REAL ESTATE

U.S. Real Estate: Dispersion as a Key Market Feature

The market is shifting toward one where value is led by real estate fundamentals, but it's important to "spend time in the tails" as structural changes introduce a broader range of potential outcomes.

RESEARCH QUARTERLY

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BARINGS

Executive Summary

ECONOMY

- Despite a stagnant labor market and policy uncertainty, the U.S. economy remained resilient in the third quarter, supported by strong investment and consumption from AI-related industries and high-income households.
- The Federal Reserve (Fed) is expected to cut rates amid stalled job growth. However, Chair Powell warned of "no risk-free path" as "tensions" persist between employment and price stability goals.

PROPERTY MARKETS

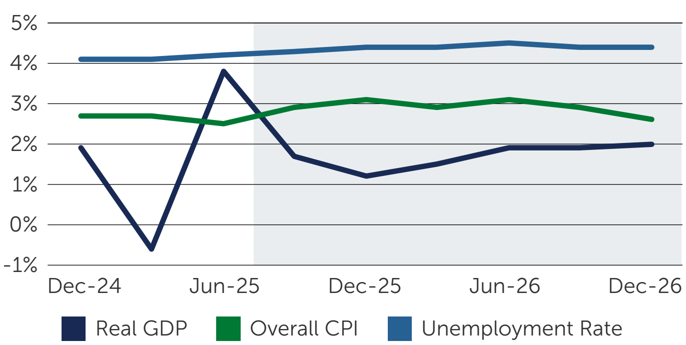
- Fundamentals improved with positive absorption across core property sectors, supported by lower construction activity.
- Performance is dispersed, varying by building quality and location, based on shifting structural demand spanning from higher quality office assets to residential housing solutions for homeownership affordability issues and aging demographics.

Economy

The economy sustained its expansion with resilient—though moderating—underlying business and consumer activity despite a stagnated labor market and continued policy uncertainty **(Figure 1)**. However, economic growth has been led by outsized investment and consumption from certain industries and households. As an example, AI-related capital expenditures, excluding power grid and other infrastructure projects, contributed about 15% of the total increase in GDP over the past year, despite the industry representing only about 3% of the overall economy.[1] In addition, consumers in the top 10% of the income distribution now account for nearly half of all personal spending, up six percentage points from five years ago.[2] There are other shifting areas of the economy as well—such as aging demographics and trade policy—with important implications for commercial real estate (CRE) as certain markets and property types are best positioned to capture evolving demand.

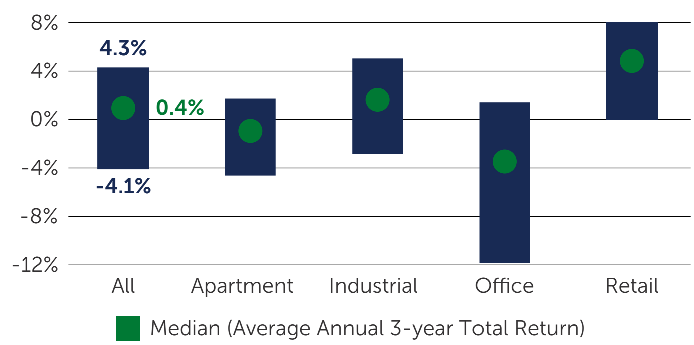
The economic environment has also contributed to slower rates of new supply. Construction activity has fallen sharply since its 2022 peak, driven by higher building and financing costs. This supported positive absorption across all core property types in the third quarter. However, dispersion is a key market feature. For example, the 25th percentile NPI portfolio delivered average total returns of 4.3% per year over the past three years—840 bps higher than the -4.1% posted by the 75th percentile portfolio **(Figure 2)**.[3] This dynamic reflects a healthier market where total returns are primarily driven by supply-demand fundamentals, with performance led by micro-location and asset-level positioning for structural shifts.

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



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

Figure 2: NCREIF NPI Total Return Distribution (%)



Source: NCREIF NPI. As of June 30, 2025.

