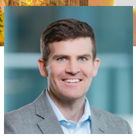
REAL ESTATE

U.S. Real Estate: Tariffs Test the Recovery

The U.S. real estate market held steady in the first quarter as solid underlying fundamentals provide a foothold for rising tariff headwinds.

RESEARCH QUARTERLY



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Research & Strategy

Executive Summary

ECONOMY

- The U.S. economy has entered this period of higher-than-expected tariffs from a favorable position with a solid labor market and generally sound household and business balance sheets.
- Markets have been volatile and repriced risk but are functioning with some improvement since the initial tariff shock.
- The duration and severity of tariffs—with paths still available to de-escalate and lower tensions—will test the strength of the economy's underlying fundamentals.

PROPERTY MARKETS

- The U.S. commercial real estate recovery held steady in the first quarter and was supported by slower development activity with greater barriers to new supply. However, economic concerns slowed tenant demand with lower absorption for all property sectors outside of multifamily during the quarter.
- CRE valuations—which have reset in recent years—were relatively unchanged in the first quarter of 2025 based on transaction cap rates and commercial property price indices. Meanwhile, transaction activity was slowed by market volatility and economic concerns.
- Public REITs have outperformed the broader U.S. equity market to-date—a positive sign for private real estate markets— supported by the cash flow and physical nature of the asset class.

Economic Outlook

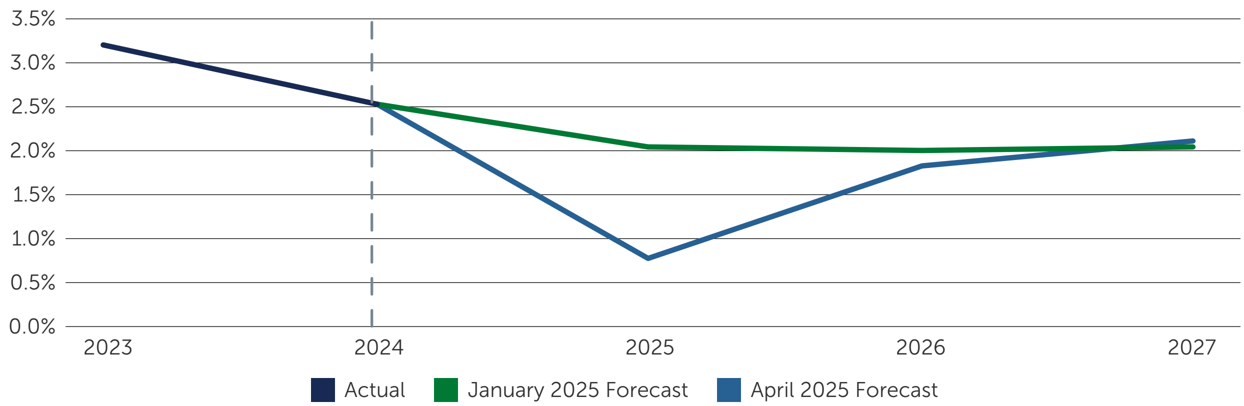
The U.S. economy has entered this period of higher-than-expected tariffs "in a solid position" as recently described by Federal Reserve (Fed) Chair Powell. However, the outlook has diminished with economists projecting 0.8% year-over-year GDP growth in 2025 as of April compared to 2.0% in January **(Figure 1)**.[1] The recently announced "reciprocal pause" on most countries is positive on balance, but tariffs remain elevated with the average U.S. global import rate above 20%, largely due to China.[2] How businesses and households respond to these headwinds will shape the outlook. Despite very low confidence apparent in "soft" survey data, the "hard" data suggest a slowing—rather than declining—economy to-date with 288,000 jobs added in March and an unemployment rate of 4.2%. The resilient labor market supported demand for commercial real estate (CRE) though there are signs policy uncertainty is damaging economic activity. The duration and severity of tariffs—with paths still available to de-escalate and lower tensions—will test the strength of the economy's underlying fundamentals and thereby the CRE recovery, which held steady in the first quarter, supported by slower development activity with greater barriers to new supply.

