# MARKET PULSE: UK PROPERTY INSIGHTS (Q4 2024)

A couple of months ago, the direction of travel for the economy and the property market looked clear. Inflation was falling back; bond yields and interest rates were on a firm downward trajectory; and the economy, while not exactly firing on all cylinders, was looking substantially better than it had done for quite a while. In turn, there were early signs that deal volumes would soon increase; confidence was returning, and with it, there was the expectation that several indicators would turn positive (albeit slowly and very patchily geographically and by sector). Today, this is still the base case, but it has a few more caveats.

Two events – the UK Budget and the US Election – have meant that while it is still the most likely scenario, it may be slower to arrive and perhaps more selective than previously thought. The main factor here is the US Election, given its world-changing implications. Moreover, while the domestic budget is more of a 'known known', the return of Donald Trump to the White House is more of a 'known unknown' as his exact agenda remains unclear, as parts of it were self-contradictory.

**In this quarter's newsletter, we look at:**

1. The UK Budget
2. The US Election
3. What does this all mean for property?
4. The current state of the market
5. In summary

## THE UK BUDGET

**The UK Budget – and some accompanying documentation – contains some important industry-specific announcements, but the most important aspect was the change in fiscal policy (taxation, borrowing and spending) and what that has meant for financial markets.**

The expectation – the inevitability – was that the budget would raise taxes (in some form) and increase both spending and borrowing. This is not a political comment; the previous government, perhaps understandably given the election, had set an impossible fiscal trajectory given spending and investment requirements. However, what happened was *rather* more about all three of those that had already been priced.

The overall settlement implies £30-£40bn more borrowing each year over the parliamentary term, rather than the £20bn expected. This means more government debt – more bonds – which in turn means lower prices and, since they move in opposite directions, higher bond yields. But that's not the only factor pushing up that all-important 10-year gilt figure. The market also judged the budget to be slightly inflationary. This is mainly because of the additional spending but also because of one of the key ways in which the additional £40bn in taxes over the next financial year will be raised – increases in employer National Insurance Contributions (NICs).

The rate at which this is charged will increase from 13.8% to 15%, and – more importantly – the threshold at which this kicks in will reduce from £9,100 to £5,000. This will increase costs for employers, which will either affect their profitability or force them to increase prices, or both.

I am not for a second suggesting that tax rises are a good thing (or indeed a bad thing), but if you are going to introduce them, this seems a little counterproductive. Pushing up prices will increase inflation, which, in turn, will lead to higher base rates and interest rates than would otherwise be possible. (And higher prices are political poison, as the US election has shown). Raising revenue in more direct ways (say through income tax) would be much less inflationary, but the government had boxed itself in with promises not to increase taxes "on working people". Arguably, this will very much do that, just indirectly.

To be fair, bond yields were going up internationally anyway before the budget, and some of these measures were expected. But the likelihood of (a) more UK government bonds being sold and (b) higher UK inflation than previously expected *partially* explains why the yield on UK public debt (10 years) went up by almost a quarter percentage point between 29th October and 6th November.

However, since then, the MPC has cut base rates by 25bps, and yields have fallen by about 12 basis points, reversing almost half the gain. Dig into the data, and the situation looks a bit volatile, which is unsurprising given everything that's going on – although the situation has somewhat stabilised at the time of writing.

So this does not – at least not yet – look like the reaction to the Liz Truss 'minibudget' when bond yields pushed out more quickly and decisively (by pretty much a whole percentage point in a week). It does, though, suggest that the base rate will be cut more slowly than previously thought. (See below because we need to digest Trump's potential impact on property, too.)

Elsewhere, the budget also increases capital gains tax rates, from 10% to 18% at the lower band and from 18% to 24% at the upper. While this is obviously not great for property owners, it was a less substantial increase than expected and does, after all, equalise (standard) CGT with residential CGT. There were also changes to reliefs around inheritance tax for agricultural land and premises, which have proved controversial but could, on the margins, lead to more land coming forward to development, assuming the planning taps are turned on.

There were also some changes to business rates, with the multiplier reduced for smaller leisure and hospitality premises, to be paid for by raising it on those with rateable values of over £500,000. For more details on this and wider points around the system, please refer to the piece written by our Head of Rating, Josh Myerson.

