H2 2025

CBRE Investment Management

U.K.

Real Estate House View

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Introduction and key calls

Although the domestic and international macro backdrop remains challenging, U.K. real estate returns are forecast to average 7.5% per annum (p.a.) over the next five years, supported by strong occupier fundamentals. Astute stock selection will enable investors to enhance their performance, along with a preference for higher-performing markets including single-family housing, logistics and City offices.

KEY CALL 1

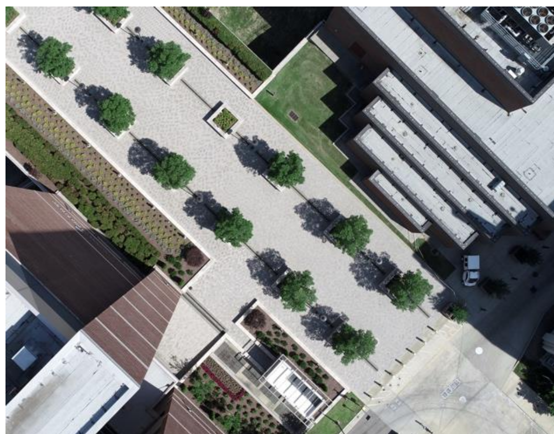
Expectations for U.K. gilts have moved higher, with further downside risk

Our macro inputs remain broadly similar to H1, except for our gilt outlook which is projected to be higher for longer with risk skewed to the downside.

KEY CALL 2

Occupier demand remains robust; rent growth will drive returns this cycle

Rental momentum continues to be strong. Speculative construction has been low by historic standards, vacancy is tight and occupiers are prepared to pay a premium for desirable assets.



KEY CALL 3

A modest downwards revision to our outlook, but total returns of 7.5% p.a. are still appealing

With forecasts converging, bottom-up stock selection not top-down sector allocation will be the key to outperformance, enabling investors to improve considerably on the aggregate 7.5% p.a. returns that we forecast for the U.K. real estate market.

A similar macro backdrop to our H1 House View....

Two sides to U.K. economic performance

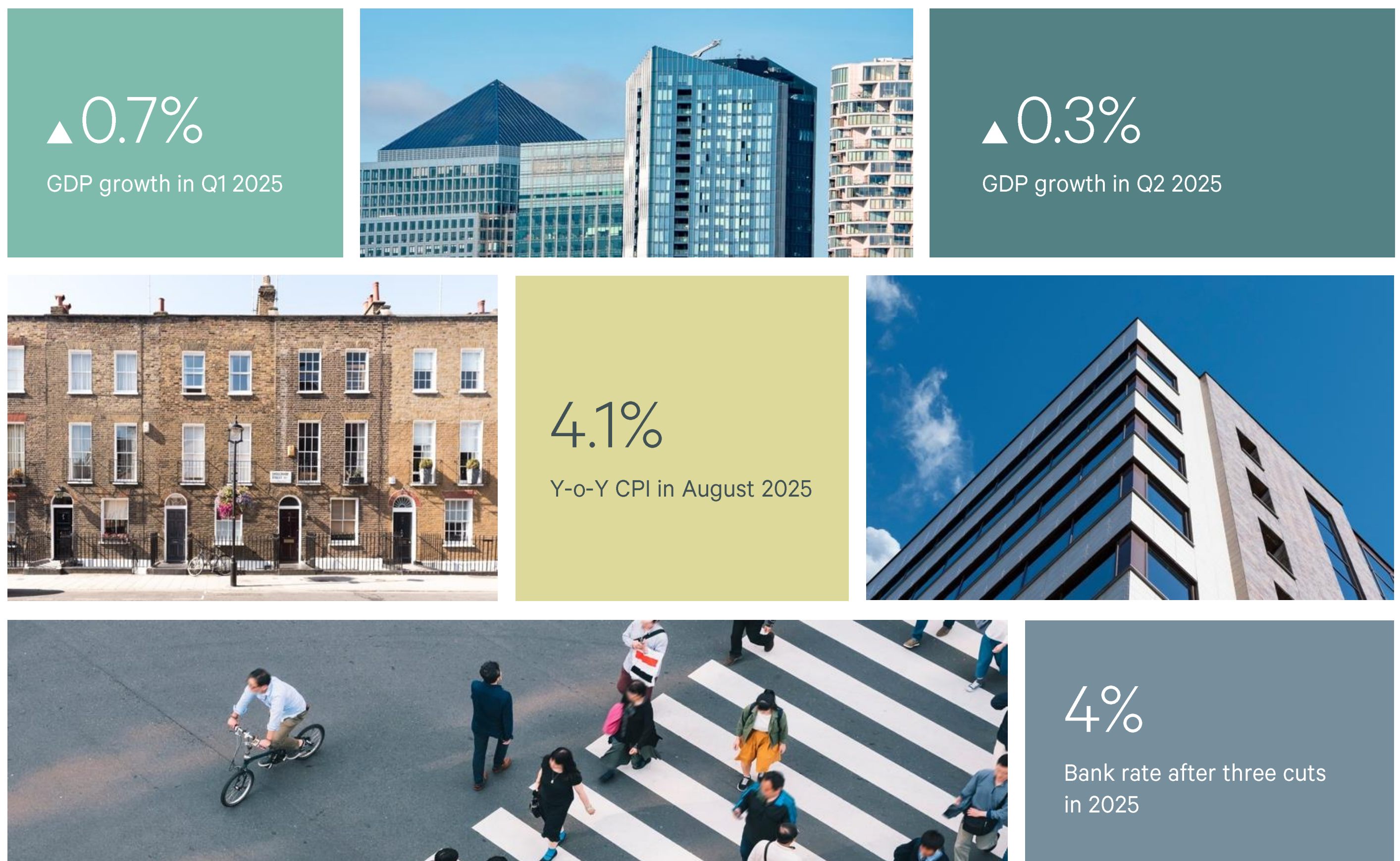
The U.K. economy grew by 0.7% in Q1 and 0.3% in Q2 2025. The bank rate has been cut three times to 4%. Unemployment rose slightly, although remains comfortably below 5%, as employers responded to tax increases.