Still, lower rates could provide incremental support for CRE if the economy remains resilient as consensus projects. The Fed is expected to cut its policy rate from 4.25% to 3.75% by year-end 2025 and to 3.0% by year-end 2026 in response to the stalled labor market.[4] However, Chair Powell recently warned there is "no risk-free path," citing "tension" between the Fed's employment and price stability goals. The government shutdown has further limited data availability at an important time, as job growth has slowed to an average of 29,000 per month over the three months ended August, while CPI rose to 3% year-over-year in September. The Fed anticipates a "one time" but not "all at once" price increase—with inflation expected to peak at 3.1% in mid-2026—but acknowledges the uncertainty and how this may impact the rate outlook.

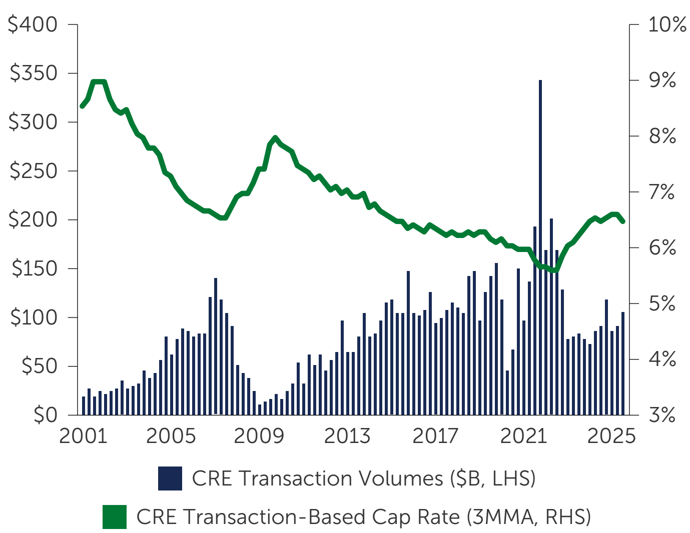
1. Source: The Economist. As of August 2025.
2. Source: Bloomberg, Moody's, Federal Reserve. As of September 16, 2025.
3. Source: NCREIF NPI. As of June 30, 2025.
4. Source: Bloomberg, BLS. As of October 21, 2025 and BLS as of August 31, 2025.

Valuations & Capital Markets

The CRE market continued its gradual recovery in the third quarter. Transaction activity remained well below its 10-year average but increased 17% year-over-year to $106 billion. Sales volumes improved across property sectors: multifamily up $5 billion to $44 billion, industrial up $2 billion to $27 billion, office up $5 billion to $19 billion, and retail up $3 billion to $16 billion. Cap rates declined by 13 bps quarter-over-quarter and were supported by lower interest rates. In addition, overall property values increased 2.6% year-over-year.[5]

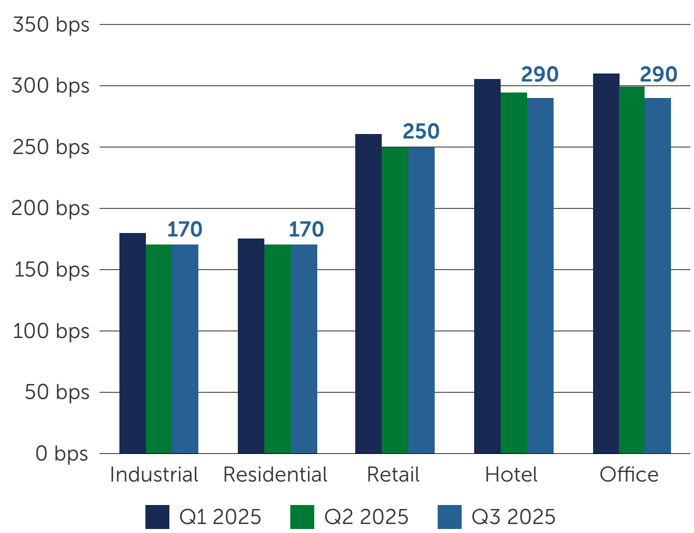
Capital markets remained competitive with fixed and floating rate debt costs down about 30 bps and 15 bps in the third quarter, driven by lower benchmark rates with relatively unchanged spreads **(Figure 4)**. CRE lending increased across most lender types with bank originations led by larger institutions. CMBS issuance reached its highest quarterly level since the GFC while debt funds were active.
Market participants note life insurance company lending slowed given competition and borrower reluctance to lock in long-term financing—such as 7 to 10 year terms—as the Fed begins to lower rates.[6]

