

Economy and Property Market Update

December 2025

Challenging economic outlook remains a drag on real estate and construction

ECONOMICS

Summary

The recent Budget confirmed the subdued outlook for the economy reflecting, in part, the belated lowering of the productivity assumption that forms an integral part of the analysis. The downbeat tone to the message is also being reflected in key real estate and construction indicators with activity generally flatlining. Forward-looking metrics remain a little more positive but it remains infrastructure that is showing the most solid trend. A modest improvement is envisaged for housing development aided by the passage of the Planning and Infrastructure Bill.

Economy

As was widely trailed, the Office for Budget Responsibility (OBR) lowered its assessment of trend productivity for the UK economy and accompanied this announcement with a scaling back in growth expectations for the next few years in the November Budget. However, on a slightly more positive note it did revise upwards this years number to reflect a stronger than anticipated first six months (Chart 1).

Alongside the focus on the economic outlook, much attention in the Budget was directed towards the fiscal numbers and the increase in the tax burden which, when measured as a share of GDP, is anticipated to climb above 38% by the end of this parliament. If it were to get to this level, it would represent the highest tax take since the 1940s. Whether this is consistent with the growth mantra that has formed a central pillar of the governments rhetoric ('number one mission') remains to be seen. Significantly, business investment is viewed (according to the OBR) as being fairly flat through the forecast period dropping 0.4% next year before edging up in 2027 (by a meagre 0.6%). This will be partly offset by a stronger commitment from the government to boost public sector capital outlays which are projected to rise by 7.8% next year followed by 5.4% in the subsequent twelve months (Chart 2).

Interestingly, even with public sector net debt seen as holding in the 95% to 97% of GDP range through the time horizon of the report, the gilt market has responded to the the various measures announced in the Budget with a degree of equanimity. Although much of the spending was front-end loaded and the tax changes back-end focused, the Chancellors commitment to sticking with the fiscal rules enabled bond investors to breathe a sigh of relief. Chart 3 demonstrates this point by tracking the recent performance of the two and ten year gilts. That said, it is worth bearing in mind that the British government is still having to pay considerably more than comparable countries to fund its borrowing; the 10 year German yield stands at just to 2.75% while in France the equivalent rate is 3.48%.

Money markets are now a little more confident that further base rate cuts are in the pipeline even though neither the OBR nor the Bank of England anticipate an early return of the inflation rate to the 2% target. Critically, the looser labour market which is manifesting itself in an increase in the unemployment rate is likely, over time, to exert downward pressure on pay settlements embedding a lower rate of core inflation beyond 2026. Alongside this, the rail fares freeze and measures to reduce households' energy bills should also help to push inflation lower. That said, money markets are currently doubting that the Monetary Policy Committee will lower the base rate much beyond the 3.5% area.

Chart 1: The OBR has scaled back its forecasts for growth over the next few years

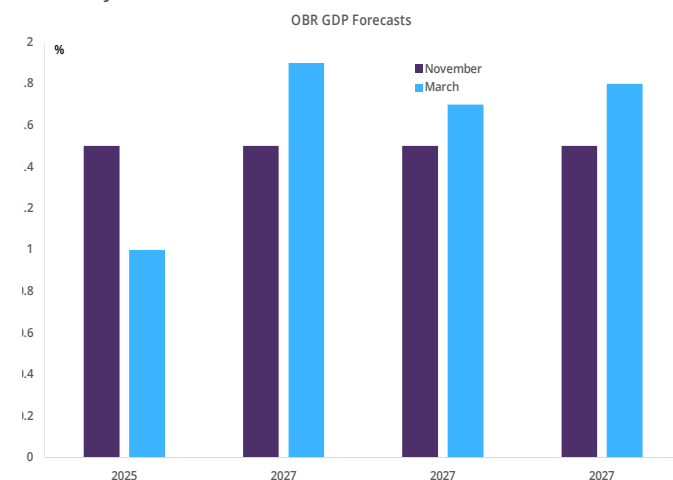


Chart 2: While public investment is expected to be relatively strong, business capex is seen at flatlining according to the OBR