Less positively, CPI has remained stubbornly high, increasing to 4.1% in August (from 3.1% a year earlier). Government borrowing has consistently exceeded expectations at the same time as the borrowing costs rose to a near 40-year high. Business and consumer confidence surveys continue to reflect skepticism regarding the future.

We continue to think the U.K.'s glass will be half full (or empty, depending on your disposition) for some time to come.

Modest tweaks to our outlook

Relative to our H1 House View, our expectations for the U.K. economy have weakened slightly. GDP growth has been trimmed by 10 basis points (bps) to approximately 1.4% p.a. while CPI will be slightly higher averaging 2.3% p.a. Employment growth expectations are slightly weaker in the short term. Based on these changes, we would have expected demand for real estate to be suppressed, however the adjustments are marginal and will likely be counteracted by the supply response.

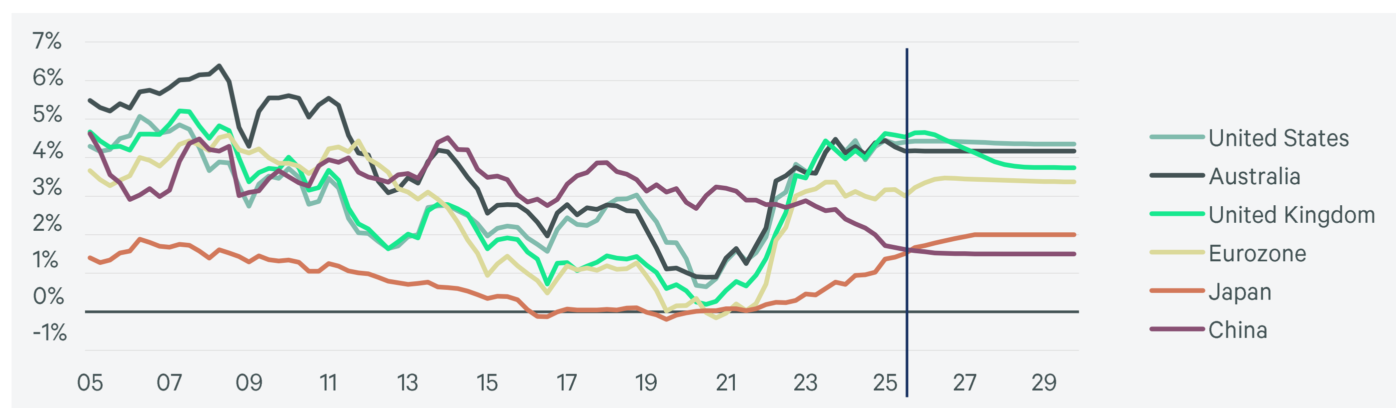


....but Gilts will be higher for longer with arguably more downside risk

U.K.-specific reasons for bond market attention

Arguably the most significant changes to our outlook are on the interest rate side. We have adjusted upwards our view of the terminal rate for both the policy rate (to 3.0% from 2.75%) and the 10-year gilt (to 3.75% from 3.50%) as shown in **Figure 1.** Gilts have stayed stubbornly high, with the premium demanded for U.K. debt relative to that of other countries remaining above historic norms. There seems to be no single reason for the premium. **Figure 2** shows that those looking to be bearish on gilts have a number of backward- and forward-looking measures to use to make a case.