Figure 3: CRE Cap Rates and Transaction Volumes



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

Figure 4: Core CRE Debt Spreads by Sector (bps)



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

5. Source: MSCI RCA. As of September 30, 2025.
6. Source: Chatham Financial. As of September 30, 2025.

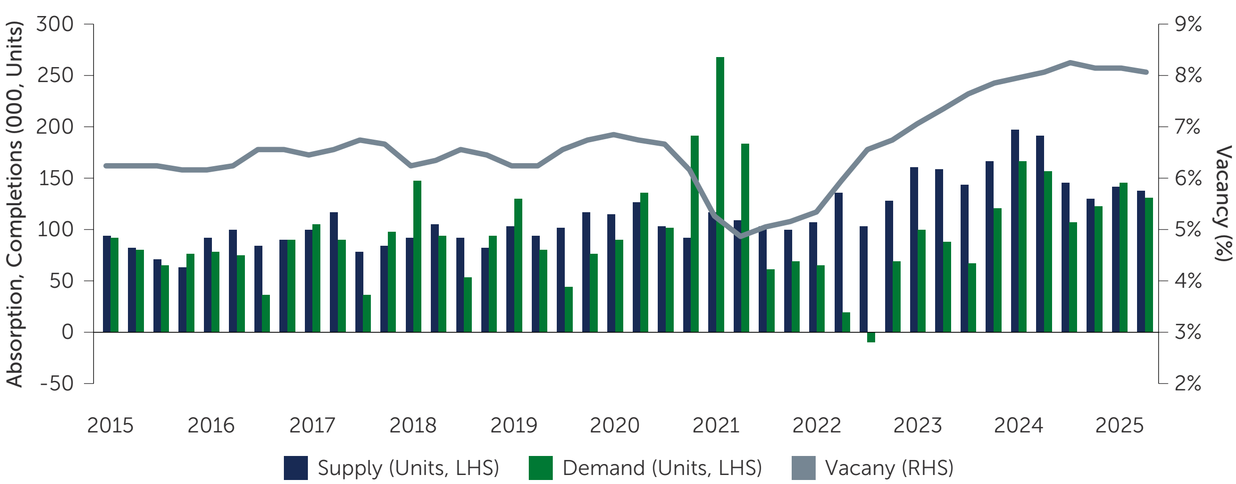
Occupier Markets

APARTMENT SECTOR

The U.S. apartment sector saw a 10 bps decline in vacancy to 8.1%, supported by resilient demand.[7] Apartment leasing activity remained strongest in Southern markets with elevated new supply—such as Austin, Charlotte, Raleigh and Nashville—while slower-growth but more established markets like Boston, New York City and San Francisco showed stronger fundamentals based on vacancy rates and rent growth. Consumer financial conditions also played a role: Class A (4- and 5-star) property vacancy rates decreased 40 bps to 10.8% as recently delivered units were absorbed, while vacancy for Class B (3-star) and Class C (1- and 2-star) properties—which typically serve moderate and lower income households—increased 10 bps to 7.7% and 5.8%, respectively. The market continues to digest new supply, but slower development supports the sector's fundamentals, with construction starts down more than 70% from their 2022 peak.[8]

