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REAL ESTATE

# U.S. Real Estate: Appreciating Income in a Shifting Economy

CRE valuations held steady in the second quarter, though transaction activity was subdued amid economic uncertainty and periods of market volatility following "Liberation Day".

RESEARCH QUARTERLY


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# Executive Summary

## ECONOMY

- Despite policy volatility and tariff-related risks, the U.S. economy remained resilient in Q2 2025, supported by low unemployment, solid household and business balance sheets, and productivity gains.
- The "One Big Beautiful Bill Act" introduced modest fiscal stimulus but raised federal deficit concerns. Trade policy around tariffs created headwinds for business investment and CRE construction starts.
- The Fed maintained a cautious stance on rate cuts, despite political pressure. Markets remain sensitive to U.S. Treasury demand, with roughly two 25 bps rate cuts expected by year-end.

## PROPERTY MARKETS

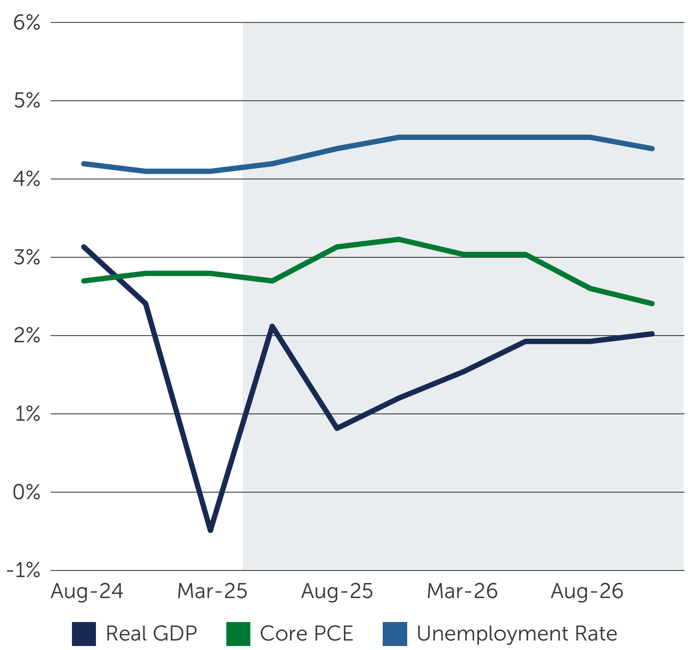
- Construction activity has slowed meaningfully across most sectors, creating a more favorable supply backdrop. This trend is notable in multifamily and industrial, where elevated costs and tighter financing conditions have curtailed new starts, reinforcing fundamentals for existing assets.
- CRE valuations held steady in Q2 2025 following a basis reset in recent years, though transaction activity was limited by economic uncertainty and periods of market volatility following "Liberation Day.
- Debt markets have improved, with spreads modestly tightening across property sectors. However, underwriting remained conservative, particularly for office and retail assets, as lenders were cautious amid valuation and economic uncertainty.

# Economic Outlook

Despite elevated uncertainty and shifting U.S. policies, the economy showed resilience in the second quarter, supported by solid fundamentals and productivity gains. The labor market is cooling, but unemployment remains low at 4.1%, and household and business balance sheets are generally healthy.[1] The "One Big, Beautiful Bill Act" adds modest fiscal stimulus through elevated federal spending—levels typically reserved for recessions. However, abrupt policy shifts, especially around trade, continue to weigh on activity. Uncertainty around tariffs has added pressure for countries to reach trade agreements before the August 1 deadline, while the Trump Administration also uses import duties to promote domestic industries like automotives, pharmaceuticals, and semiconductor manufacturing. These moves also come with trade-offs—for instance, there are signs higher import costs are being passed to consumers while some businesses are delaying their investment decisions.