Figure 1: **10-Year government bond yields, %**



Source: Oxford Economic Forecasting and CBRE Investment Management.

Figure 2: **Factors influencing Government bond pricing, ranking of G7 countries**

	U.K.	Canada	France	Germany	Italy	Japan	U.S.
Change in Government debt, % of GDP, 2001-2024	3	5	4	7	6	1	2
Change in net interest payments, % GDP, 2019-2024	2	3	4	5	6	7	1
Index-linked Government debt, proportion of total stock, 2023	1	6	3	5	2	7	4
Foreign ownership of Government debt, proportion of total stock, 2023	1	4	2	5	3	7	6
Primary budget deficit, 2024	1	5	3	6	7	4	2
Change in CPI, y/y to August 2025	1	5	7	4	6	3	2
Change in 10yr Government bond yield, bps, Jan-22 to Sep-25	1	6	2	3	5	7	4

Source: Capital Economics, IMF, OBR, OECD, Refinitiv, World Bank.

Late November budget: reassurance or revision?

The next U.K. Government budget will be delivered in late November. Faced with a funding shortfall, the Chancellor is already suggesting that manifesto promises ruling out tax increases will be broken. It remains to be seen the extent to which markets will be reassured or further unnerved by the policy package that ends up being announced. Until we have greater clarity, we see the risks to our outlook for gilts as trending more to the downside.

Several forces are dampening liquidity

Quantifiable impact of uncertainty, debt pricing and day one spreads

Total U.K. investment volumes in 2024 exceeded £50 billion, and market expectations at the start of the year were for further improvement in 2025. That has not come to pass; transaction data has consistently remained on course for an annual total closer to £40 billion. A number of factors are feeding into this outcome. **Figure 3** shows the relationship between transaction volumes and a composite measure of wider market volatility, the accretiveness of credit to returns and the real estate spread to gilts. The historically strong relationship among the factors and higher uncertainty, higher cost of debt and current lower day one spreads explains much of 2025's slowdown.

Figure 3: Investment volumes versus volatility, debt accretion and relative pricing composite index

Source: Bloomberg, RCA, CBRE Investment Management, CBRE IM Treasury, CBRE IM House View H1 2024, MSCI Quarterly Universe.