It appears aspects of President Trump's tariffs are to force negotiations with trade partners—and set a new trade "equilibrium" to address "imbalances". But other elements of his policies signal structural changes with long-term implications for CRE including reshoring manufacturing for industries such as automotives, pharmaceuticals, and technology. The extent of which is unknown, and the outcome is unpredictable, leading to increased market volatility. Equity markets declined 19% from the recent peak to trough but have since recovered some of the losses while REITs have outperformed **(Figure 2)**.[3] Such "risk-off" events typically trigger a flight-to-quality behavior which leads to lower Treasury (UST) yields as investors bid up the price of safe haven assets, but markets acted differently in recent weeks. The 10-year UST rose from 4.0% to as high as 4.5% over the course of several trading days and has since settled around 4.3%.[4] There are a range of views on this market reaction from technical reasons—such as levered investors selling USTs to raise cash—to more challenging factors such as foreign capital outflows and U.S. dollar concerns. Capital markets are expected to remain volatile given trade and other policy outcomes such as taxes and the federal debt ceiling are unknown. In addition, economic headwinds may put pressure on risk premia with CRE cap rates up a relatively modest 6 basis points (bps) quarter-over-quarter to 6.64% in the first quarter.[5]

1. Survey conducted April 4–8, 2025. Source: WSJ. As of April 8, 2025.
2. MEX, CAN excluded from "reciprocal tariffs"; CHN has a 145% tariff with exceptions for items. Weighted average. Source: IMF; USRT. As of April 12, 2025.
3. VIX measures equity volatility. Equity performance measured by the S&P 500. Source: NAREIT, S&P, CBOE, ICE. As of April 16, 2025.
4. Source: CNBC. As of April 25, 2025.
5. The cap rate is a simple average for office, retail, industrial, and multifamily properties over the quarter's three months. Source: MSCI RCA. As of March 31, 2025.

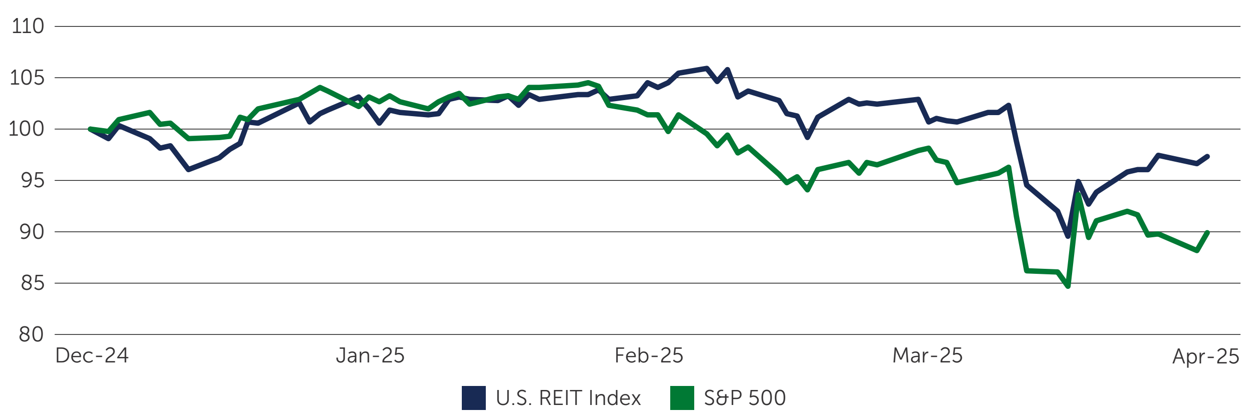
Although elevated, financial stress remains below previous periods of high volatility—such as the pandemic and the high inflationary period in 2022—while Fed officials note the system continues to function with tools available to address a disorderly market.[6] However, the expected growth slowdown and higher inflation from tariffs may be a more challenging scenario for the central bank to respond to given tensions posed to its dual mandate. Chair Powell recently suggested the price stability goal may be favored in the nearer term to achieve longer "periods of strong labor markets." The market has taken a more aggressive view given recession risks and anticipates about 100 bps in rate cuts this year[7] compared to 50 bps expected by the Fed, which is also concerned about stagflation[8]. This "wait and see" stance has caused friction between Chair Powell and President Trump, adding yet another layer of unpredictability. In this environment, favoring a framework-based scenario approach, driven by long-term structural fundamentals, and maintaining optionality may be most useful.

