Challenges, concerns… and optimism

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Property

UK real estate remains a key asset class for many investors – both in the UK and globally. Looking at the prospects for this area in 2026 means looking at underlying fundamentals, but also why this may remain attractive over the longer term.

Key lessons learned from 2025

The property market underwent a significant value correction that started in the middle of 2022 and continued into 2023. The subsequent recovery has been notably slow and, at times, seemingly appeared to stall altogether. This experience served as a crucial reminder that recoveries in the property sector are often gradual, with investors typically adopting a cautious approach. As risks become more apparent, investor confidence can waver, further prolonging the recovery period.

Another important lesson from 2025 was the persistent and sometimes unbridgeable gap between buyer and seller pricing expectations. This disparity has frequently resulted in a reduction in the number of completed transactions, as parties struggled to agree on valuations.

Despite these challenges, one positive development has been the pronounced competition for high quality assets. This strong demand for prime properties has played a significant role in establishing market pricing benchmarks.

Finally, the influence of macroeconomic conditions on investor activity was particularly evident in 2025. Even in the face of robust rental growth and healthy occupier demand, many investors have remained hesitant, and the market has not witnessed a large-scale return of investment activity. While there have been isolated areas of intense transactional activity, a consistent and broad-based recovery is yet to materialise.

In what way will 2026 be different from 2025?

If the coming months bring greater clarity around the UK's fiscal position, this could support a reduction in gilt yields and overall debt costs. Such conditions may improve investor sentiment and encourage increased transaction activity in the months ahead.

Should debt become more accretive under these circumstances, debt-backed investors are more likely to re-engage, helping to drive a sustained rebound in capital values across sectors. Combined with continued robust rental growth, these dynamics would create strong total return opportunities for investors.

Outlook for UK real estate

Our overall outlook for the UK real estate market is broadly positive. While optimism is gradually becoming more widespread, there are still some notable challenges. Concerns surrounding public finances and the complexities of the current inflationary environment continue to create a degree of uncertainty, making the landscape less clear-cut.

We anticipate that the differences in performance across various sectors will be less pronounced compared to the previous cycle. Rather than expecting a rapid upturn, we predict a steady and measured recovery. With limited potential for further inward yield movement, it will be essential for investors to focus on proactive asset management and the realisation of income growth to generate positive alpha.

There is currently robust occupier demand in most sectors, coupled with a shortage of prime space. This dynamic is expected to support ongoing rental growth, which in turn will drive cashflow growth for investors. Performance will increasingly be determined by asset-specific factors, with prime and well-located properties forecast to outperform the broader market. We think this trend is expected to be particularly evident in the office sector, where prime assets are likely to lead the way.

What makes UK real estate so attractive to overseas investors?

The UK is a leading destination for overseas capital, consistently attracting a significant share of international investment. Over the past decade, overseas capital has accounted for approximately 50% of the market, with some years reaching as high as 60%. London stands out as the principal performer within the UK, regularly drawing more overseas investment than any other city on the global stage.