Forecast convergence and unwilling sellers are also a factor

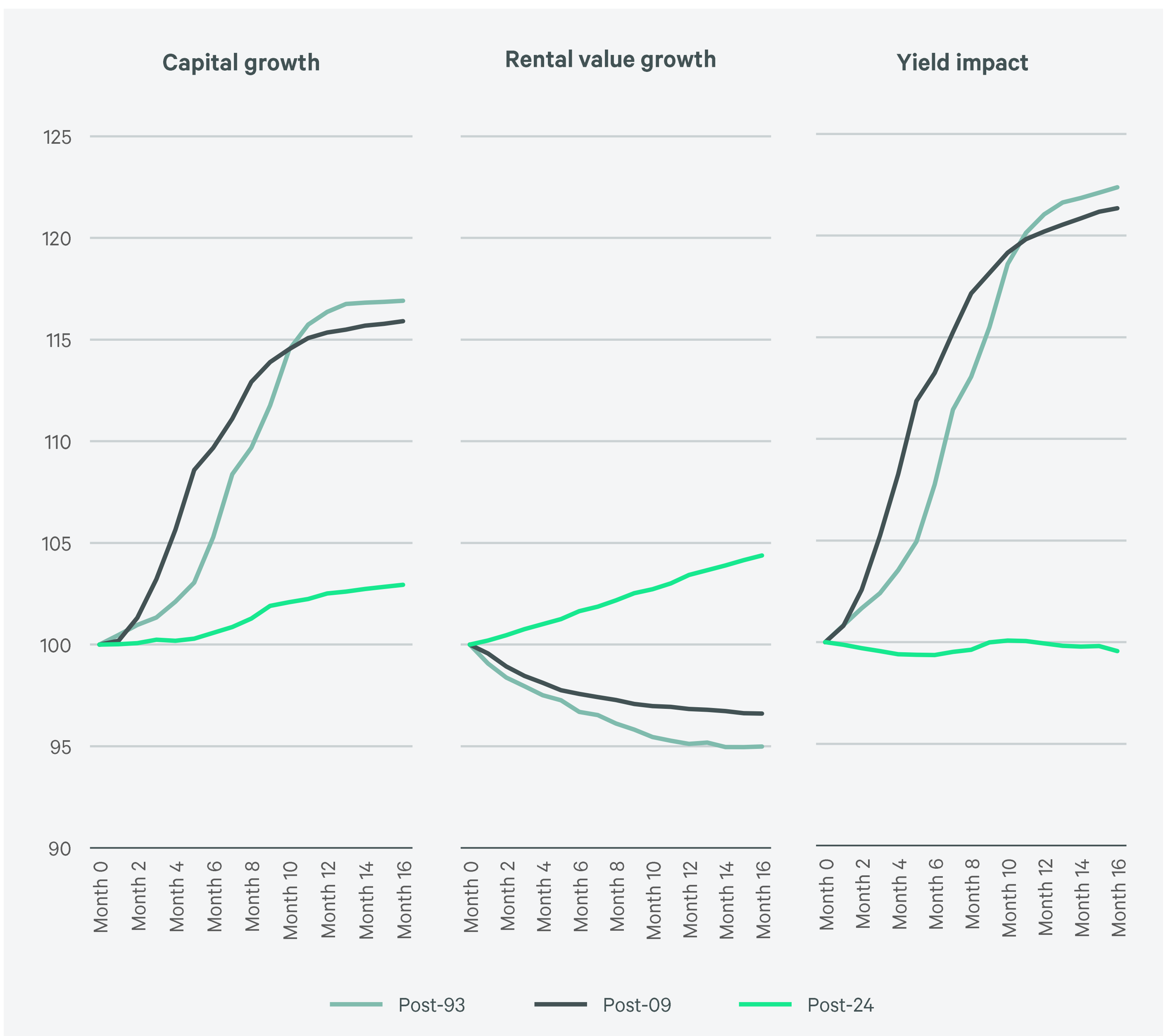
But those three factors do not explain all the recent slowdown in transactions, otherwise the 2025 reading would not be so far below the line. We think there are two other less quantifiable factors dampening volumes. We believe that the convergence of sector-level forecast expectations compared with five years ago is not pushing investors to realign portfolio weights. The lack of capital distributions by late-2010s vintage private equity funds also points to an unwillingness to transact at current valuations. A comparison with 2011 and 2012 is interesting—both years saw lower-than-expected volumes due to the inability of borrowers and banks to transact distressed assets post-GFC. This time, the nature and ownership of the distress is different, but the impact on wider volumes is the same.

Occupier demand remains robust

A rent-driven recovery supported by low vacancy

Typically, recoveries are yield-driven. **Figure 4** shows the progression of capital growth and its rent and yield components in the periods following the bottoming out of values in 1993, 2009 and 2024. The norm is for yields to rebound sharply while rents still fall. The current recovery is an exception—yields have remained flat while rents have continued to grow.

Figure 4: **Performance following trough in capital values, indexed, all property**