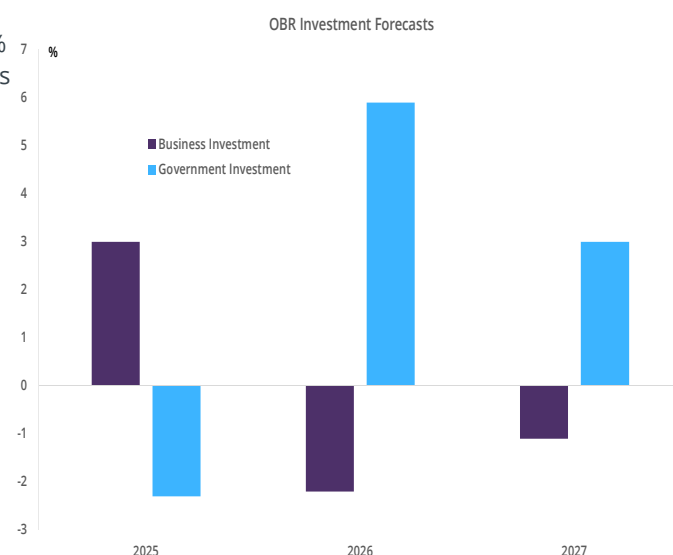
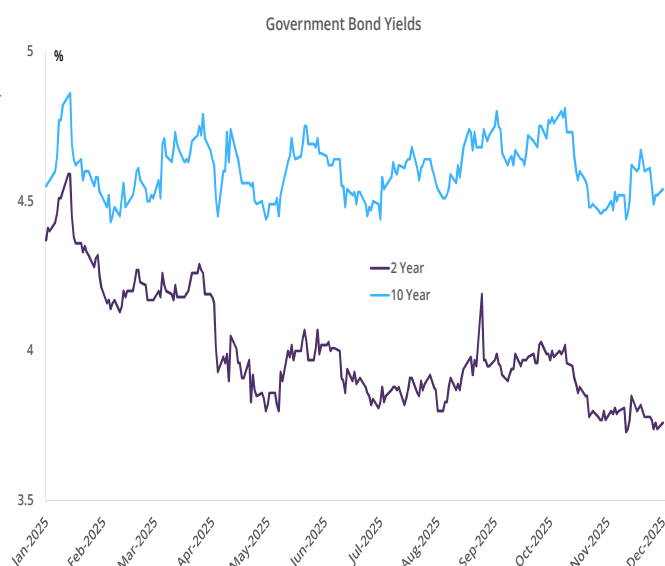


Chart 3: The gilt market has stabilised after a pre Budget wobble



Commercial Property

Transaction activity in the commercial property market was little changed in Q3 from the previous quarter according to the latest data from Lambert Smith Hampton. As shown in Chart 4, around £8.8bn of assets changed hands in the latest three month period which is more than a quarter down on the average over the past five years. Within this, office activity slipped to a five-year low at just £1.5bn.

Consistent with this picture, sentiment from the Q3 2025 RICS UK Commercial Property Monitor also points towards depressed appetite to take up space within the office sector as evidenced by the net balance for the occupier demand series falling to -4% from an already flat +2%. Indeed, this weak sentiment extends beyond offices with industrials moving into the negative zone from +4% to -6% and retail spaces being noticeably more downbeat at -21% compared to last quarter's -13% when measured in net balance terms. On the investment side of the market, the headline enquiries metric has slipped into the negative zone (0 in Q2 to -11% in Q3) with noticeable declines across all three recorded categories: offices (-3% to -13%), industrials (10% to 0) and retails (-11% to -23%). Interestingly, London stands out at the bright spot with regards to both investment and occupier demand in comparison to the national average. This is further corroborated by recent data from CBRE which indicates stronger total returns on Central London offices (2.2%) against all offices (1.1%). Elsewhere, at a sectoral level the latest CBRE data also points to firmer returns in both the retail and industrial sectors. (Chart 5).