The sector continues to benefit from increased long-term demand amid persistent homeownership affordability issues. For example, the number of renter households has increased by 1.2 million year-to-date, reaching 46.8 million.[9] This trend is being driven by a 22% rent-to-own discount, which remains wide despite a nearly 50 bps decline in mortgage rates during the quarter.[10] These positive demand fundamentals create a potential compelling entry point for the sector, as apartment values have fallen roughly 15% since 2022. At the same time, indicators suggest there are challenged sponsor capital structures as non-Agency CMBS apartment delinquency rates increased over the past year from 3.3% to 6.6% as of September.[11]

Figure 5: Apartment Vacancy Modestly Declined on Resilient Demand While New Supply Trends Lower



Source: CoStar. As of September 30, 2025.

7. Includes stabilized and unstabilized apartment properties. Source: CoStar. As of September 30, 2025
8. Source: CoStar. As of June 30, 2025.
9. Source: Oxford Economics, BEA. As of September 2025.
10. U.S. median monthly mortgage payment of $2,100 and rent payment of $1,630. Source: MBA, FRED, Apartments.com. As of September 30, 2025.
11. Delinquent for 30+ days or more. Source: Trepp. As of September 30, 2025.

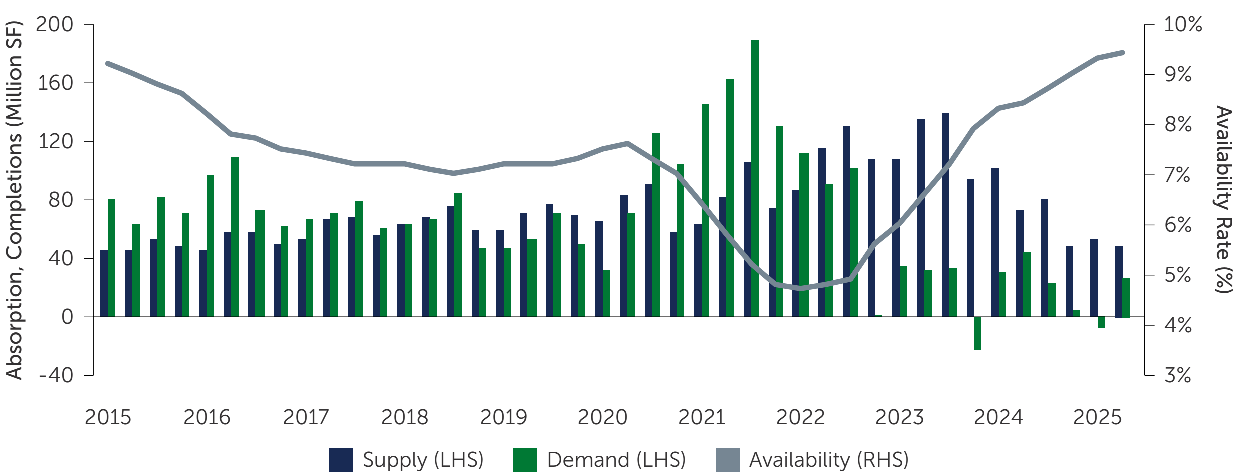
Occupier Markets

INDUSTRIAL SECTOR

Industrial availability increased slightly—up 10 bps to 9.3%—but at a slower pace.[12] The sector benefited from improved tenant leasing activity, which drove absorption to its highest level in a year. Occupier demand was strongest in smaller-sized warehouses. As an example, leasing for industrial space 300,000 SF or less increased 15% year-over-year, while leasing for larger blocks was 0% year-to-date in September. New supply remains a headwind, but absorption has been strong for newer vintage facilities with modern racking and automation technology. Properties built since 2020 have recorded roughly 200 million SF of positive absorption year-to-date, compared to nearly 90 million SF of negative absorption for older and less functional warehouses.[13] Fundamentals should improve further as construction starts have declined nearly 65% from their peak in 2021.