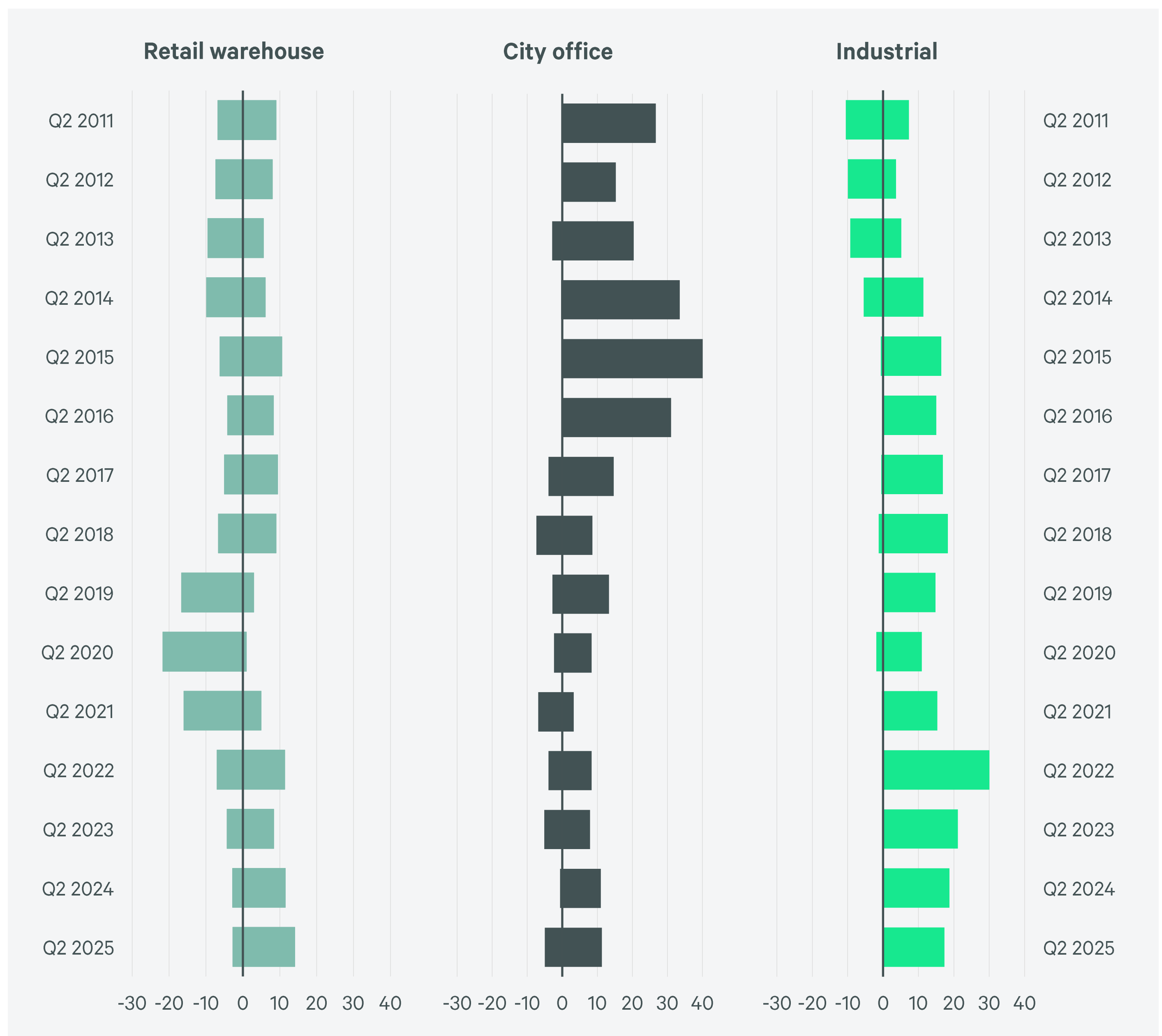


Source: MSCI Monthly Index.

The previous upswing was not accompanied by a speculative construction boom. Consequently, vacancy rates in most markets currently remain close to or below equilibrium levels and support growth. **Figure 5** shows that for key markets at the asset level, double-digit rates of growth are not uncommon on the upside while downsides are very limited, suggesting that demand is particularly fierce for the right assets that would provide investors with strong outperformance.

The supply-side conditions behind the current recovery are unique.

Figure 5: **Rolling 12m ERV growth, 5th-95th percentile range**



Source: MSCI Quarterly Index.

Rent growth will power capital improvements

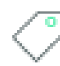
Rents are projected to rise by more than inflation, particularly in residential and logistics markets

At the all property level, our forecast is for annualized rent growth of 2.6% over the five-year period—rents will continue to grow in real terms. We expect asset-level differentiation to be a greater determinant of performance than in the previous five to seven years, when sector allocation was dominant. Our five-year forecasts are shown in **Figure 6.**

Rent growth will be strongest in the residential market, at 3.1% p.a. on average. Single-family housing is poised to perform strongest at 4.1%, ahead of multifamily at 3.4% p.a. and purpose-built student accommodation (PBSA) at 2.8% p.a.