## THE US ELECTION

**Last week, Donald Trump, in contrast to late polls, won a definitive victory in the US election. And with the House and the Senate looking like they will be Republican-dominated too, he will be free to pursue the agenda he was elected on: tax cuts, tariffs and some pretty big shifts in how the US deals with geopolitics.**

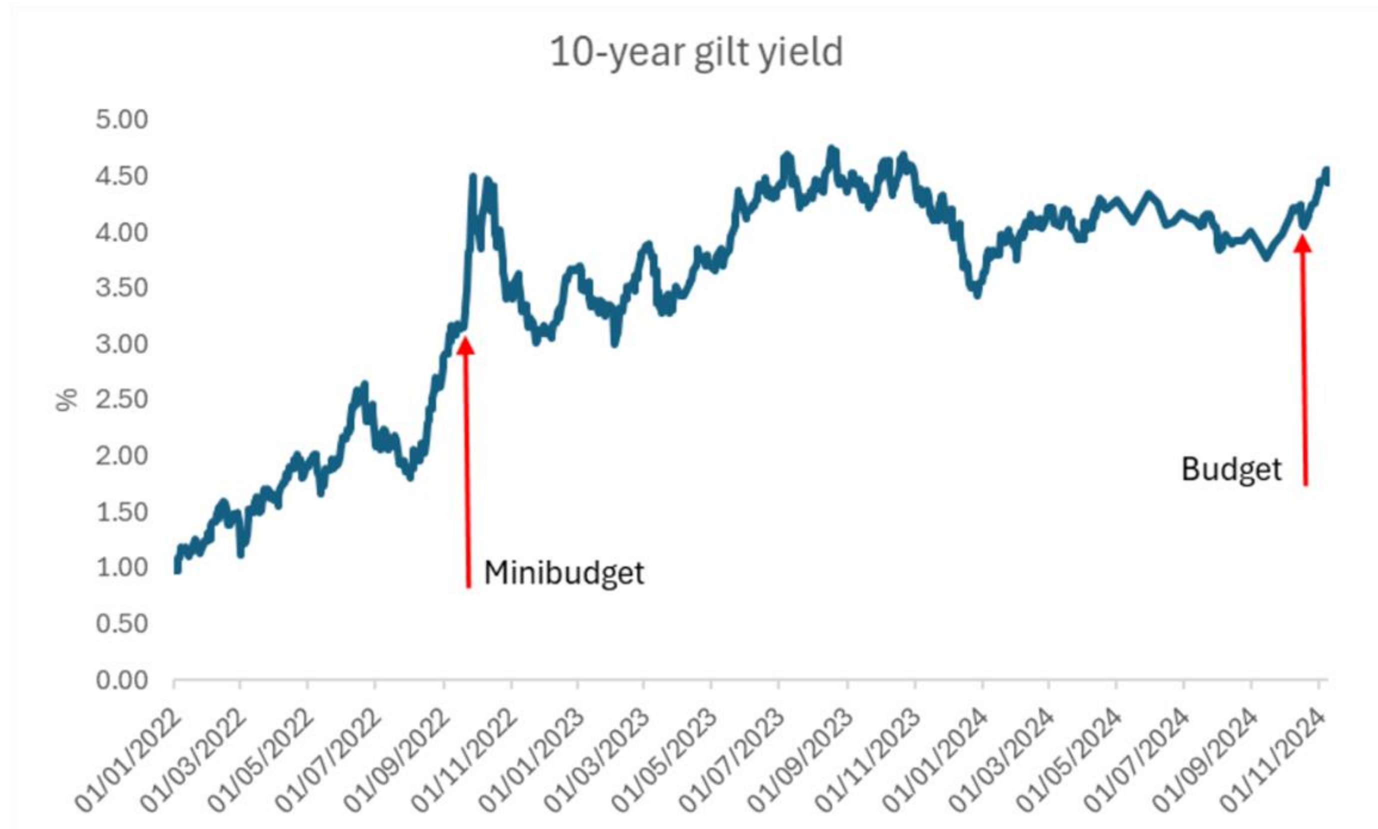
Those tax cuts explain why equity markets did well – tax cuts being good for corporate America – and also why Treasury bond yields rose – as those same cuts are assumed to be inflationary, pumping more demand into the economy. Tariffs, by increasing the price of foreign-made goods, would have the same impact. (A 25 bps cut in Treasury rates followed, taming the market somewhat.)