Figure 1: U.S. Real GDP (YOY, Q4)



Source: WSJ, S&P (S&P 500), Vanguard (VNQ) CoStar. As of April 8, 2025.

Figure 2: Equity Markets (Indexed)



Source: WSJ, S&P (S&P 500), Vanguard (VNQ) CoStar. As of April 22, 2025.

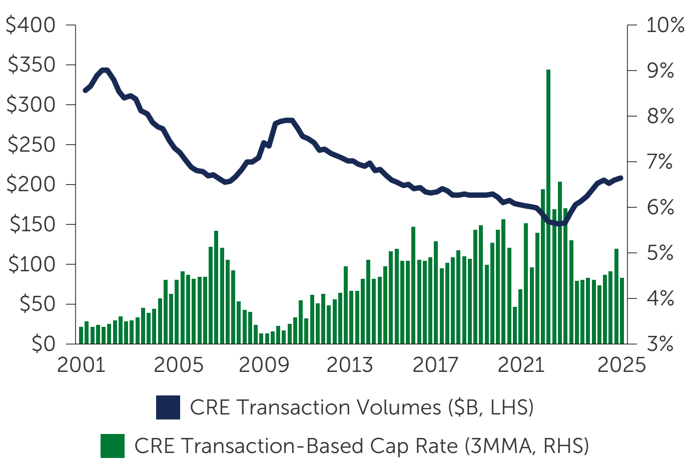
6. Market stress measured by the Chicago Fed Financial Conditions Index. Source: Federal Reserve. As of April 11, 2025.
7. Source: CME Group. As of April 24, 2025.
8. Source: Federal Reserve SEP. As of March 31, 2025.

Valuations & Capital Markets

CRE valuations, which have reset in recent years, were relatively unchanged in the first quarter of 2025 while transaction activity was slowed by market volatility and economic concerns. Transaction-based cap rates increased 6 bps quarter-over-quarter to 6.64% in the first quarter of 2025 and compares to 5.65% for the same period of 2022 **(Figure 3)**. Office cap rates increased by 22 bps in the quarter compared to 12 bps for retail, while multifamily and industrial cap rates declined by 5 bps and 8 bps, respectively. There are limited data on the initial valuation impact from trade policy, but investment grade CMBS spreads have increased about 15 bps since the start of the month—though the full effect will depend on the duration and magnitude of tariffs and how the economy responds.[9]