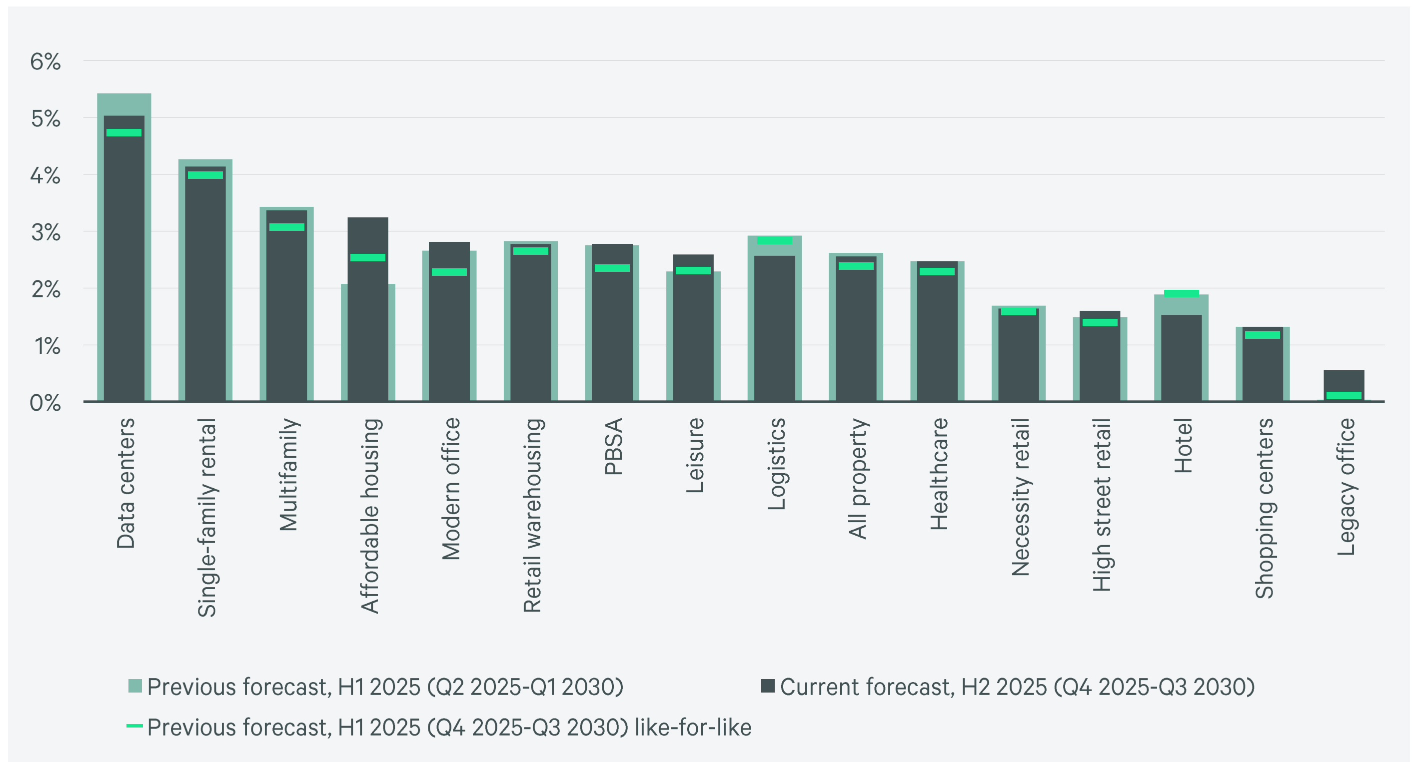
The rate of logistics rent growth will slow, but at 2.6% p.a. exceeds inflation and matches the all property average.

The divergence in performance between modern office (2.8% p.a.) and legacy office (0.6% p.a.) will persist. We expect continued strong growth in London City offices (3.1% p.a.), where supply of the best space remains tight.



Retail will see weaker growth in aggregate at 1.7% p.a., but strong tenant demand and tight supply will drive retail warehouse to outperform at 2.8% p.a.

Figure 6: **Rent growth, Q4 2025-Q3 2030, % Y-o-Y average**



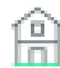
Source: CBRE Investment Management, forecasts as of H2 2025.

Total returns will average 7.5% p.a. over the five-year forecast period

Single-family housing the top performer, but sector forecasts are converging

Figure 7 provides a breakdown of our five-year total return expectations. Performance is differentiated largely along rental growth lines as yield compression is limited.

Logistics returns average 8.2% p.a, out-performing residential thanks to a higher starting yield.