Twelve-month point estimates indicate a clear divergence in performance across sectors (Chart 6). In the rental market, prime office (+1.7%) and prime industrial (+1.6%) are the only segments expected to register meaningful growth, while secondary office (-3.0%) and secondary retail (-3.7%) are forecast to continue to underperform. A similar pattern is evident in capital values, with modest gains anticipated for prime office (+1.0%) and prime industrial (+1.5%), contrasted by ongoing declines across secondary assets and retail, most notably secondary retail at -3.1%. This reinforces the persistent prime-versus-secondary divide across the commercial property market.

Turning to alternative asset classes, sentiment is markedly stronger across most segments. Data centres stand out as the clear outperformer, with rental expectations point estimates sitting at +3.7% and capital values at +3.6%, reflecting sustained structural demand. This strength is underpinned by projections that the number of data centres will increase by almost a fifth by 2030, alongside the government's designation of these facilities as critical national infrastructure and a key driver of future economic growth. More modest positive growth is anticipated for multifamily (rents +1.9%, capital values +0.7%), aged care (both +1.6%), student housing (+1.3% rents; +0.6% capital values) and life sciences (+1.2% rents; +0.7% capital values). By contrast, leisure assets are expected to remain under pressure, with both rental and capital values projected to fall by 1.0%, while hotels show flat to slightly negative capital value expectations (-0.3%) despite marginal rental growth (+0.3%).

Chart 4: Lambert Smith Hampton data shows that quarterly real estate volumes little changed in Q3

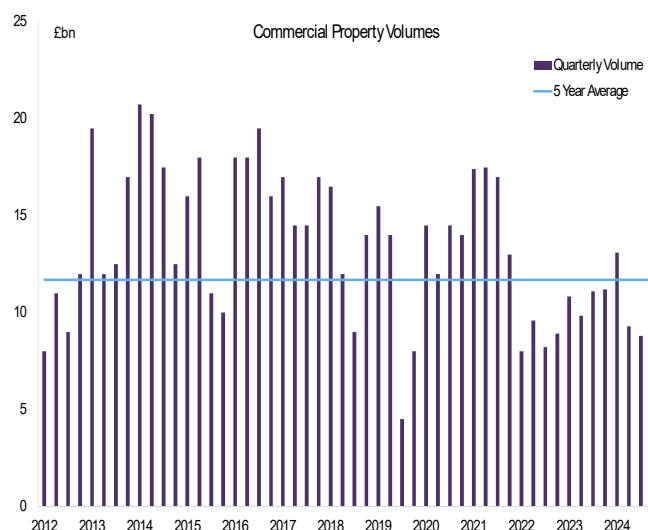


Chart 5: CBRE numbers points towards solid returns despite the challenging economic climate

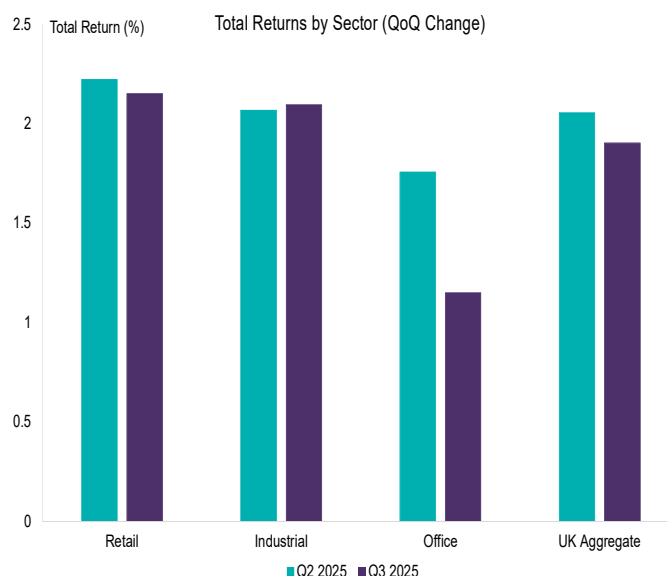
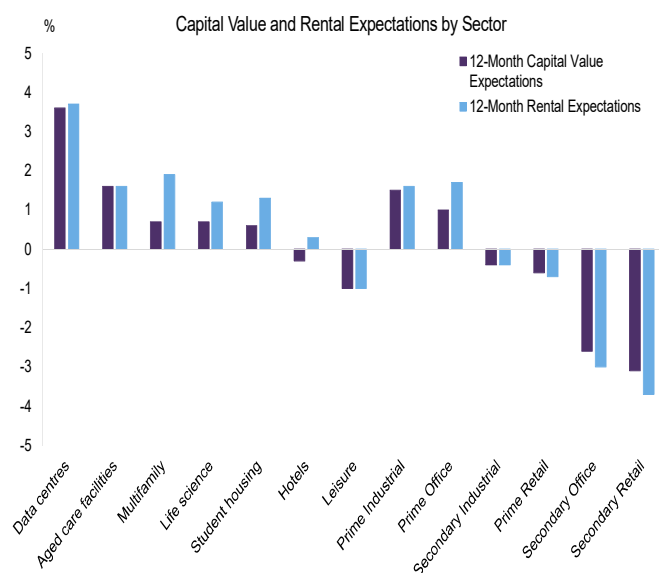