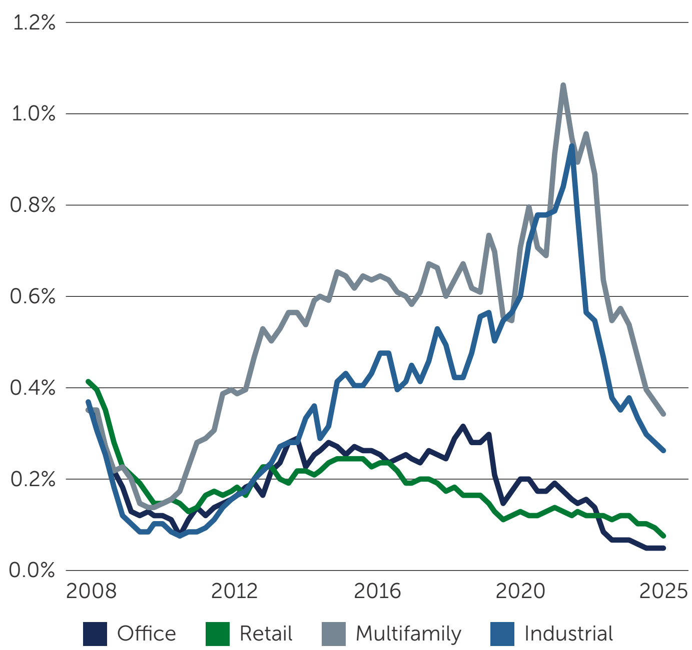
The environment has also contributed to a slowdown in commercial real estate (CRE) construction starts, which have declined sharply since their 2022 peak due to rising costs and tighter financing. While this creates a favorable supply backdrop for a CRE recovery—assuming continued economic growth—the impact of shifting policy will vary by sector, region and strategy. As a result, dispersion is likely to remain a defining market feature, with a focus on strong supply-demand dynamics.

**Figure 1: U.S. Economic Forecasts (YOY)**




Sources: Bloomberg; BEA; BLS. As of June 30, 2025.

**Figure 2: U.S. Construction Starts (% of Inventory)**




Source: CoStar (2-quarter moving average). As of June 30, 2025.

1. Source: BLS. As of June 30, 2025. Federal Reserve. As of March 31, 2025.

Despite early volatility, financial markets have largely looked through the shifting policy dynamics, with investors betting that extreme outcomes will be avoided. This optimism has helped push U.S. equities to record highs, and REIT index prices have rebounded to where they started the year. Private CRE values have kept pace[2], with NFI-ODCE capital returns flat year-to-date through the second quarter, while income returns have benefited from the economy's resilience.[3]

Still, interest rates remain an overhang on valuations, with both the fed funds rate and the 10-year U.S. Treasury yield hovering around 4.3% in mid-July.[4] There are different factors driving short-term and long-term rates and current policies often put them in conflict. The "front end" of the curve is heavily influenced by monetary policy—and although the Trump Administration is pressuring the Fed to cut rates, the FOMC has held steady, citing a balanced labor market and inflation risks tied to tariffs.[5] The "long end" of the curve has been relatively range bound with the 10-year UST trading between 4.0%–4.5% since "Liberation Day," reflecting the growth and inflation outlook, along with rising fiscal deficits.

This backdrop presents risks of higher long-term rates, especially as investors eye the government's mounting debt and interest costs. While President Trump's push for rate cuts aims to ease this burden, there could be unintended consequences if it undermines Fed independence or stokes inflation. So far, Treasury auctions haven't shown signs of stress, but markets remain alert, with expectations for two 25 bp cuts by year-end.

2. U.S. equities measured by the S&P 500. Sources: Bloomberg; S&P; NAREIT. As of July 21, 2025
3. Preliminary NCREIF NFI ODCE data. Capital and income returns were 0.07% and 2.03% year-to-date. Source: NCREIF. As of June 30, 2025.
4. Source: Bloomberg. As of July 21, 2025.
5. Based on recent speeches, testimonies and other Federal Reserve communication. Source: Federal Reserve. As of July 21, 2025.