Trump has promised a 60% tariff on goods made in China and a 10-20% tariff (depending on which speech you read) on imports from everywhere else. This would, needless to say, have a dramatic effect on the world economy – and Britain's. The Centre for Economic and Business Research, for example, thinks it would cut UK growth rates by about half.

While manufacturing is not as important to the UK's economy as, say, Germany's, the US is one of the few countries with which we have a trade surplus in goods. On the other hand, with the UK outside the EU, there is the potential for a carve-out deal, or a trade deal, which could reduce or remove the problem – and as we all know, Trump is keen on deals. However, that might not go down well with our immediate neighbours who, despite Brexit, remain our largest trading partners in aggregate.

Of course, no one knows which parts of the programme Trump will follow through on or how long it will take to draw up and negotiate tariffs, which is why the risks here are perhaps rather more long-term, even if they might lead to more uncertainty in the short-term.

## WHAT DOES ALL THIS MEAN FOR PROPERTY



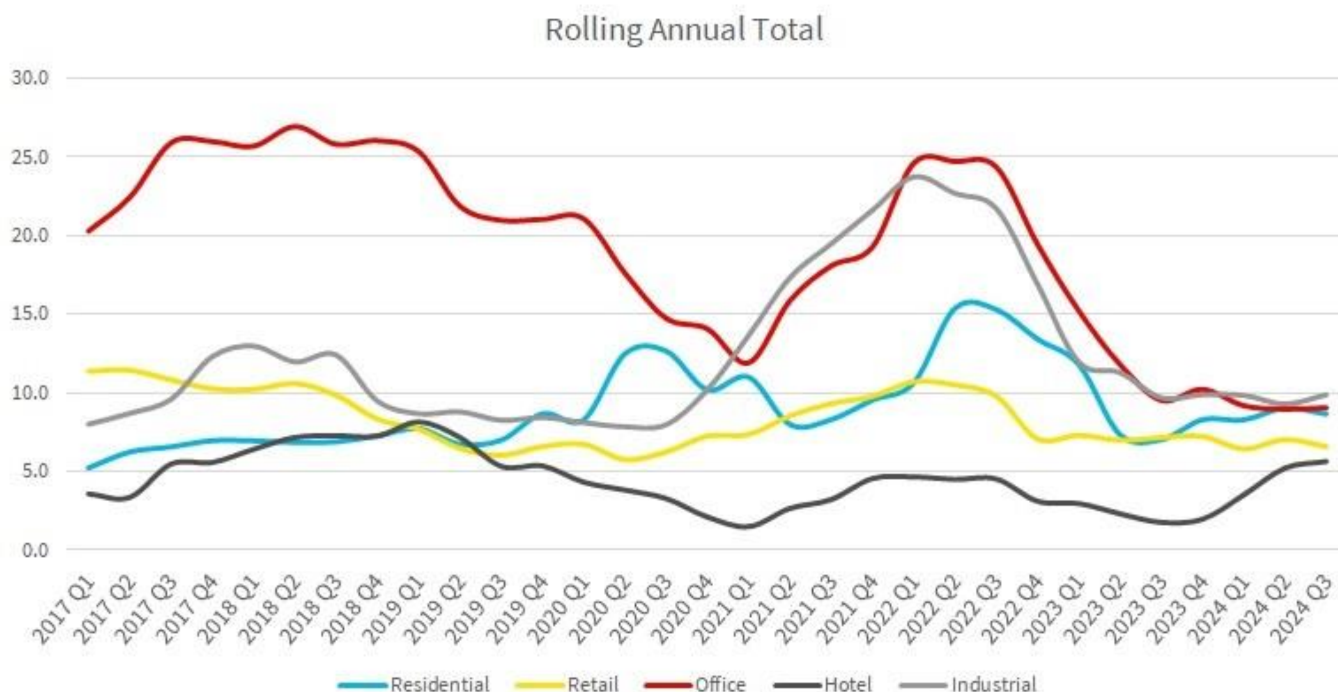

**The gilt yield has a big impact on our markets, mainly because it represents the risk-free rate against which property yields are measured. It also indirectly affects debt costs. This is quite easy to understand; in theory, at least, government debt is the safest investment available. As property is inherently riskier, then investors some sort of premium above this level to justify buying it, otherwise they may as well simply go for theoretically safer government bonds. So if gilt yields rise or fall, then so should property yields.**

At present, base rates are now expected to fall more slowly than before. While Oxford Economics' forecast of 3.75% by the end of 2025 is being retained for now, market expectations – which were at around the same point – have risen by 50bps since the budget and Trump. This *should* imply that gilts will continue falling but at a reduced pace compared to before.