Chart 6: Alternative assets expected to continue strong performance with exception of leisure



Residential Property

In anticipation of the policy decisions announced in the November Budget, a pronounced slowdown in activity emerged across the residential sector, with both buyers and sellers adopting a wait-and-see approach amid heightened uncertainty, as reflected in the latest RICS UK Residential Survey and supporting anecdotal evidence. Accordingly, the RICS measures of new buyer enquiries and agreed sales remained firmly in negative territory in the three months leading up to the Budget, with both posting net balance readings of -24% in October. That said, seasonally adjusted HMRC transaction data (Chart 7) point to subdued conditions across the year as a whole, notwithstanding a strong spike in March to 178,000 transactions (after which the higher thresholds that were put in place in September 2022 reverted back), suggesting that wider economic factors, rather than Budget-related uncertainty alone, have also been weighing on market activity.

Nevertheless, despite lacklustre consumer confidence and a soft labour market, house prices proved relatively resilient albeit slightly softer, with Nationwide reporting a modest annual growth of 1.8% in November, marginally lower than October's 2.4%. The decision to avoid a widely speculated property tax on homes above £500k, alongside the greater certainty delivered by the recent Budget, may prompt a short-term uplift in sales activity as buyers release pent-up demand in the run-up to these announcements. At the higher-value end of the market, the surcharge on properties valued above £2m is expected to weigh on demand at this level. However, the back-loaded nature of the increase, together with the relatively small size of this segment (around 145,000 properties according to Savills, rising to an estimated 190,000 by 2028 based on Knight Frank projections), suggests the measure is unlikely to have a material impact on demand at the aggregate level. RICS (Chart 8) price and sales expectations over the coming three months remain flat although display materially less negative readings compared to the previous month with the former moving to -12% from -21% and the latter from -10% to -3%.

Meanwhile, in the lettings market, tenant demand shows further signs of moderation, with the latest net balance slipping to -3% from +5%, albeit still broadly neutral. More notably, supply constraints remain acute, with the net balance for landlord instructions holding close to recent readings at -33% (Chart 9). The forthcoming Renters' Rights Bill, alongside the Chancellor's decision to raise taxes on property, dividends and savings income, risks exacerbating these pressures further on an already constrained private rental sector. Furthermore, the additional costs imposed on landlords through these new measures may ultimately be passed on to tenants via higher rents. Consistent with this, rental expectations over the coming three months remain positive at a net balance of +15%, albeit notably softer than last quarter's +27%. It should be noted, however, that this survey period did not capture the latest Budget measures, which are likely to exert upward pressure on rents.