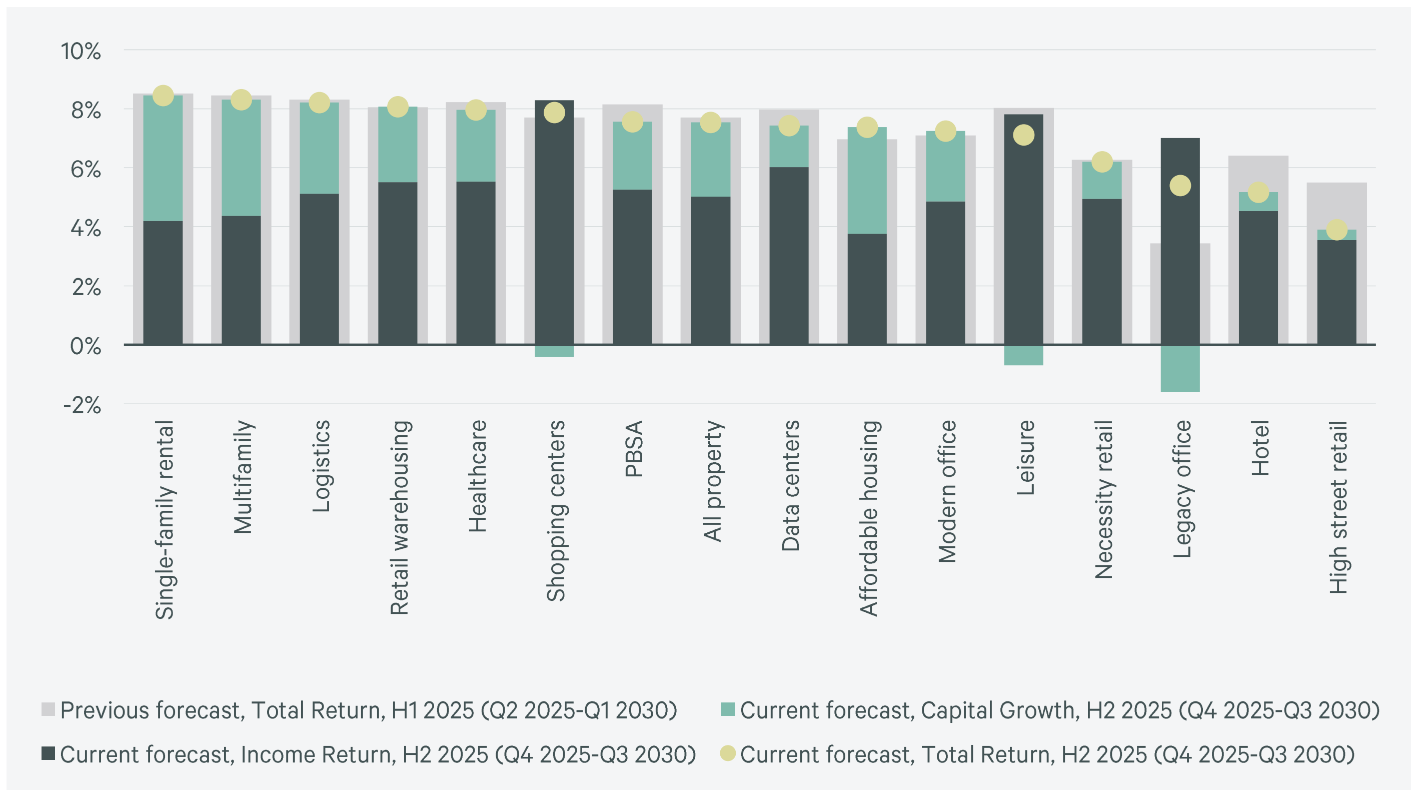


Residential total returns average 7.9% p.a. Within the sector, single family performs highest at 8.5% p.a. followed by multifamily at 8.3% p.a. and PBSA at 7.6% p.a.

At 7.3% p.a. modern office returns are a shade below the all property average, but there are pockets of significant outperformance, including London City at 8.5% p.a.

While retail returns are forecast at 6.5%, this figure is distorted by super prime London where starting yields are below 3%. Both retail warehouse (8.1% p.a.) and shopping centers (7.8%-7.9% p.a.) offer attractive returns, the latter powered by a high income return and the former by strong rent growth.

Figure 7: **Total return and breakdown, Q4 2025-Q3 2030, % Y-o-Y average**



Source: CBRE Investment Management, forecasts as of H2 2025.

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Portfolio construction

Utilizing RARE for top-down allocation decisions

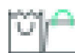
Underpinning our allocation decision-making is our RARE (Risk Adjusted Real Estate) tool, which compares our forecast (expected) returns with required returns. The latter are generated by adding segment-specific risk premia to expected inflation and risk-free values to set hurdle rates above which a segment would (in aggregate) represent good value, but below which it would (again, in aggregate) represent poor value. We can also show relative value within real estate, by comparing each segment to the average gap between expected and required return.

Performing this analysis for our latest five-year forecast period shows the following (**Figure 8**):

The Absolute RARE line is above the Relative RARE line, indicating that in aggregate U.K. real estate returns are slightly below fair value, which is understandable given elevated fixed income benchmarks.

Legacy office sits far below the RARE lines, but some prime markets, especially London City, offer compelling risk-adjusted performance.

All logistics and residential markets sit above either one or both lines, suggesting that good value is easiest to find in these sectors.



Within the retail market, retail warehouse is close enough to the RARE lines to suggest they offer fair risk-adjusted returns.

It should be understood that an indication that a segment offers or does not offer value at the aggregate level does not guarantee value at the asset level. Individual assets in good value segments may not offer value and vice versa. As a top-down portfolio construction tool, however, RARE helps us to understand tactical allocation.

