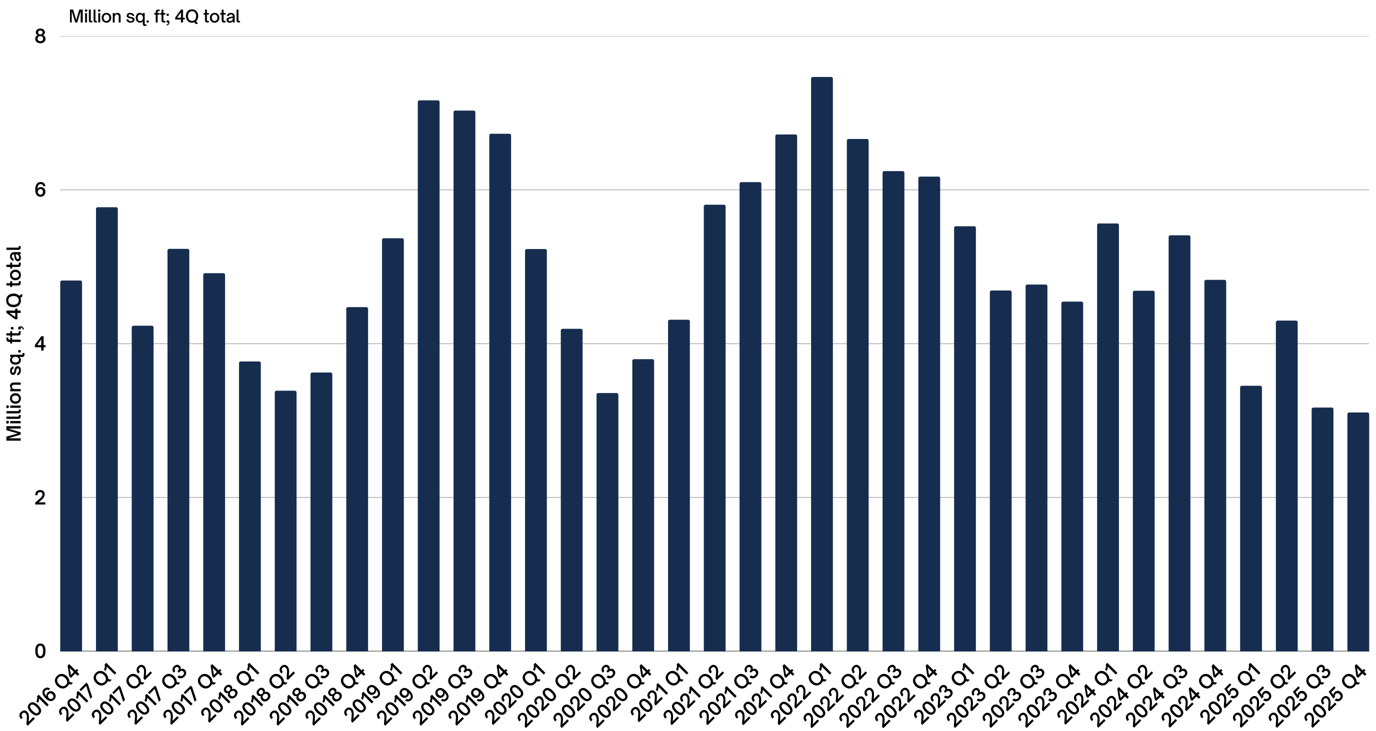
BoE interest rate, Dec (first cut since August 2025)

CENTRAL LONDON OFFICES

Strong performance in 2025 may be an indicator of a more widespread pickup in activity

WATLING VIEW

London Office Construction Starts



Sources: CoStar

- The Central London development market has been comparatively active in recent years, with around 8 million sq completed during 2025. This represents a record year for completions. However, construction starts in 2025 fell to their lowest since 2010.
- 2026 and 2027 will see a lower level of completions at 6-7 million sq ft pa, although a third of the completions scheduled for 2027 have not yet started construction. According to agents reports, a further 10 million sq ft is scheduled for completion in 2028/29, 60% of which is not yet being built. Around a quarter of the total pipeline has already been pre-let.
- Although the strategic case for new construction or refurbishment appears clear, the practical barriers are significant. The time taken to find a site, develop a scheme and secure planning permission is considerable. Construction costs are high and uncertain, debt finance is expensive, and the economic and market outlook is unclear. Whilst in aggregate the case for construction appears undeniable, the risks surrounding any specific scheme are considerable.