Chart 7: Latest data from HMRC continue to indicate flat activity across the sales market

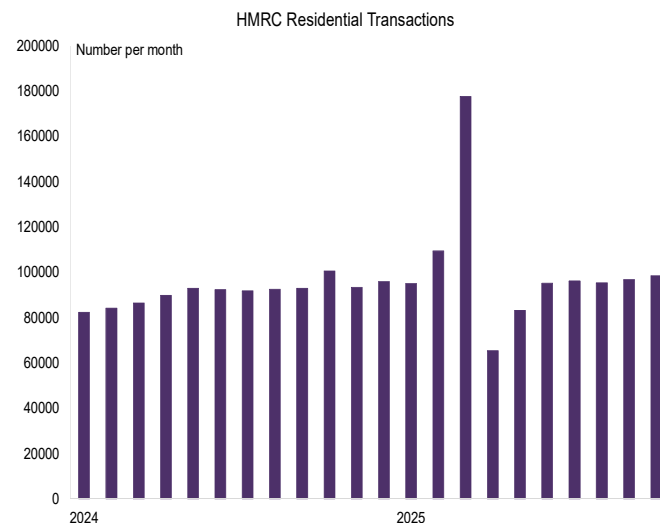


Chart 8: Both price and sales expectations remain in negative territory although show tentative signs of recovery

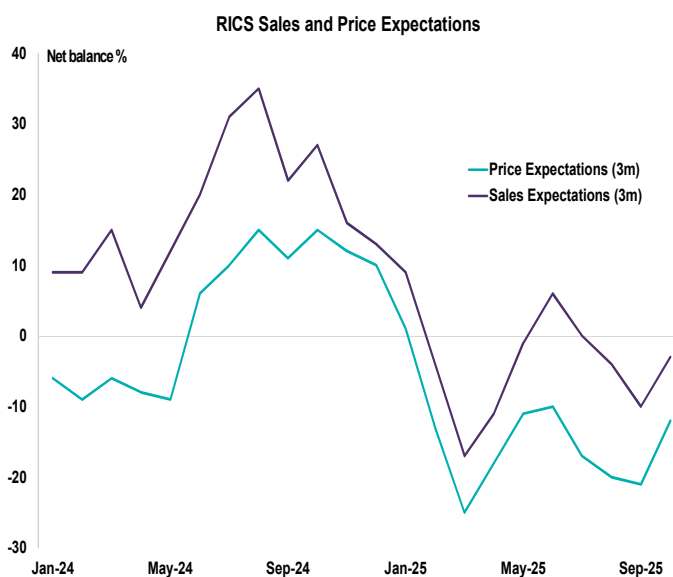
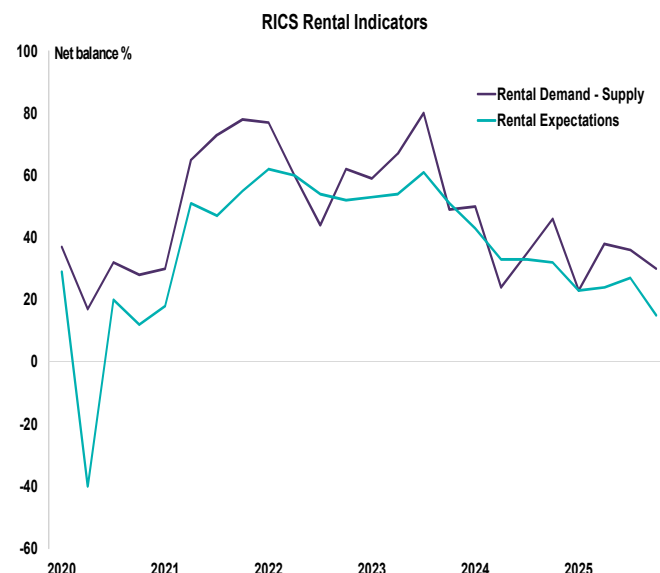


Chart 9: Mismatch between rental supply and demand persists, reinforcing the long-running structural imbalance in the market