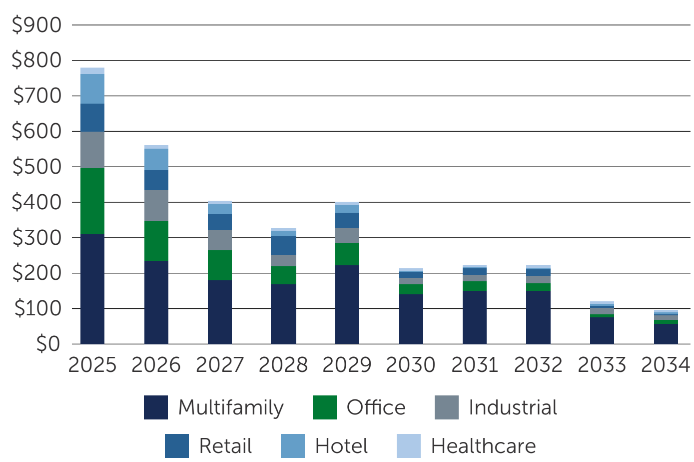
Property transactions declined 30% quarter-over-quarter to $83 billion in the first quarter of 2025, with lower volumes across all property types except for retail.[10] Institutional and private investors were marginally net property buyers whereas REITs and foreign owners were modestly net sellers. Banks represent roughly 50% of the CRE debt market, and with some exceptions, they continued to grow their loan portfolios but at a reduced pace. For example, Fed data shows banks' aggregate CRE loans on balance sheet rose by 0.4% year-over-year as of April compared to 1.2% in December.[11] Transaction activity is expected to remain constrained by macro concerns with originations driven by loan refinancings given significant debt maturities. The CRE loan maturity wall is "front heavy" as previously matured loans were often extended. For example, last year an estimated $573 billion in loans were due in 2025 compared to this year's $957 billion forecast for 2025 **(Figure 4)**.[12] In addition, there are signs of weakening credit performance as CMBS delinquency rates increased from 4.7% to 6.7% year-over-year as of March 2025.[13]

Figure 3: CRE Cap Rates and Transaction Volumes



Source: MSCI RCA, MBA. As of March 31, 2025 (LHS).

Figure 4: CRE Debt Maturity Wall by Sector ($B)



Source: MSCI RCA, MBA. As of February 28, 2025 (RHS).

9. Based on an index that tracks spreads on CMBS securities in the secondary market. Source: ICE. As of April 23, 2025.
10. Private investor refers to companies whose control is in private hands such as family offices. Source: MSCI RCA. As of March 31, 2025.
11. Source: Federal Reserve. As of April 2, 2025.
12. Source: MBA. As of February 28, 2025.
13. Includes CMBS loans that are 30+ days past due. Source: Trepp. As of March 31, 2025.
14. Source: CoStar. As of March 31, 2025.

