RICS

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Economy and Property Market Update

February 2026

Economic picture remains subdued but more interest rate cuts on the way

ECONOMICS

Summary

The UK economy ended last year on a flat note and there is little reason to anticipate much of an acceleration through 2026. A more favourable inflation environment will, however, enable the Bank of England to continue lowering interest rates. There are some signs that this may be feeding through into slightly more positive sentiment in the real estate sector but for now, the construction industry continues to struggle against a backdrop of ongoing financial challenges and hurdles related to planning and regulation.

Economy

The latest indicators on the economy suggest that growth was a miserly 0.1% in the final three months of the year. That leaves the full year increase in GDP at 1.3%. The poor performance in the run in to the end of 2025 partly reflects the uncertainty stemming from the decision to delay the Budget until the end of November and the accompanying speculation about the potential measures that could be announced. Chart 1 tracks a range of forecasts for the economy over the next couple of years. For now, there is little sense that the underlying growth picture will gather any momentum even if residual seasonality pushes up the first quarter number. More fundamentally, only modest gains in real income and a tightening fiscal policy will present powerful headwinds to the economy.

Given this backdrop, it was not such a surprise that the latest meeting of the Bank of England's Monetary Policy Committee actually came close to sanctioning another interest rate cut. In the event, it proved a 5 to 4 vote to hold policy steady. Nevertheless, the tone of the discussion was more dovish than anticipated downplaying the importance of pay data with greater focus on concerns about activity and slack in the labour market. This has been reflected in money market expectations regarding the future path of base rates (Chart 2). A cut in March or April bringing the base rate to 3.5% now looks plausible with one or two further moves as the year progresses. Revisions to the Bank's expectations for inflation provide further justification for a more accomodating monetary stance. In the November analysis, it didn't envisage the headline inflation rate falling below the 2% target until the second quarter of next year. Updated analysis from the Bank, now sees this goal being hit in the third quarter of this year, and significantly, the inflation rate not picking-up again over the forecast time horizon.

The shift in mood regarding interest rates is, to some extent, being felt along the yield curve which can be more relevant when it comes to mortgage lending and some business borrowing. So for example, two year gilt yields have slipped from around 4% in early autumn to just 3.5%. However further out, the influence of global trends and the increased level of political uncertainty domestically are proving more influential with the five year yield actually higher than it was in early October and the ten year little changed. Given the ongoing challenges on the political front and the possibility of a leftward shift in policy, there is little prospect of this changing in the coming months.

One more encouraging aspect of the economic performance has been the improving trend in business investment even if it has been a little inconsistent (and did slip back in the fourth quarter of last year). Chart 3 tracks the headline number. Significantly, while household spending stands just 1.7% higher than in the months prior to the onset of Covid, business investment is 9.1% stronger. A big part of the increase has been, predictably, in the area of ICT equipment which in the last year alone has seen an increase in spending of more than 17%.

Chart 1: There is little prospect of a meaningful acceleration in economic activity over the next few years

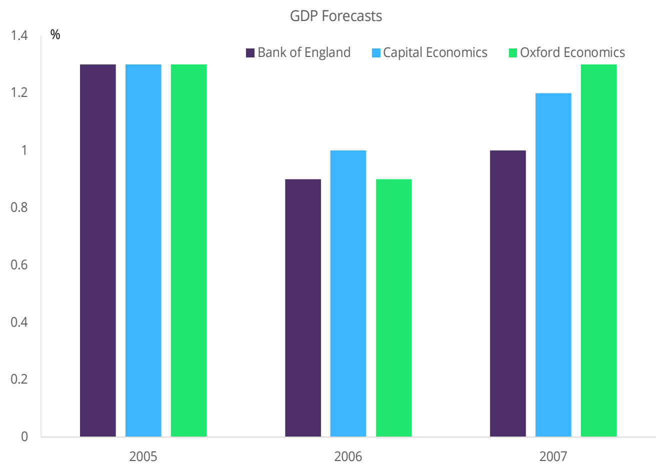


Chart 2: Money markets are now a little more optimistic about the near term course of interest rates