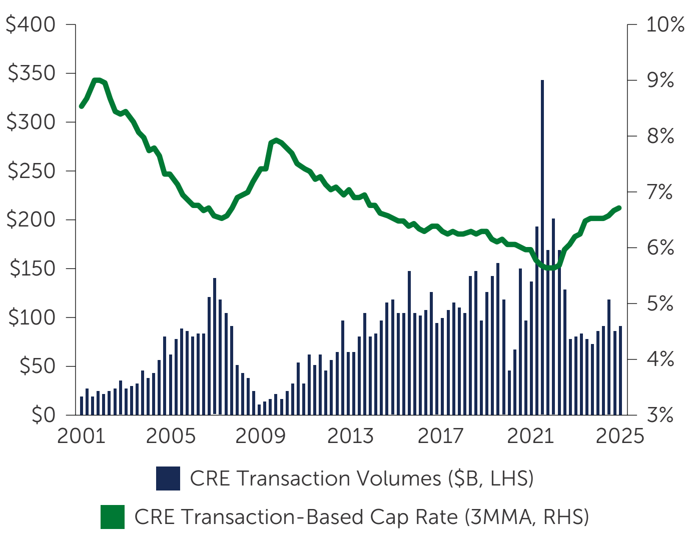
# Valuations & Capital Markets

Following a multi-year reset, commercial real estate (CRE) valuations held steady in the second quarter. Transaction activity remained subdued, but increased 4% quarter-over-quarter despite economic uncertainty and post–"Liberation Day" market volatility. Cap rates were roughly flat quarter-over-quarter at 6.70%—but up from 5.63% in Q2 2022—while property values were largely unchanged.[6] Office cap rates were higher than all other sectors at 7.52% but declined 15 bps quarter-over-quarter, while industrial cap rates increased 36 bps to 6.65%. The retail and apartment sectors were relatively unchanged at 7.08% and 5.54%, respectively.

CRE property sales increased $4 billion quarter-over-quarter to $91 billion but remained well below the 10-year average of $121 billion.[7] Property sales rose for office (+$4B to $18B) and apartments (+4B to $35B) but declined for industrial (-$1B to $23B) and retail (-$3B to $15B). Private investors and owner-occupiers were modest net buyers, while REITs, institutional, and foreign investors were net sellers.

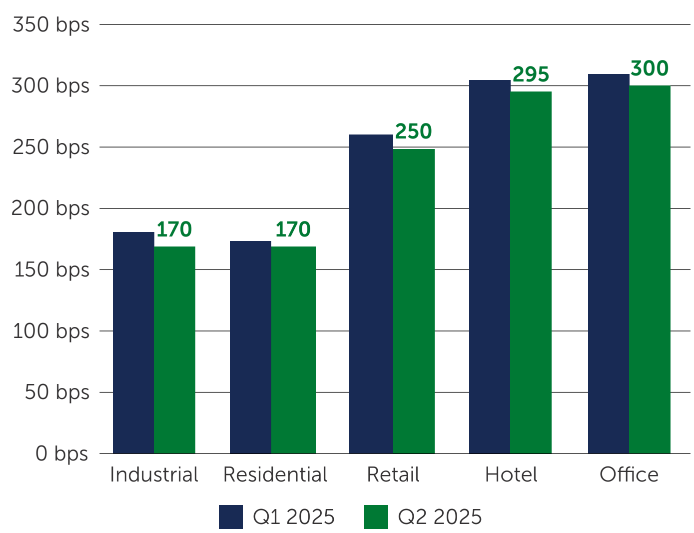
Debt capital markets continue to show signs of recovery since the initial tariff announcement, with CMBS spreads tightening to pre-Liberation Day levels.[8] Issuance, too, hit a post–financial crisis high in the first half of the year for this segment of the market. More broadly, debt spreads narrowed 5-10 bps across property types on the back of increased activity from banks, life insurers, and debt funds. Still, underwriting remains tight—especially for office and retail—while lenders continue to favor industrial and multifamily assets.

**Figure 3: CRE Cap Rates and Transaction Volumes**




Source: MSCI RCA. As of June 30, 2025.

**Figure 4: Core CRE Debt Spreads By Sector (bps)**




Source: Chatham Financial. As of June 30, 2025.