We have long held the view that office occupancy will ultimately return to more "normal" levels, albeit with a hybrid element. With increasing numbers of employers mandating a return to the office at least 3 or 4 days a week, central London may be an early beneficiary of this process.

That is not happening without significant changes in the market. Occupiers now require top quality space that is attractive to employees, and highly accessible locations that minimize the burden of commuting are in strong demand. Vacancy rates for Grade A space that meets these requirements are extremely low across most core submarkets, and this appears unlikely to alter any time soon. Construction starts in the capital are at a 15 year low, new schemes take time to bring online, and refurbishments are challenging given the high level of build costs and the price of debt.

As a result, rents are rising sharply at the premium end of the market as occupiers compete for the best available space. Pre-lets are likely to become more common, with lenders increasingly competitive around larger high quality schemes. This has not escaped the attention of investors, with transaction volumes in central London running well ahead of 2024 levels.

Central London's office sector is often seen as the bellwether of the UK market as a whole. The dynamics now playing out here could well start to be seen more widely in 2026, albeit that the bifurcation between "the best and the rest" will remain a constant theme.

2.1%

West End Grade A office vacancy (BNP Paribas)

£145 psf

New record rent achieved in the City of London

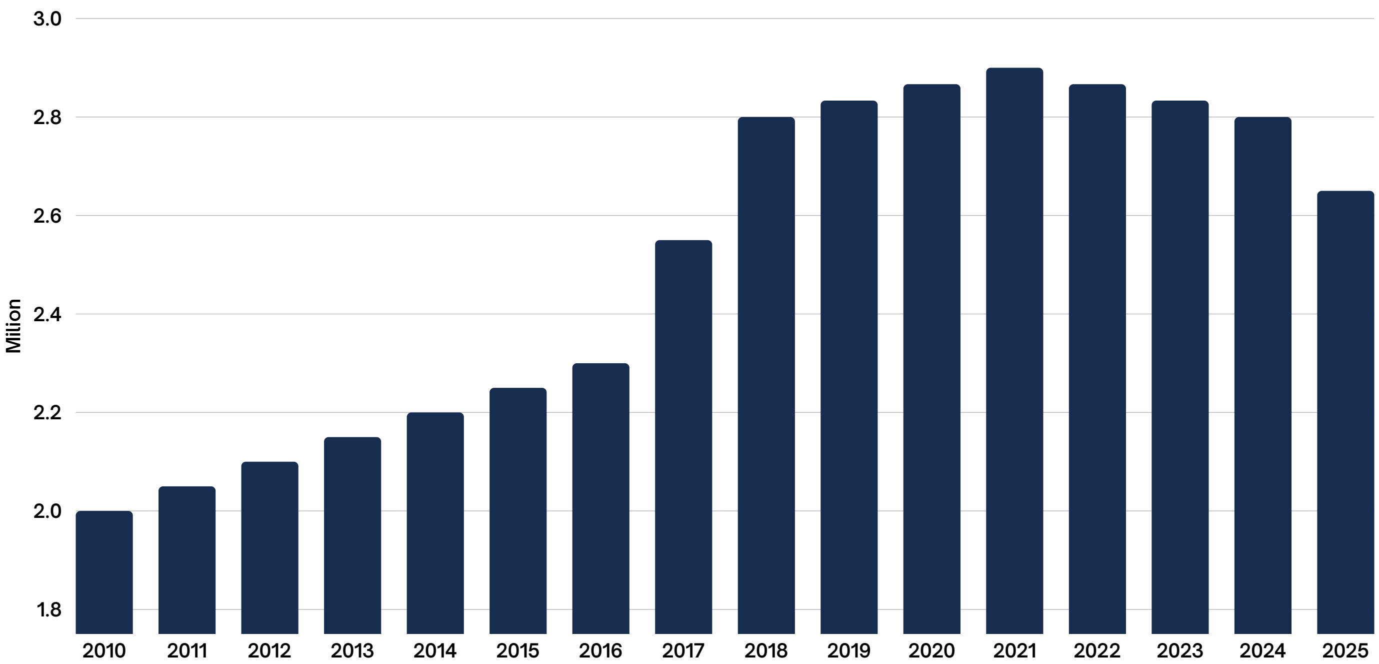
80%

Proportion of space being leased that is Grade A (C&W)

RESIDENTIAL

Private rented sector continues to professionalise amid growing headwinds

UK Private Residential Landlords



Sources: English Private Landlord Survey (EPLS), DLUHC/English Housing Survey*

*includes estimates; some years interpolated.

- Private landlords are exiting the UK residential market due to a combination of financial pressure, regulatory change, and shifting risk-reward dynamics that have made buy-to-let (BTL) far less attractive than in the past.