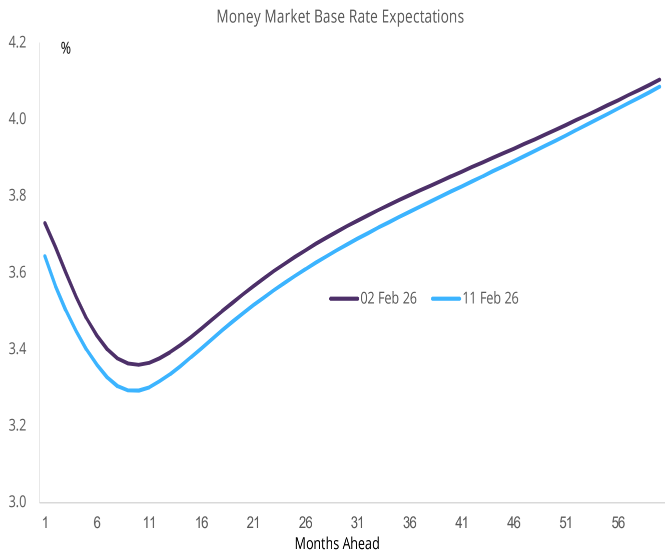
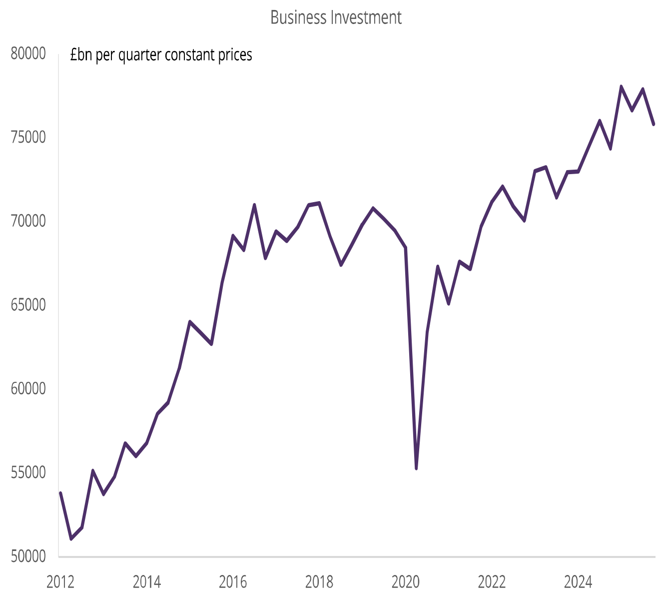


Chart 3: One relatively bright spot in the trend in business investment



Commercial Property

The back end of 2025 witnessed a firmer trend in activity in the commercial real estate market. Data from Real Capital Analytics shows that although full year volumes were little changed on 2024, the second half saw a 10% increase compared with same period of the preceding year; the Q4 story is broadly similar also showing a 10% gain (Chart 4). Central London office transactions were particularly strong in the final three months of the year recording an increase of almost 40% compared with the same period a year earlier. The uplift is also reflected in the reported 22 transactions above £100 million iin London offices (for the whole of 2025) as against just 11 in 2024.

RICS data capturing the overall level of investment enquiries at a national level (in net balance terms) continues to paint a more subdued picture but as Chart 5 highlights, the headline number masks the better trend in the capital and, in particular, the appetite from overseas buyers. This is captured clearly in the latest analysis of the real estate sector by Lambert Smith Hampton. It notes that 'overseas capital played a central role' in the Q4 number 'with inflows doubling quarter on quarter to £8.3bn'.

Despite the better tone to some activity numbers, pricing on real estate assets in general remains subdued. The January CBRE data shows the headline increase in capital values running at around 1% on a twelve month comparison. But within this, West End & Midtown Offices are posting a 6.5% gain with Central London in aggregate at just over 4%. Meanwhile, the picture regarding rents has continued to display a more resilient tone. The composite CBRE rental value index shows a 3% gain set against the beginning of 2025.