6. Simple average based on office, retail, industrial, and multifamily properties. Transaction based. Source: MSCI RCA (3-month moving avg.). As of June 30, 2025.
7. Private investor refers to companies whose control is in private hands such as family offices. Source: MSCI RCA. As of June 30, 2025.
8. Sources: ICE; Wells Fargo; Bank of America. As of July 21, 2025.

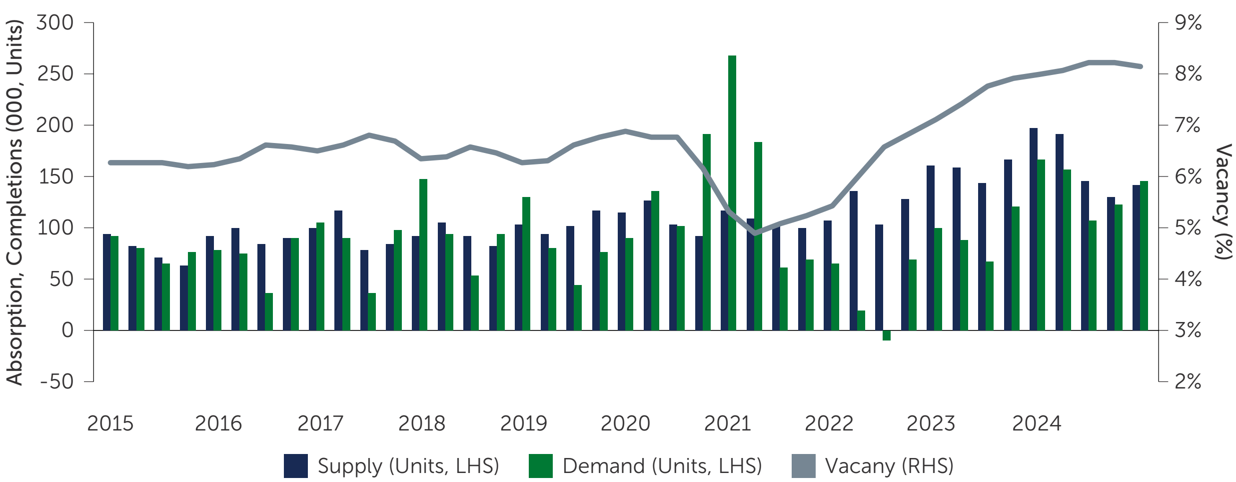
# Occupier Markets

## APARTMENT SECTOR

The U.S. apartment sector saw a 10 bps drop in vacancy to 8.1% as demand outpaced new supply.[9] Leasing was strongest in higher-quality properties, which have seen the bulk of recent development. Class A (4- and 5-star) units made up 86% of absorption, with vacancy falling from 11.5% to 11.1%, though still above the 7.5% rate for Class B (3-star) units. Lower-tier (1- and 2-star) properties had the lowest vacancy at 5.7% but saw negative absorption as affordability pressures weighed on lower-income renters. Southern and Mountain West markets—like Austin, Charlotte, and Salt Lake City—led absorption, though gains often came with concessions, which slowed rent growth. While national rent growth decelerated quarter-over-quarter, the sector looks positioned for further improvement, supported by a gradually expanding economy and a 73% drop in construction starts from peak levels.[10]

Fundamentals have strengthened even as valuations have reset. Although credit performance has weakened, the softness is largely due to capital structure issues rather than asset quality. As an example, non-agency CMBS multifamily delinquencies rose from 1.0% in June 2022 to 5.9% in June 2025, while bank loan delinquencies increased from 0.3% to 1.5%.[11] This may present a compelling entry point, especially as rental demand benefits from the growing affordability gap: as a measure, the median monthly mortgage payment reached roughly $2,200 in May, compared to roughly $1,350 to rent an apartment.

**Figure 5: Apartment Vacancy Edges Lower as Demand Outpaced Supply with a Slowdown In New Starts**




Source: CoStar. As of June 30, 2025.