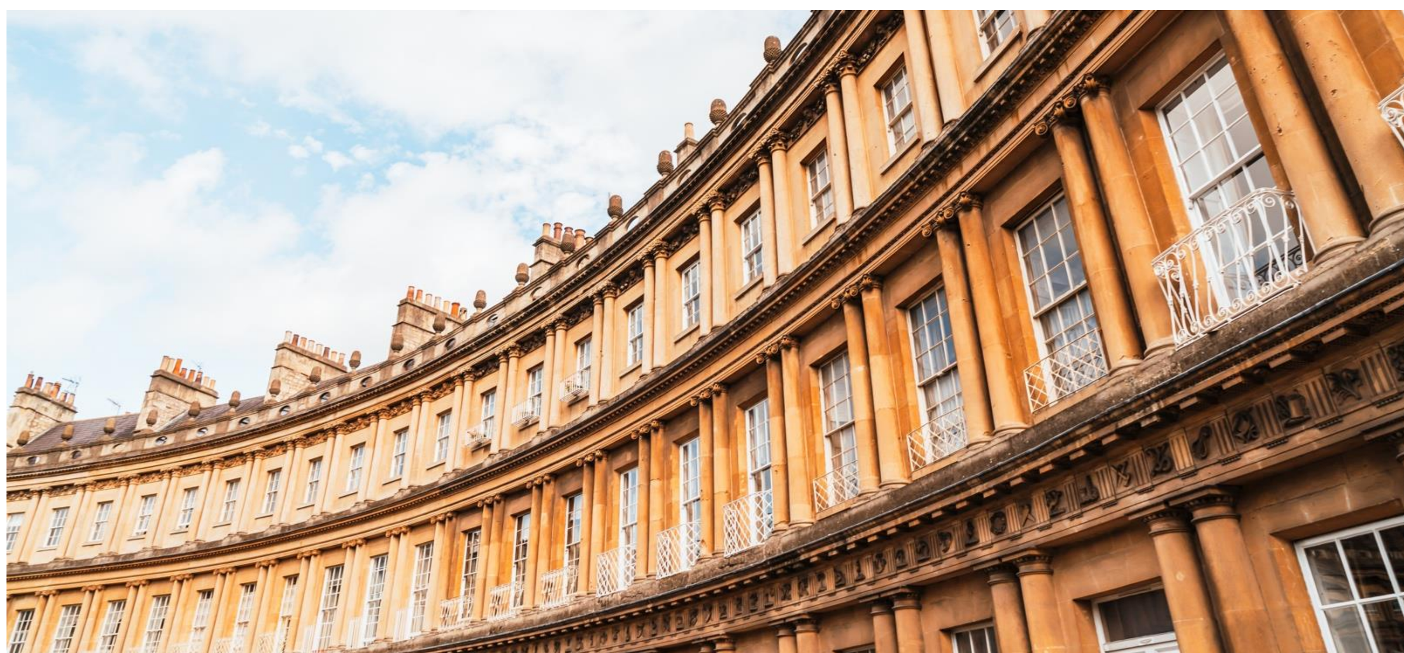


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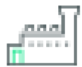
Figure 8: Required return and total return, % Y-o-Y, average, Q4 2025-Q3 2030

PBSA = Purpose-built student accommodation, HS = High street retail
Total Return figures reflect unlevered property returns of a passive fully invested portfolio before fees and taxes. The return is the 5-year average per annum for the period Q4 2025-Q3 2030. Assumptions are generalized to provide a consistent market outlook and asset specific strategies have not been taken into account.
Absolute RARE line: Markets above the line are expected to generate returns higher than their required return.
Relative RARE line: During late cycle phases, markets may not achieve required returns given high pricing. The relative analysis takes the average gap between required and forecasted return (the benchmark bubble) as a given for all markets when setting the hurdle (the benchmark line). Hence, markets above the line are expected to perform relatively better than markets below the line.
Source: CBRE Investment Management, forecasts as of H2 2025.

Our model portfolio is overweight logistics, residential and selected others

Our model portfolio **(Figure 9)** shows the broad sector allocations that we would adopt were we to construct an optimal U.K. core real estate portfolio from an H2 2025 starting point. The model portfolio shows where we consider market benchmark weights to be and where the upper and lower limits of our sector allocation might stretch to.



As would be expected given the high absolute and risk-adjusted returns we identified previously, the logistics sector has the largest tactical allocation and a significant overweight relative to the benchmark.

Our next-largest tactical allocation is to residential. Our allocation is at the top end of the strategic band, which might be higher were supply of stock not a limiting factor.

Given our strong expectations for modern City office returns, we increased our tactical allocation to offices, although it remains at the lower end of our strategic band and represents a considerable underweight position relative to the benchmark.

Our retail tactical allocation sits roughly in the middle of the strategic band; within the sector we have an overweight position to retail warehouse.

Figure 9: **U.K. model portfolio for core unlevered local currency investors, tactical positioning, % of GAV**

Other refers to the sectors classified as other in MSCI except hotel and leisure in the MSCI index.
Source: MSCI U.K. Quarterly Index, CBRE Investment Management, as at H2 2025.

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