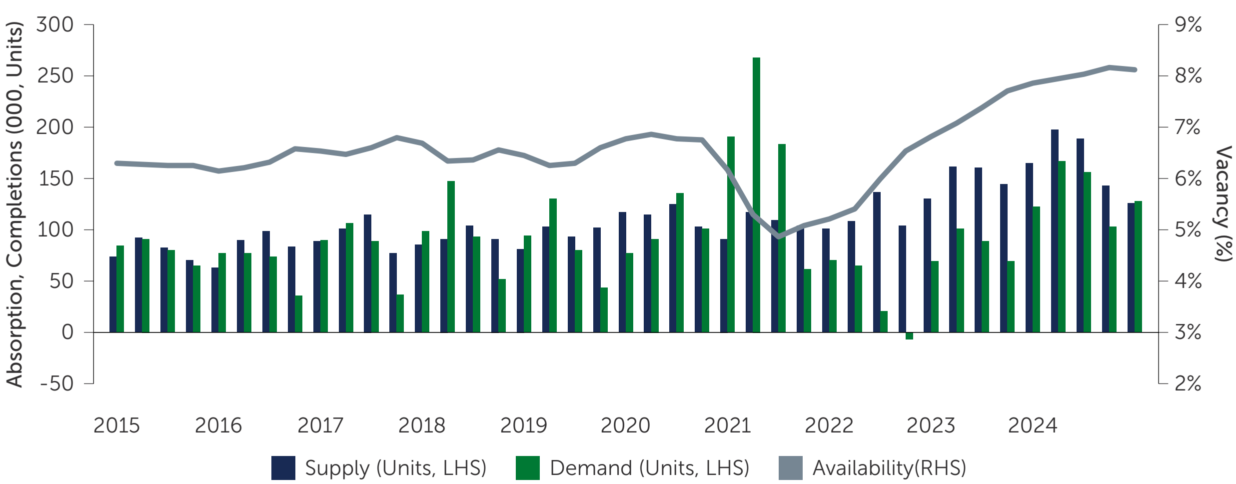
Occupier Markets

APARTMENT SECTOR

The apartment vacancy rate was unchanged quarter-over-quarter at 8.1% in the first quarter of 2025 as demand outpaced new deliveries for the first time since 2021 **(Figure 5)**. The sector's improvement was driven by the higher quality segment which has experienced heavy new supply, accounting for 71% of new deliveries during the quarter.[14] For example, 4- and 5-star property vacancy declined 30 bps to 11.4% but is still meaningfully above 7.4% for more affordable 3-star units. Absorption rates were highest for many Southern markets—such as Austin, Raleigh, and Charlotte—but vacancy remained elevated compared to slower growth, lower new supply Northeast and West markets including Boston, New York, and Los Angeles. Renters are likely to take a cautious approach on future leasing decisions given economic headwinds, but households enter this period of uncertainty with generally sound fundamentals as consumer balances sheets are largely solid and the unemployment rate remains low at 4.2%.[15] The sector' supply-demand balance also benefits from rapidly lower development activity as multifamily starts declined 70% since their 2022 peak.[16]

The sector's improving fundamentals coincide with softer credit performance, often a function of capital structure issues and higher interest rates rather than asset quality. For example, CMBS multifamily loan 30+ day delinquency rates increased from 1.84% to 5.44% over the past year[17], while bank delinquency rates increased from 0.55% to 1.35%[18]. In addition, there is $310 billion in multifamily loans maturing in 2025, including an estimated $95 billion of loans that matured in 2024 but were extended, which were often originated during a much lower rate environment. This is expected to create opportunities, but the outlook favors markets with durable economic and employment drivers and structural features that are less sensitive to (or may benefit from) trade and immigration policy changes.

Figure 5: Apartment Vacancy Stabilized, Demand Outpaced Supply for the First Time Since 2021



Source: CoStar. As of March 31, 2025.

15. Source: BLS. As of March 31, 2025.
16. Source: CoStar data. As of March 31, 2025.
17. Source: CMBS delinquency rates are at their highest level since 2015. Source: Trepp. As of March 31, 2025.
18. Source: FDIC. As of December 31, 2024.