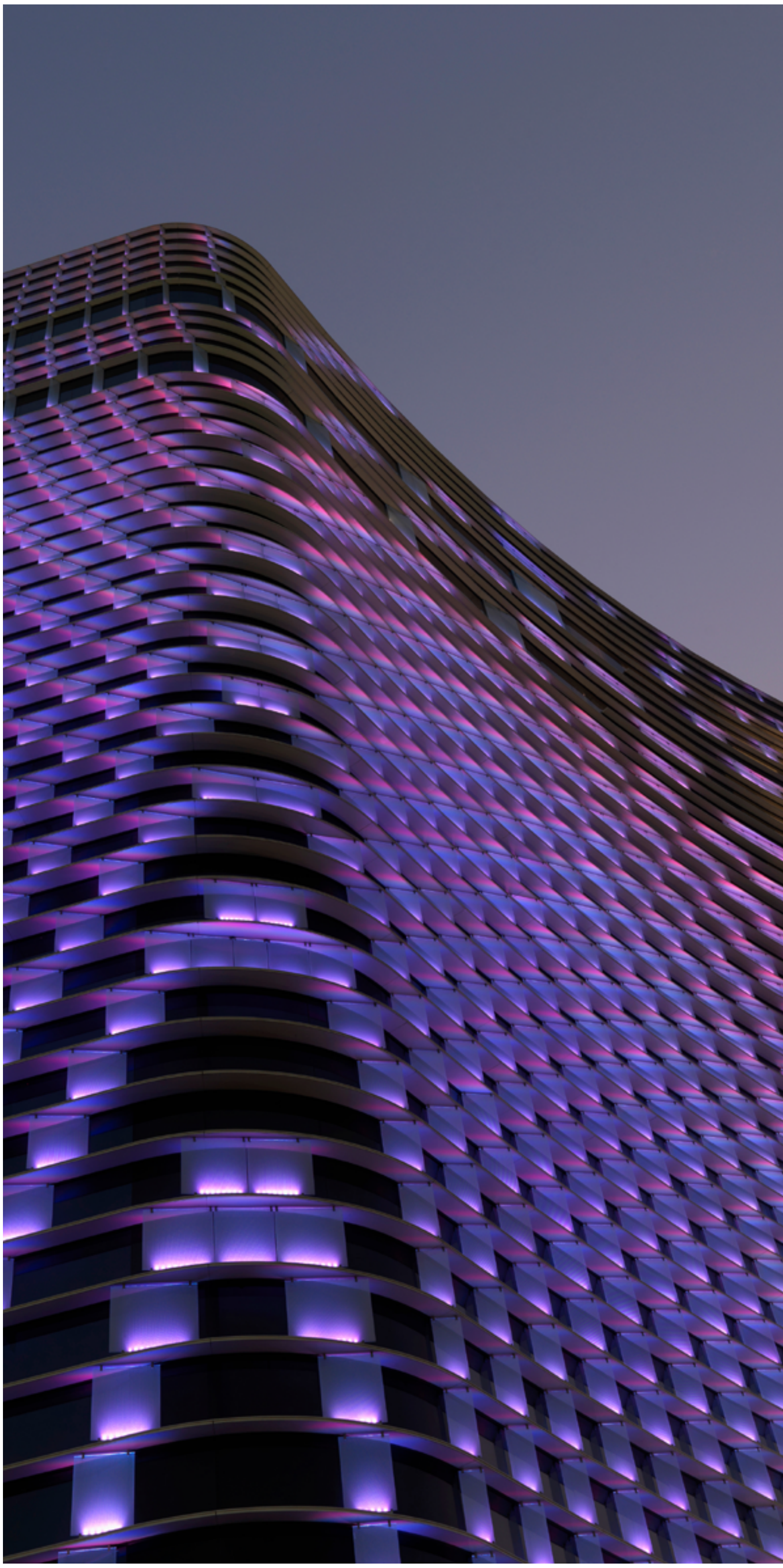
There are several compelling reasons why international investors are drawn to the UK, many of which extend beyond the property sector itself. The English language, cultural familiarity, and longstanding educational connections – many investors were educated at UK universities – contribute to the country's enduring 'soft power' and appeal. Confidence in the UK's legal system further underpins this attraction. While political stability was historically a crucial factor, its significance may have shifted somewhat in the post-Brexit era.

From a real estate perspective, the UK offers a range of benefits that are highly valued by overseas investors. These include a transparent and liquid property market, a track record of robust total returns, and the historic use of upward-only rent reviews — though it should be noted that the government is considering legislative changes to this practice. The scale of opportunity is also a major draw, with London ranking among the world's largest office markets. Additionally, the planning system, while challenging for developers, serves to constrain supply and thereby helps support rental growth, which is attractive to investors seeking long-term value and stability.

Overseas investors continue to look at the UK

Many of the key factors that have historically attracted international capital to the UK remain firmly in place and are expected to persist for the foreseeable future. In the context of political uncertainties across the continent and globally, the UK's reputation for stability may once again become an appealing attribute for overseas investors.

At present, the most compelling aspect for international investors is the UK's current position within the property cycle. Occupier markets across most sectors have shown remarkable resilience, with robust rental growth observed in the post pandemic period. While this rate of growth is expected to moderate, it is anticipated to remain above historic averages, providing continued support for income growth and cashflow stability.