9. Includes stabilized and unstabilized apartment properties. Source: CoStar. As of June 30, 2025.
10. Source: CoStar. As of June 30, 2025.
11. Delinquent defined as 30+ days past due. Source: Trepp. As of June 30, 2025. FDIC. As of March 31, 2025.

# Occupier Markets

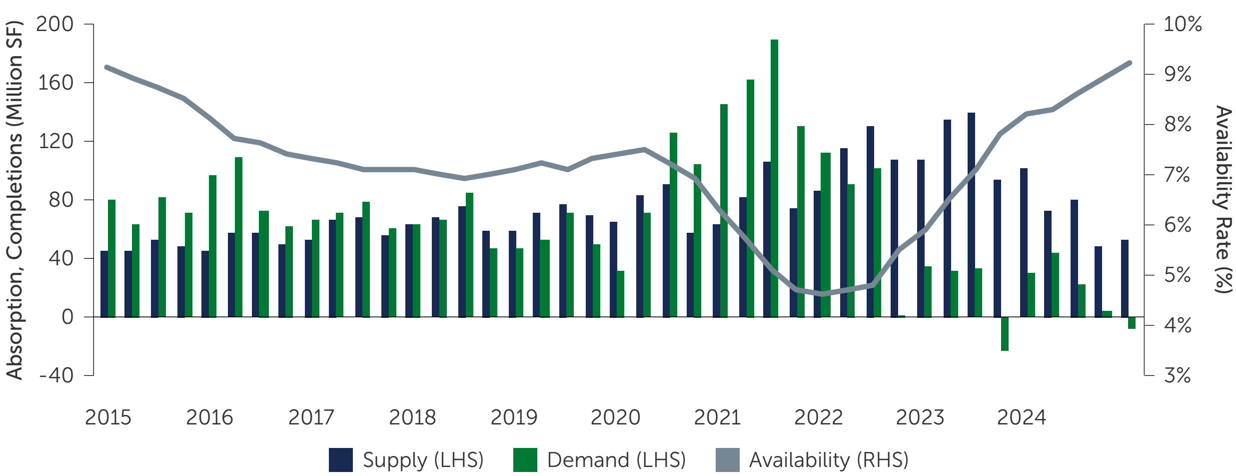
## INDUSTRIAL SECTOR

The industrial availability rate rose 30 bps to 9.2% during the quarter.[12] While policy uncertainty weighed on sentiment, gross leasing volume is up 8.5% year-to-date, largely driven by demand for properties under 700,000 SF.[13] Supply continues to outpace demand, but the picture varies by market and property type. For example, the industrial sector posted negative net absorption, but it was concentrated in older warehouses (25+ years old, less than 30-foot clear heights) that no longer well meet tenant needs. Port markets with high exposure to China trade also saw negative absorption.

Also impacting demand, tenant mix or user type continues to shift. Retailers and wholesalers are increasingly outsourcing logistics to third-party providers (3PLs), who accounted for 35% of leasing activity this year. This shift has led to higher move-outs among these traditional tenants and weaker demand for buildings leased to them.

Looking ahead, trade policy remains a key source of uncertainty for the sector. The Trump Administration's tariff strategy is delaying leasing decisions and reshaping global supply chains. Markets with high exposure to China—like Los Angeles, where 30% or more of trade is China-linked—face headwinds. These could ease if trade reroutes through other Southeast Asia countries or worsen if good flows shift to East Coast ports. At the same time, reshoring is gaining traction, especially for the motor vehicle parts, pharmaceutical, and semiconductor industries, and concentrated in regions with advantages such as workforce and infrastructure.

**Figure 6: Availability Increases on Cautious Demand but New Supply Slowing Significantly**




Source: CBRE EA. As of June 30, 2025.