So, the same logic applies to property yields and to pricing. Things are still going to get better gradually for market activity, but even more gradually than before all this happened. The same applies to the housing market, where mortgage rates will probably still decline, albeit at a slower rate. The question is whether this poses risks for one of the government's central domestic policy planks – increasing housing supply.

## CURRENT STATE OF THE MARKET

**Although the mood music changed a little over the Summer – with talk of more deals on the table – that isn't yet visible in the data. Investment volumes in Q3 were £9.4bn, the lowest for a year – although they were above the figure for the same quarter in 2023. All sectors were down except industrial and offices, which had a comparatively strong three months. Residential was particularly weak, although it's misleading to read too much into these statistics, as the long-term picture is still that the living sector is seeing a greater share of activity while offices are in decline.**




Investment Returns haven't changed hugely since the last quarter, with industrial still leading the pack with a 4.9% annual return and offices the laggard at -3.6%. The notable change has been the shift in retail's position, which is now at 3.8%, ahead of residential; this reflects the high (6%) income return in the segment and lowered levels of capital losses.

The leasing market is showing some signs of resilience, particularly in Central London, where net absorption appears positive, supporting rental growth. While industrial leasing is down on the boom of a couple of years ago, it has remained historically very respectable levels. There is also some good news in the housing market; prices are more buoyant, and the start is up (from a low base), even if planning applications are still at a low ebb, which brings us conveniently to some of the other measures in the budget.

Many of the other measures announced at the same time as the key fiscal changes demonstrate how seriously this government takes increasing the housing supply; in other words, they're mostly about planning and enabling infrastructure. So there is an additional £500m for the affordable housing programme, 300 additional planning, additional funding for initiatives such as the Cambridge Growth Company and the Liverpool Docks Regeneration, and commitments to both East-West rail (Oxford-Cambridge) and the HS2 line coming right into Euston.

The government also announced that it will be publishing a Planning and Infrastructure Bill in the New Year. This will provide more detail on precisely how the government intends to reform planning – as well as controversial areas such as Hope Value around Compulsory Purchase Orders (CPOs) and whether this will have a key part in the new generation of New Towns Labour wants to initiate. This will be accompanied by a 10-year infrastructure strategy –

which presumably will dovetail with housing and planning policy providing rail, road, digital, energy and water links to where housing growth needs to happen.

There are a few issues with all of this – not least how affordable housing will be ramped up given the problems in the sector, which might leave you asking whether councils will need to be more involved. Most obviously, though, there's the issue of whether mortgage rates will remain relatively high, meaning that it's harder to drive the sort of increase in housebuilding the government wants to see. But it all sounds good, at least for the residential sector – by which I mean there's little mention of commercial in recent planning missives.

## IN SUMMARY

**The world has certainly become more volatile over the past month. In particular, inflation is now expected to stay higher for longer (while still coming down).**

This means that the Bank of England will be slower in cutting rates, with some forecasters already putting up the end-2026 figure by 25-50bps. This means debt costs – and, with them, property yields – will be higher for longer, too. And while the trajectory remains unchanged, the longer-term risks look a bit more worrying, with the prospect of higher inflation driven by a very different US policy environment. (It will take time for a tariff regime, for example, to be drawn up, passed and executed).

However, there are wider factors pulling inflation down in the longer term, and the Bank of England seems committed to a cutting agenda. So – without any future shocks, a big 'if' in today's world – the investment and development markets will continue to improve, just at a slower pace than before. The residential sector, supported by the government and favoured by investors (if slightly behind industrial), looks most likely to be the outperformer.

To learn more, please contact Jon Neale.