- Higher mortgage interest costs, which continue to ripple through the market as fixed-rate deals reset, are encouraging many existing owners to sell out. The 3% stamp duty surcharge on second homes and the new 2% additional tax on rental income are additional disincentives.
- Regulation and compliance costs are also increasing, with EPC and licensing requirements imposing time and financial costs on landlords. With house price growth having slowed, returns are lower and many ageing owners at or approaching retirement are choosing to cash out their gains, with ever fewer BTL buyers in the market to replace them.

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The residential rented sector is continuing to see consolidation in favour of professional operators as the steady decline in individual landlords appears set to accelerate further following the recent Budget.

The overall housing market remained sluggish during the second half of the year, mirroring the wider economy which also slowed, amid buyer uncertainty over what measures the Chancellor would introduce to help repair the government's finances.

Larger investors continue to favour the living sectors and the latter part of the year has seen funds continue to flow into build-to-rent (BTR) properties. Challenges around the viability of construction are encouraging buyers towards operational assets, with financing harder to secure for smaller, riskier projects.

We continue to believe that the preconditions are there for a more sustained recovery in the residential market when the economy, and confidence, improves. The latent demand in the market and the ongoing undersupply of UK housing will continue to offer opportunities, although lenders should be wary of localised pockets of oversupply or schemes not appropriately positioned relative to local demand.

In general, the ongoing withdrawal of private landlords from an increasingly difficult environment for "amateurs" and smaller players will benefit the larger, more professional operators capable of delivering quality product that suits the local market.

1.8%

House price growth in the year to November according to Nationwide

-32%

Net balance, RICS surveyors seeing an increase in new buyers minus those seeing a decrease (Nov 25)