12. Source: CBRE EA. As of June 30, 2025.
13. Source: CBRE. As of June 30, 2025.

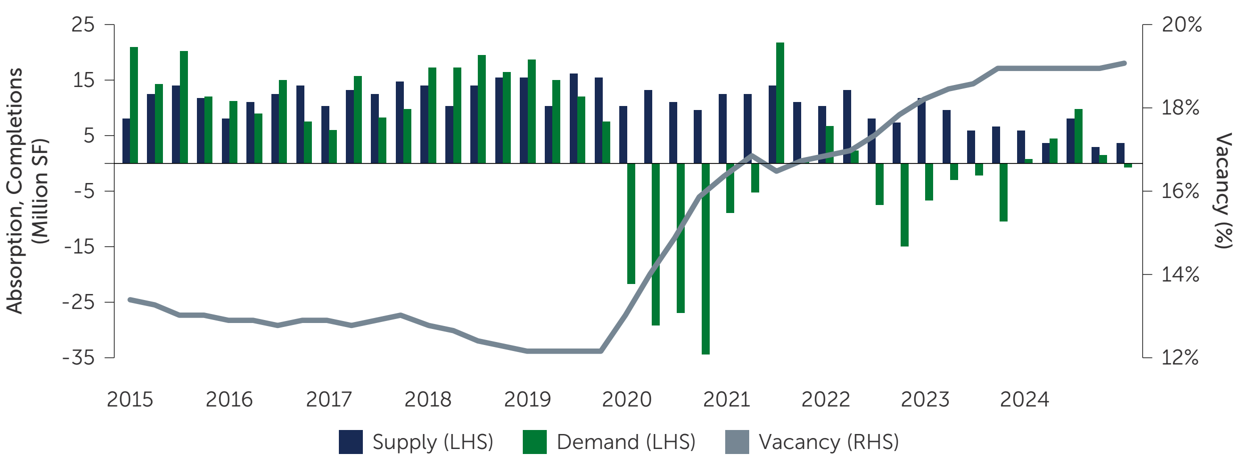
# Occupier Markets

## OFFICE SECTOR

Office vacancy ticked up 10 bps to 19.1%, with leasing momentum concentrated in an expanding set of higher-quality buildings.[14] Newly built and Class A+ properties have driven the vast majority of net absorption over the past five years, but the broader Class A segment added 5 million SF of net absorption in the quarter. Meanwhile, inventory removals—mostly for renovations and repurposing—accounted for 85% of negative absorption, with those buildings averaging 20% occupancy. The sector continues to improve but the recovery remains fragile and tied closely to macro conditions. Slowing office-using job growth and potential AI-driven shifts in hiring are also key risks. Still, there are encouraging signs: corporate downsizing has eased, with tenants cutting space by just 3% at lease expiration over the past year, down from 11% previously[15]. Active tenant requirements rose quarter-over-quarter as well, reaching their highest level since Q4 2021.

Performance across the office sector continues to vary widely—even within the same metro areas—making micro-location fundamentals critical. Assets supported by strong demand drivers like skilled labor, transit access, return-to-office trends, and lifestyle amenities look best positioned. Credit stress persists, however, and upcoming debt maturities may spur transactions and opportunities. For instance, office prices are down nearly 40% since 2022, and CMBS office delinquency rates hit a record 11.1% in June 2025, with over $40 billion in debt past original maturity date.[16]

**Figure 7: Office Vacancy Increased 10 bps but Active Tenant Requirements Suggest Improving Demand**




Source: CBRE EA. As of June 30, 2025.

14. Sources: JLL; CBRE EA. As of June 30, 2025.
15. Source: JLL. As of June 30, 2025.
16. Values based on capital returns. Sources: NCREIF; Moody's; Newmark. As of March 31, 2025. Trepp. As of June 30, 2025.