Looking ahead, the feedback to the RICS Commercial Property Monitor still reflects a degree of caution at the national level. Close to 40% of respondents still view the market to be in a downturn with another quarter perceiving it to be at the bottom of the cycle. In contrast, in central London while a similar proportion do still view the market to be in a downturn phase, a higher share see in it an upturn phase (45% v 32%). The diverse feedback around the market likely reflects the ongoing divergence in asset performance. Chart 6 tracks the twelve months RICS expectations for different sectors of the real estate universe (we have taken an average of the net balance readings for the capital value and rental outlook). The results highlight the continuing strength of Data Centres with Aged Care Facilities also viewed as likely to perform solidly. Interestingly, the third highest ranking sector is prime Offices which reiterates the strong demand for best-in-class assets and contrasts with the projection for a further decline in the value of secondary Offices. The value placed on premium assets can be seen in data provided by Savills that shows 83% of office take-up in the West End is BREEAM-rated Excellent or Outstanding and that prime rents on average rose by around 6% on 2024 levels.

Chart 4: Investment volumes picked up smartly in the latter part of the year

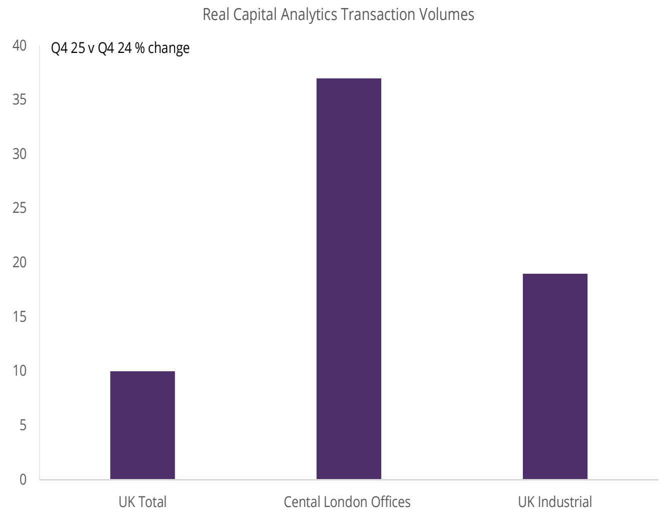


Chart 5: RICS data demonstrates the uplift in foreign investment particularly in London offices

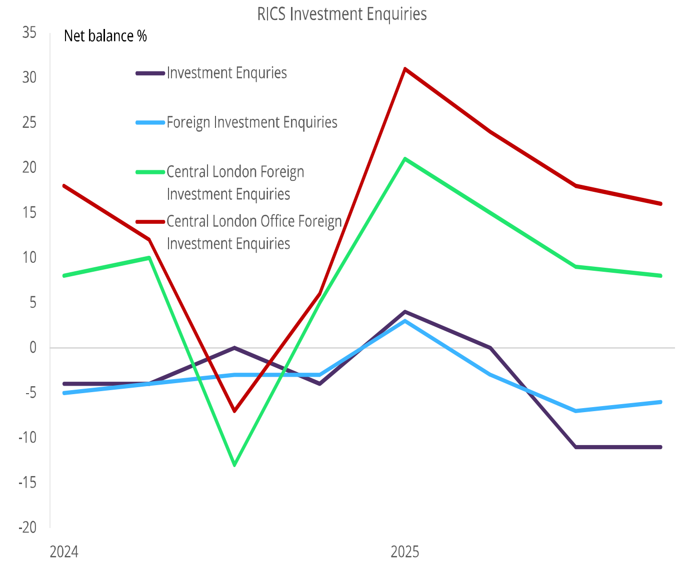
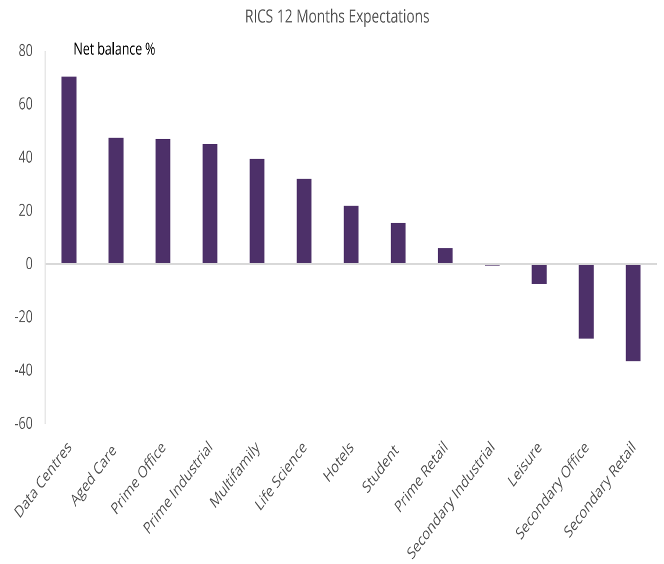