Construction

The latest ONS data shows construction activity edged up by 0.1% in Q3 compared with the previous quarter. While the validity of this data has been questioned in recent months, the feedback broadly aligns with the latest RICS UK Construction Monitor. At the aggregate level, total workloads remain flat, with sentiment softening slightly from Q2 (net balance -3%) to Q3 (net balance -8%). Compared with Q2 2025, workloads at the sectoral level (Chart 10) weakened further in Q3, with public housing falling from -7% to -12%, private housing from -5% to -10%, private commercial from -5% to -11%, and private industrial from -9% to -11%. The net balance for infrastructure also eased back, from +11% to +8%, while other public works slipped from -1% to -4%. New work also saw a sharper deterioration in Q3, slipping from -5% to -13%. In contrast, repair and maintenance activity showed more resilience, easing only slightly from +5% to +2%.

Although current conditions remain flat, expectations for the year ahead are a little more upbeat, albeit less so than earlier in the year, with a net balance of +9% of contributors now anticipating growth compared with +17% in both Q1 and Q2. This is consistent with the latest CPA forecast, which projects construction output to rise by 2.8% in 2026 and 3.6% in 2027, supported by easing global economic and geopolitical tensions and a significant uplift in private housebuilding and infrastructure. While respondents to the latest UK Construction Monitor still expect an increase in private residential development activity over the coming year (net balance +7%, down from +15% in Q2), infrastructure is set to lead the expansion, with a net balance of +24% pointing to the strongest growth outlook (Chart 11). With respect to employment projections, the net balance eased from +16% to +10%, while profit margin expectations fell more sharply from -11% to -19%, with financial pressures seen as intensifying partly because of the rise in the minimum wage.

Looking at factors impeding activity within the construction space (Chart 12), insufficient demand edged up from 38% to 41%, while labour shortages eased slightly (39% to 37%), a trend that appears consistent with the generally subdued level of activity across the sector. Financial constraints remained elevated at 61% across both periods, while planning and regulation pressures edged up slightly from 61% to 62%. However, the introduction of the Planning and Infrastructure Bill, which aims to streamline planning processes, could help to ease this constraint over the coming quarters. Alongside these structural challenges, anecdotal feedback suggests business confidence has also been dampened by uncertainty surrounding the impending Budget, with many firms adopting a cautious stance until greater clarity emerges.

Delving deeper into infrastructure reveals a clear divide in expectations across subsectors. Energy stands out strongly, with a net balance of +58% of respondents anticipating growth - a reflection of the UK's strategic push to expand domestic energy capacity through projects such as Sizewell C, planned SMRs, and wider investment in grid upgrades and renewables. Water and sewage expectations are also firmly positive at +19%, while roads (+8%), communications (+9%), and rail (+5%) indicate more modest expansion over the coming year.

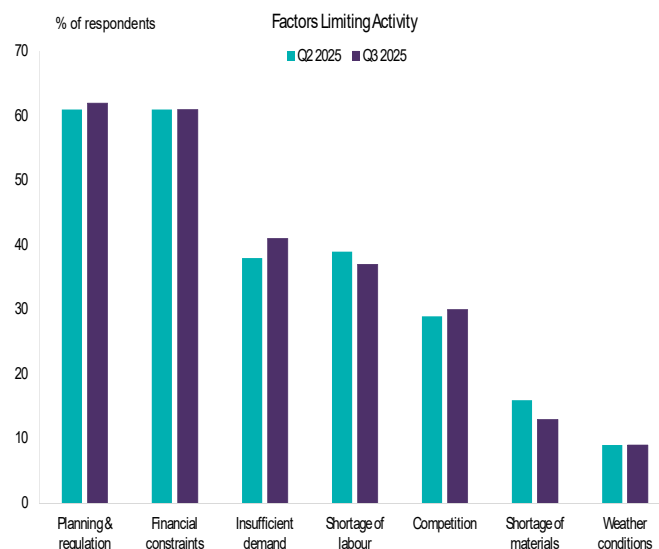
Chart 10: Subdued trend in workloads continues with only infrastructure seeing growth



Chart 11: Expectations for the next year remain modest away from infrastructure



Chart 12: Financial and planning constraints remain key obstacles as weak demand grows more prominent



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