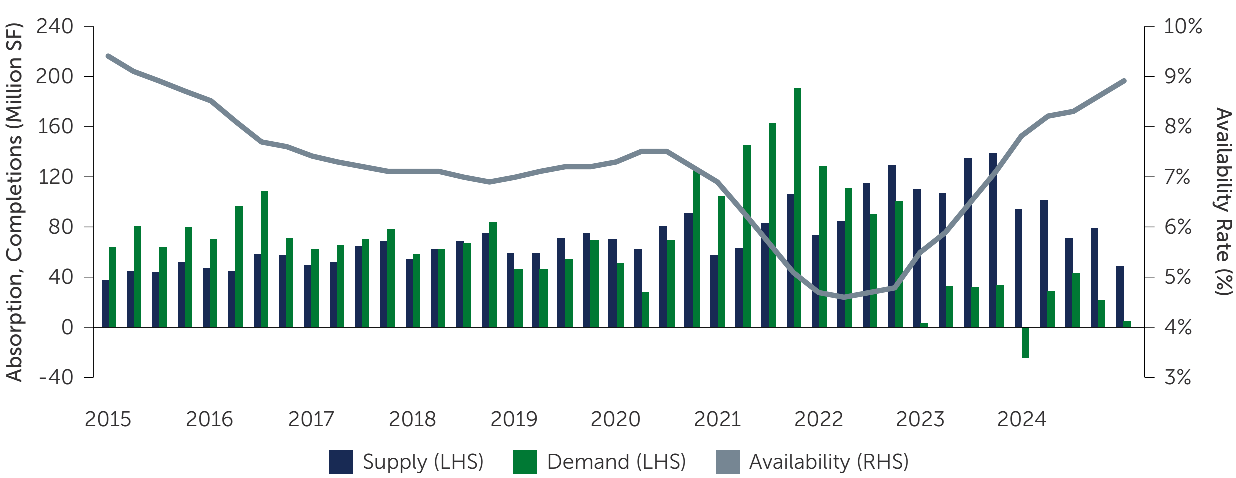
Occupier Markets

INDUSTRIAL SECTOR

The industrial availability rate increased 30 bps quarter-over-quarter to 8.9% in the first quarter of 2025 while asking rents were unchanged year-over-year **(Figure 6)**. New supply, which has declined significantly, continued to weigh on the sector's fundamentals as only 40% of delivered space was pre-leased.[19] Absorption slowed and was constrained by trade policy uncertainty as businesses are taking a cautious approach to leasing, purchasing, and investment decisions.[20] Industrial fundamentals are stronger for smaller-sized product given lower development activity for this segment of the market. For example, warehouses with less than 200,000 SF had a 7.5% availability rate as of the first quarter compared to 11.1% for properties with greater than 200,000 SF.[21]

President Trump's constantly evolving trade policies are expected to negatively impact near-term economic growth but also have long-term impacts on global supply chains. This places increased emphasis on assessing a port market's trade partners, type of incoming goods, and the durability of trade. For example, President Trump has taken an especially aggressive stance towards China and imposed a 145% tariff rate—with some exemptions—which may reinforce policies from his past Administration that shifted supply chains and imports to other Asian countries, Mexico, and Canada. There are also parts of the economy President Trump appears to prioritize for reshoring, including industries such as motor vehicles, pharmaceuticals, and semiconductors. These structural changes will have significant impacts on industrial markets as companies reshape supply chains, likely increase their use of 3PLs, and enhance their U.S. production capabilities. This is expected to benefit port markets that offer efficient shipping routes and are supported by economic, demographic, and other fundamental factors. Inland industrial markets and last mile distribution centers may be more insulated from trade with certain areas standing to gain from exposure to increased domestic manufacturing activity.

Figure 6: Availability Increases on Tepid Demand but New Supply has Declined 65% from Peak



Source: CBRE EA. As of March 31, 2025.

19. Source: CBRE EA. As of March 31, 2025.
20. Source: Newmark. As of April 4, 2025.
21. Source: CBRE EA. As of March 31, 2025.