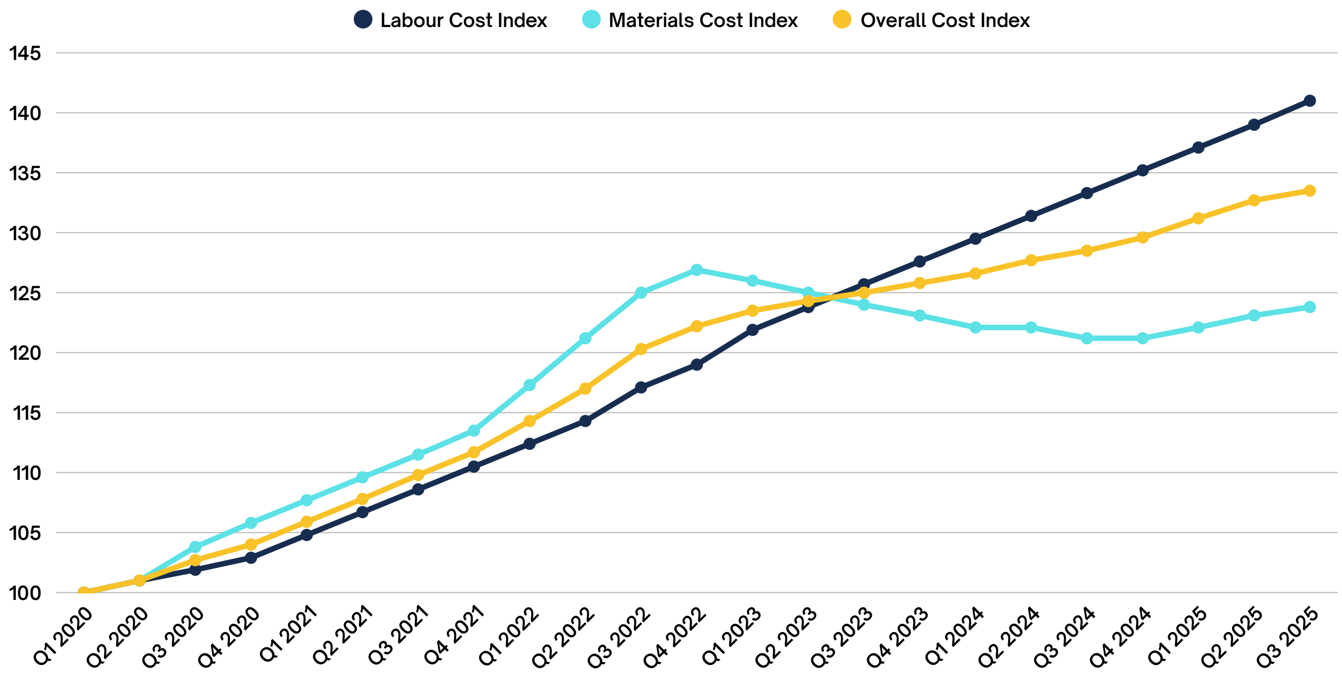
5%

UK average rent increase, year to Oct 2025 (ONS)

CONSTRUCTION COSTS

Repositioning assets is strategically attractive but remains financially challenging

UK Construction Costs Since The COVID Pandemic



Source: BCIS, Industry Sources

- Overall construction costs are typically around a third higher than pre-COVID, though this does depend on the particular project, driven initially by materials price shocks and more recently by sustained labour cost inflation.
- Materials costs experienced extreme volatility in 2021–2022, reflecting global supply-chain disruption, energy price spikes, and geopolitical tensions. While these pressures have since moderated, material prices have largely stabilised at elevated levels and ongoing exposure to global commodity markets continues to create volatility risk.
- Labour costs have now become the dominant driver of construction inflation. Persistent skills shortages, Brexit-related workforce constraints, increases in the National Living Wage, and higher employer taxes have pushed wage growth above general inflation. As a result, labour cost indices show steady and continuing increases, even as materials inflation slows.

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UK real estate construction costs have risen sharply since 2020 and remain structurally higher than pre-pandemic levels, even though inflationary pressures have eased from their peak.

This is now one of the key challenges facing the market, particularly in the office sector. The total reduction in demand for space as a result of hybrid working will be lower than many anticipated, but it is clear that the nature of that demand has fundamentally changed.

Occupiers need top quality space that meets the new environmental standards to attract employees back to the office. Such space is now clearly attracting a rental and capital value premium, and in many markets is in increasingly short supply. One would expect this to be the catalyst for a wave of upgrading and repositioning of well-located secondary assets. This is being held back by the current level of construction costs and uncertainty over their future trajectory.

Looking ahead, industry forecasters such as BCIS expect construction costs and tender prices to continue rising, albeit at a slower, more stable pace. Medium-term projections suggest growth typically in the low single digits over the next few years.

Upgrading properties to meet both environmental legislation and occupier demand will remain challenging until rising values for better quality assets – or further declines in the price of redundant buildings - justify the investment required.

4.4%

BCIS Building Cost Annual Inflation, Oct 2025

7.1%

Annual construction labour cost growth to mid-2025

15%

Forecast construction cost increase to 2030 (BCIS)

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