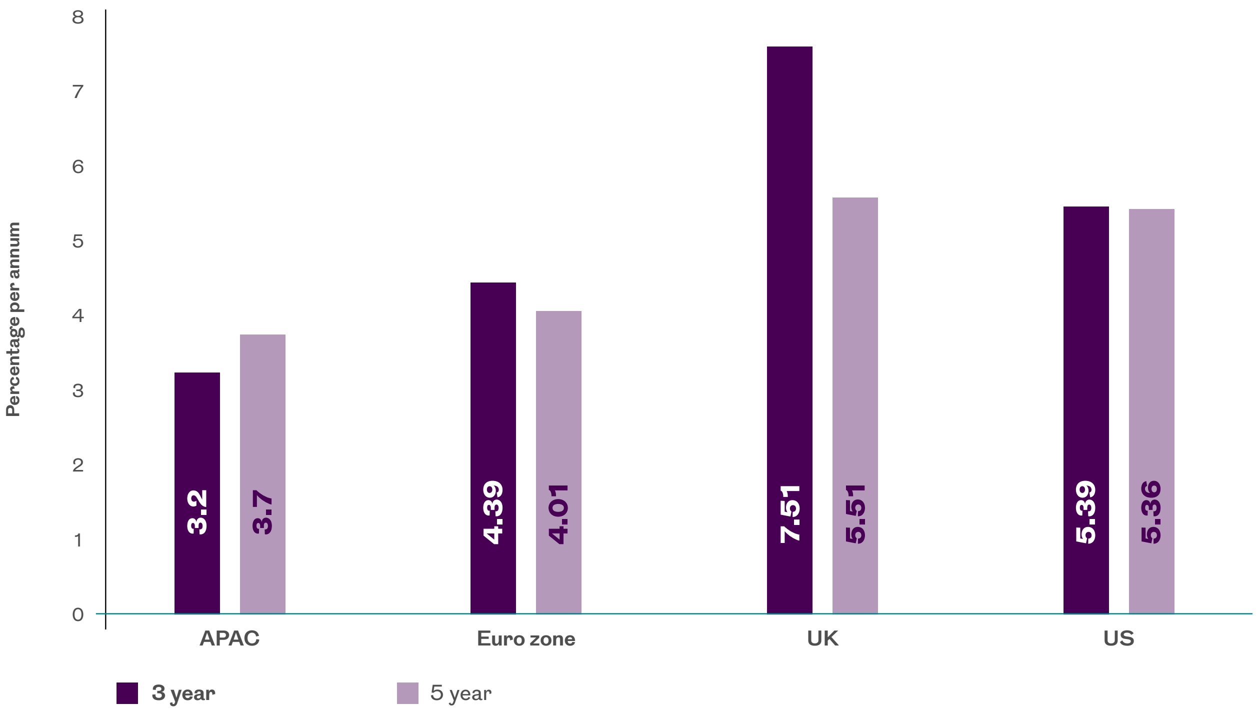


The UK is set to be the second-fastest-growing of the world's most advanced economies this year, according to recent projections from the International Monetary Fund. The UK economy is forecast to achieve annualised GDP growth of 1.3% this year and next, outpacing other major European economies such as France, which is projected at 0.8%, and Germany at 0.5%. This economic momentum is expected to underpin occupational markets and further enhance the appeal of UK real estate for international investors.

One notable factor absent from the recent recovery has been a sustained improvement in investor sentiment, which is essential for a consistent increase in capital values. However, it is anticipated that we are at a turning point, with a full capital value recovery expected to commence. Capital Economics forecast UK total property returns of 7.5% and 5.5% annualised over the next three and five years respectively[1] – figures that outperform other markets. This robust performance is projected to be evident across all real estate sectors.

Overseas investors are acutely aware of these emerging opportunities and it is our view that 2026 could see this awareness translate into increased activity within the UK market.

All Property predicted total returns, 2026-30



Source: Capital Economics, Global Property Returns & Valuations, October 2025 . Forward looking statements are subject to certain risks and uncertainties. Actual outcomes may be materially different from those expressed or implied.

[1]Source: Capital Economics, Global Property Returns & Valuations, October 2025.

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