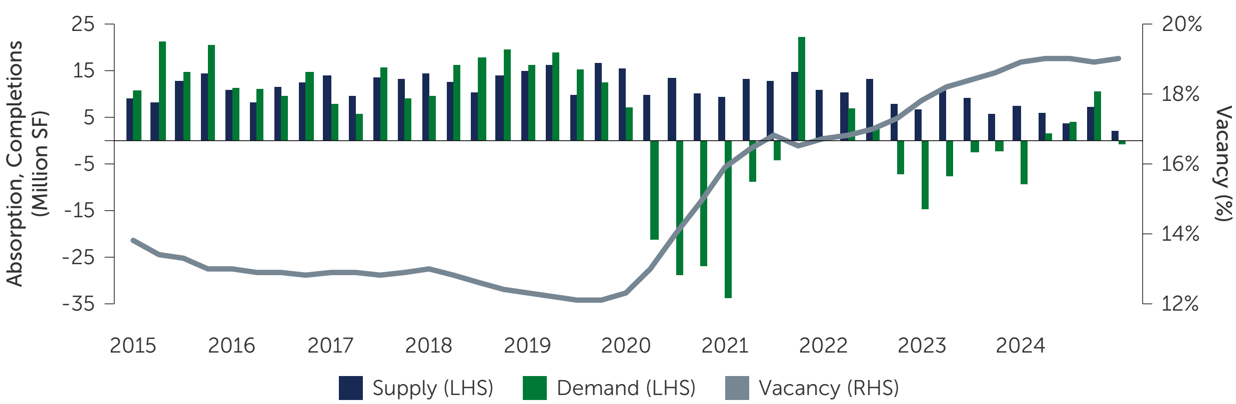
Occupier Markets

OFFICE SECTOR

Office vacancy rates increased a modest 10 bps quarter-over-quarter to 19.0% in the first quarter of 2025, largely due to federal lease terminations and softer leasing in lower quality properties **(Figure 7)**. For example, absorption was 0.0% for 3-star buildings during the quarter compared to 0.3% for 4- and 5-star offices.[22] The sector's leasing activity was led by financial services companies which represented 39% of leases signed and is above its share of roughly 24% of total leasing in 2023 and 2024.[23] The office recovery is fragile and macro concerns are an added headwind but there are encouraging signs. For example, office downsizing rates have improved and are stabilizing with larger corporate users shedding 7% of space upon expiration over the past year compared to 12% in 2023.[24] The sector is supported by improved demand from increased return-to-office trends with office attendance up 4 percentage points year-over-year to 68% of pre-pandemic levels in March.[25] In addition, new supply is limited with just 2.1 million SF delivered in the first quarter, compared to a 10.9 million SF 10-year average.[26]

Market performance is highly dispersed. In particular, micro locations with durable demand drivers matched by high-quality assets, a skilled workforce, and connectivity and lifestyle offerings are best positioned. Recent market volatility and upcoming debt maturities may present opportunities given the impact of lower market liquidity, basis reset, and higher interest rates. According to the MBA, office debt set to come due in 2025 totals approximately $190 billion, which includes an estimated $80 billion that was extended in 2024. Credit indicators also point to challenges as delinquency rates for CMBS loans secured by office properties reached 9.76% in March compared to 6.58% the same time a year ago.[27]

Figure 7: Office Vacancy Increased 10 bps on Federal Lease Terminations and Lower Quality Assets



Source: CBRE EA. As of March 31, 2025.

22. Source: CoStar. As of March 31, 2025.
23. Includes properties in select major U.S. office markets. Source: Avison Young. As of March 31, 2025.
24. Source: JLL. As of March 31, 2025.
25. Source: Placar.ai. As of March 31, 2025.
26. Source: CoStar. As of December 31, 2024.
27. 30 or more days delinquent. Source: Trepp. As of March 31, 2025.