Chart 6: The outlook for Data Centres remains most positive but prime Offices continue to be in heavy demand



Residential Property

Sentiment in the residential market does appear to be showing signs of improving after what was a somewhat challenging second half to 2025. The macro environment was certainly not helpful, exacerbated as it was by an extended run up to the late autumn Budget. But despite the announcement of a High-Value Council Tax Surcharge (for properties valued at £2m or more to take effect from April 2028), the worst fears of a more penal environment for residential property were not realised. This, coupled with the sense that interest rates may fall a little faster than previously anticipated, is contributing to the less negative feedback being received to the RICS Residential Survey. Significantly as Chart 7 highlights, both the New Buyer Enquiries and Newly Agreed Sales metrics do appear to be stabilising. The latest assessment from Zoopla paints a similar picture suggesting that 'confidence has begun to return' albeit that its numbers show demand tracking 9% lower than what was a very strong start to 2025.

Another theme that is captured in both the RICS and Zoopla reports, as well as in the Land Registry dataset (Chart 8), is the localised nature of the housing market. RICS and Land Registry numbers are both presented at a regional level and significantly, they each show the picture in Northern Ireland to be strongest across the UK with the North of England and Scotland also seeing solid gains. At the other end of the spectrum stands London with negative readings in both series. Zoopla looks at the numbers more granually and shows the highest house price growth over 2025 was recorded in Burnley with several other towns and cities across the North West registering price gains of over 4% including Rochdale, Blackburn, Liverpool and Wigan.

Looking forward, the expectations metrics from the latest RICS survey are showing a more encouraging trend (even in the capital). Chart 9 tracks the headline 12 months expectation series for both prices and sales. The results presented in net balance terms show the price indicator at its best level since the beginning of last year. Meanwhile, the sales series although only slightly up from the December reading is still its highest level since the back end of 2024.

As far as the lettings market is concerned, RICS data suggests that tenant demand has edged upwards over the past quarter albeit only very modestly. However, with the instruction series continuing to fall this is still translating into some level of rental growth. That said, the net balance reading for this series is pointing to a slower rate of increase than was the case through the earlier part of this decade. This is consistent with the Zoopla numbers which shows rent increases on new lets running at just over 2%, some way below wage growth (this contrasts with a high watermark of around 12% in 2022/early 2023). Whether the introduction of the Renters Rights Act results in more landlords exiting the market remains to be seen but that, on balance, is likely to push rents in an upward direction.

Chart 7: RICS New Buyers Enquiries and Sales Agreed metrics have begun to stabilise