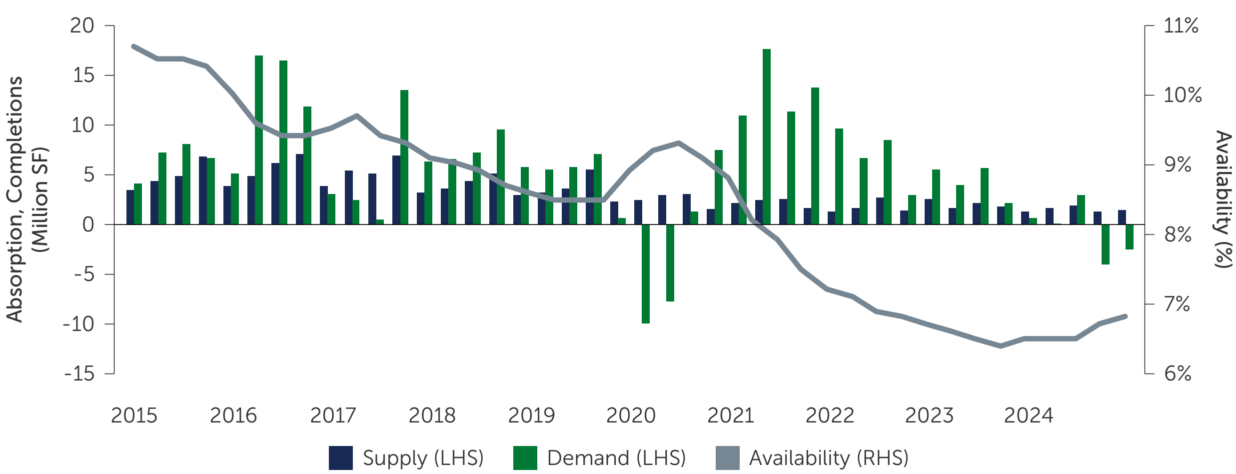
# Occupier Markets

## RETAIL SECTOR

In the retail sector, availability at neighborhood, community, and strip (NC&S) shopping centers rose 10 bps to 6.8%, still low by historical standards.[17] While absorption was negative for a second straight quarter, the softness appears tied to specific recent bankrupt retailers—like Party City, The Container Store, and Joann—rather than broad-based weakness. Drugstore chains such as Rite Aid, Walgreens, and CVS are also reworking their strategies, and some discount retailers are closing underperforming stores. Regionally, markets like the Bay Area and parts of the Midwest, such as Detroit and Cleveland, are showing softer fundamentals. That said, limited quality new supply remains supportive of the sector. Since the pandemic, completions have averaged just 2.0 million SF per quarter—down from 4.2 million pre-pandemic—with only 1.3 million SF delivered in the second quarter.[18]

Consumers, for their part, remain resilient but cautious, while sentiment has improved since tariffs were announced in April. Retail sales rose 0.6% month-over-month in June—well above expectations—though inflation and preemptive buying may have played a role.[19] Spending is still supported by a strong labor market, elevated household wealth, and the mortgage rate-lock effect. While credit delinquencies are rising among younger and lower-income consumers, NC&S centers remain well-positioned due to their focus on essential retail like grocery, as well as strong supply-demand dynamics.

**Figure 8: Retail Availability and New Supply Near Record Lows, Softer Demand Is Nuanced**




Source: CBRE EA. As of June 30, 2025.

17. Source: CBRE EA. As of June 30, 2025.
18. Source: CBRE EA. As of June 30, 2025.
19. Sources: Census Bureau; Reuters. As of June 30, 2025.

# Occupier Markets

## SELF-STORAGE SECTOR

Self-storage vacancy held steady at 7.3%, aligning with the 2014–2019 average as the sector continues to normalize.[20] After years of elevated new supply, large operators have prioritized occupancy and offered low rents to attractive tenants, resulting in a significant difference between renewal and move-in rates. The sector's demand has been impacted by a sluggish housing market, a key driver of move-ins. Home sales are near 30-year lows, constrained by elevated mortgage rates. Still, other demand sources—like renters needing extra space and small business inventory storage—remain intact. On the supply side, new supply is expected to slow to 1.5% of existing inventory this year, down from 2.0% in 2024, helping to support demand.

**Figure 9: Self Storage Occupancy and Rents are Normalizing Near Pre-Covid Levels**


*Q2 2025 data estimated based given data availability. Source: Green Street. As of June 30, 2025.

20. Source: Green Street. As of June 30, 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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