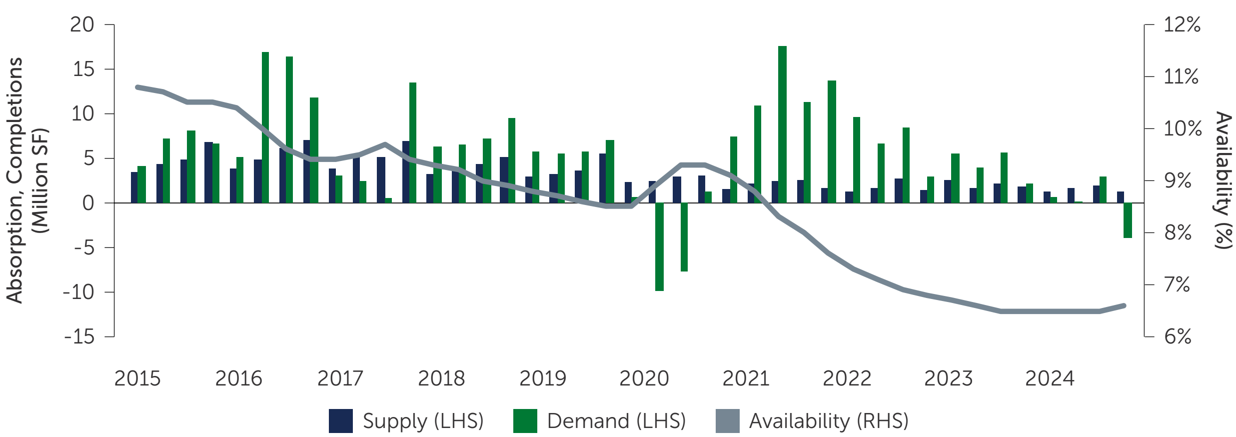
Occupier Markets

RETAIL SECTOR

Neighborhood and community shopping center (N&CS) availability increased 10 bps quarter-over-quarter to 6.6% in the first quarter of 2025 but remains just above its record low **(Figure 8)**. The vacancy rate was led by recent bankruptcies—such as Party City, The Container Store, and Conn's—and retailers closing unprofitable stores including Walgreens and Family Dollar. The relatively low level of quality available space provides a solid supply backdrop for recent store closures as open space was backfilled in 7.5 months in 2024—the shortest amount of time in nearly 15 years.[28] The sector's fundamentals are also supported by scarce new supply as completions declined to 1.3 million SF during the quarter, which compares to a quarterly average of 3.3 million SF over the past 10 years.[29]

Consumer sentiment reached its lowest levels in March and April since the peak of inflation in 2022 given trade war concerns, but consumer spending increased in March.[30] For example, overall retail sales rose 1.4% month-over-month (above economists' 1.2% consensus estimates) and 0.5% excluding motor vehicles and parts compared to 0.3% forecasts.[31] There are aspects of the retail sales data that was driven by households front-running tariffs before anticipated price increases but consumption continues to be supported by a solid labor market and the recent decline in gas prices. However, there are increased signs consumers are taking a cautious stance while credit indicators point to challenges for certain household segments. For example, 30% of consumers expect to be "somewhat" or "much" worse-off financially over the next 12-months—up from 20% in December while subprime auto loans delinquency rates increased 45 bps to 6.07%.[32] Nonetheless, the sector's favorable supply-demand fundamentals and often non-discretionary offerings such as grocery stores position NC&S well for a range of potential economic outcomes.

Figure 8: N&CS Retail at Record Lows for Availability and New Supply



Source: CBRE EA. As of March 31, 2025.

28. Based on median. Source: CoStar. As of March 31, 2025.
29. Source: CBRE EA. As of March 31, 2025.
30. Source: University of Michigan. As of April 11, 2025.
31. Source: Census Bureau, Dow Jones. As of March 31, 2025.
32. Auto data based on ABS loans. Source: Federal Reserve Bank of New York; Fitch. As of March 31, 2025.

Occupier Markets

SELF-STORAGE SECTOR

Self-storage vacancy rates were relatively unchanged at 7.3% in the first quarter of 2025 and is in-line with the sector's average from 2014 to 2019, along with effective rents **(Figure 9)**. New customer rental move-in rates declined 7% year-over-year as of January based on recent REIT data.[33] The slowdown was driven by elevated new supply and slow housing market activity which is a key source of incremental demand. Home sales are at a near 30-year low and limited by elevated mortgage rates, which averaged 6.8% during the first quarter.[34] However, new supply is expected to decline to roughly 1.5% of existing inventory in 2025 compared to 2.0% in 2024 and 2.4% in 2023, given higher construction, land and borrowing costs.

Figure 9: Self Storage Occupancy and Rents Are Stablizing Near Pre-Pandemic Levels

*Q1 2025 data estimated based given data availability. Source: Green Street. As of March 31, 2025.

33. Source: Green Street. As of January 31, 2025.
34. Existing home sales. Source: NAR; Federal Reserve; Freddie Mac. As of March 31, 2025.

About the Team

BRE's research team efforts are led by Paul Stewart, based in Europe and Lincoln Janes in the U.S. The research team is structured by sector and geographic expertise. The team's diverse backgrounds include appraisal, legal, technological and academic applications across multiple asset-classes, across buy and sell-side shops in markets around the globe. The real estate research team is complemented by an analytics function enhancing the team's ability to collect, augment and analyze data to inform better decision making.

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