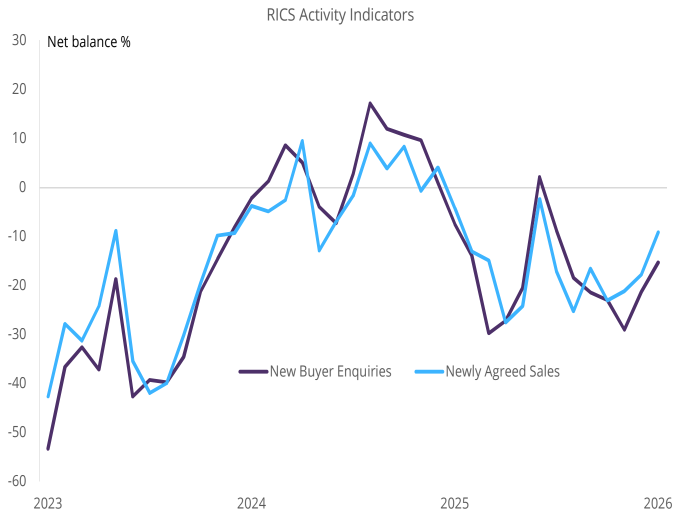


Chart 8: The more affordable regions are seeing the strongest house price gains

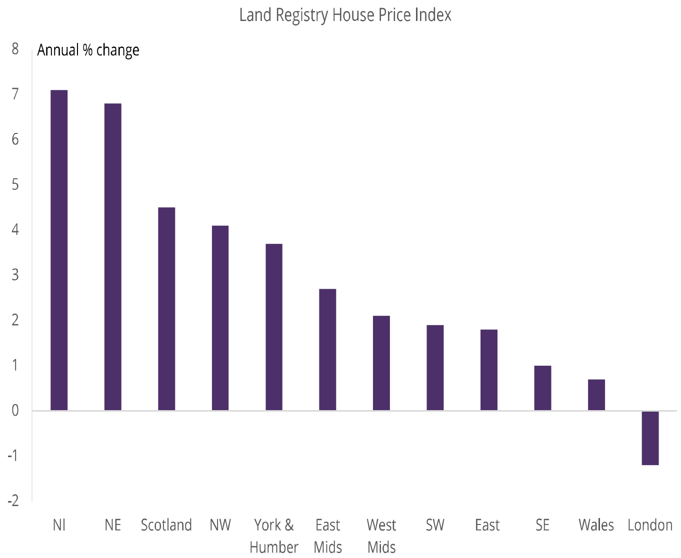
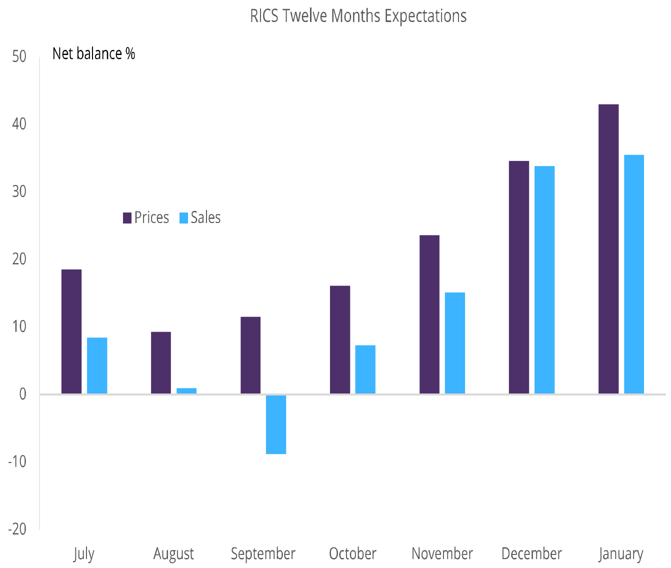


Chart 9: The forward-looking RICS datasets are pointing to a firmer market



Construction

The latest data from the ONS indicates that construction activity fell by 2.1% in Q4 following a 0.4% increase in Q3. The main contributor to this was the decrease in private new housing, which slipped by 3.6% over the period. This is broadly in line with the latest results from the RICS UK Construction Monitor. The headline net balance may have improved marginally in the final quarter of the year but remains stuck in negative territory (-6% v -8%). Chart 10 shows that infrastructure was the only sector to record positive activity in Q4, with a net balance of +12%.

Looking ahead, the outlook over the next twelve months appears a little more favourable with the headline net balance for workloads rising from +9% to +17%. This broadly chimes with the recently released forecasts from the Construction Products Association who have pencilled a modest 1.7 % increase in construction output in 2026 compared with an estimated rise of just 0.3% in 2025. At the sectoral level (Chart 11), feedback to the RICS survey suggests all sectors will, to a greater or lesser extent, show a slightly more upbeat outlook. Private residential expectations strengthened from +7% to +14%, while private non-residential rose from +2% to +13%. With regards to the former, a sustained pickup in building work will be necessary to meet the government's ambitious housebuilding targets, with housebuilders forecasting that the 1.5 million goal is likely to be missed in the absence of a stronger policy impetus. Infrastructure is expected to maintain its momentum and continue to outperform, with the net balance increasing from +24% to +32%.

Within the infrastructure segment, energy is expected to see the strongest growth, with 61% of respondents citing it as the leading sub-sector. This reflects a long-running trend that has been evident since 2021 and aligns with the government's 10-year National Infrastructure Strategy, where the energy transition and associated investment in cleaner energy projects are likely to provide sustained support for construction activity in both the near and longer term. Elsewhere, a sizeable proportion of respondents (17%) have cited water as the sub-sector with the most positive outlook with investment is likely to speed up under under AMP8.

Financial constraints remain the most widely cited obstacle to activity in the RICS UK Construction Monitor (Chart 12), with the share of respondents reporting this issue holding steady at 60%, in line with recent readings. Planning and regulatory pressures also continue to feature prominently, with 59% of respondents identifying this as a constraint on operations. While the Planning and Infrastructure Act is intended to streamline development processes, it is early days since its passage. Separately, concerns persist over the building safety process. Labour shortages are less prevalent than they have been but a lack of skills will rapidly re-emerge as a barrier if development plans gather pace. Against this backdrop, profit margins are seen as remaining under pressure through the course of this year.

Chart 10: RICS construction workload indicators remain subdued across all sectors away from infrastructure

Chart 11: Twelve-month workload expectations have edged upwards according to the latest RICS survey

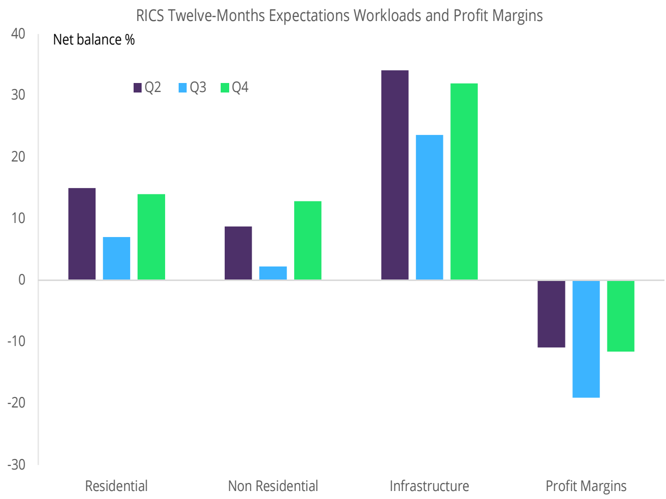
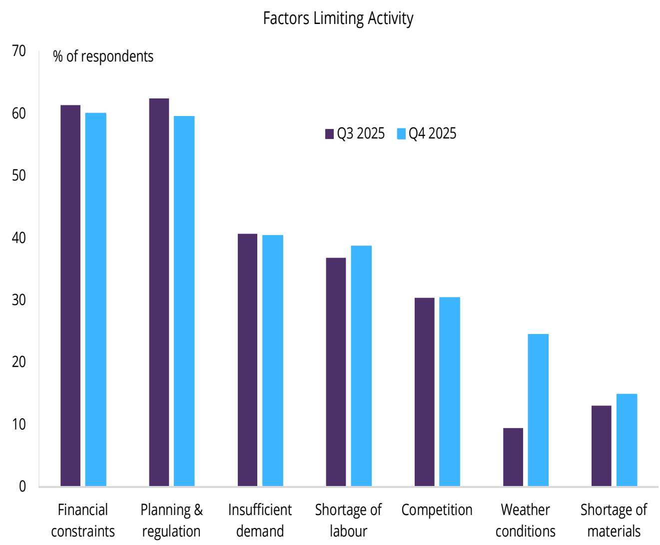


Chart 12: Financial constraints and planning and regulation remain key challenges according to RICS respondents



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