Resilient consumer spending, e-commerce growth and increased built-to-suit deliveries were key absorption drivers as companies adapt to trade policy and economic uncertainty. The Trump Administration is negotiating trade agreements with a range of countries, while the Supreme Court's International Emergency Economic Powers Act (IEEPA) tariff proceedings are set to begin in November. U.S.-China trade and the United States-Mexico-Canada Agreement (USMCA) review are key ongoing and upcoming negotiations. Outcomes will likely be shaped by geopolitical, economic and demographic factors, creating nuanced implications for demand varying across port markets, regional manufacturing and distribution hubs, and fulfillment centers.

Figure 6: Industrial Availability Increased but at a Slower Pace with Improved Tenant Demand



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

12. Source: CBRE. As of September 30, 2025.
13. Such as those with lower clear heights. Source: Cushman & Wakefield. As of September 30, 2025.

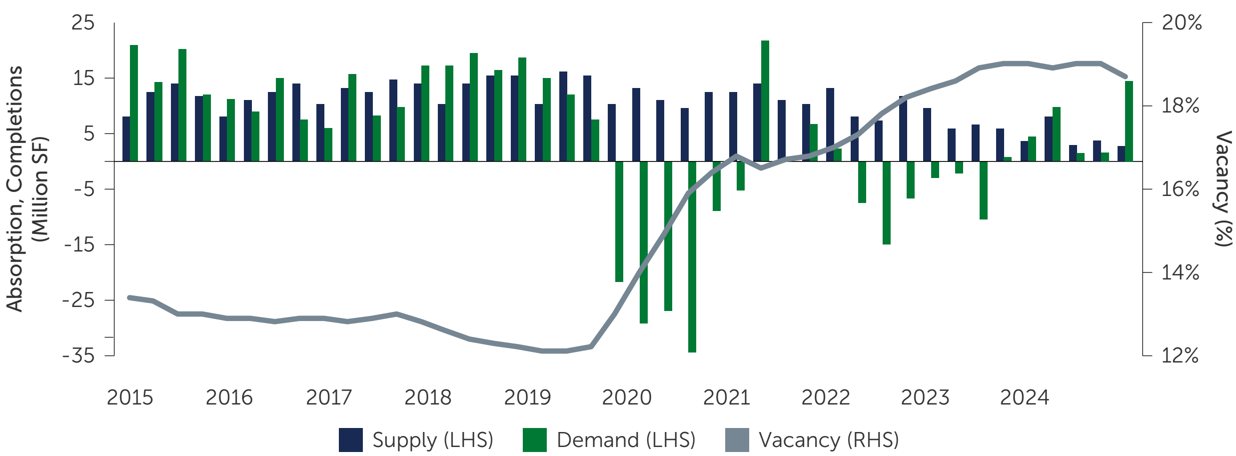
Occupier Markets

OFFICE SECTOR

Office vacancy fell 30 bps to 18.7% during the quarter, marking the strongest net absorption since 2021. Leasing activity was supported by the gradual return-to-office trend, driven by more hybrid and fewer fully remote arrangements. For example, over the past year, the percentage of office employees working fully remote declined from 22% to 18%, while hybrid workers increased from 38% to 44%.[14] BLS data also suggest hybrid workers are spending more days in the office per week. The technology sector—with recent emphasis on in-person work—increased its share of total office leasing by five percentage points year-over-year to 17.3%.[15] Financial services tenants continue to represent the largest industry for leasing and increased their share by four percentage points to 28.6%.

The sector's improved fundamentals have been supported by modest construction activity, with only 2.8 million SF delivered during the quarter—74% below the 10-year average.[16] The limited new supply has driven a pricing premium for Class A+ properties: leasing is 12.5% above pre-pandemic levels, and effective rent growth is up 8.5% year-over-year, well above the broader Class A segment.[17] Similar outperformance is evident in office properties offering strong transit access, skilled labor pools, lifestyle amenities and related features. These dynamics create opportunities in stressed assets and capital structures, as values have fallen nearly 40% since 2022, while credit stress persists with CMBS office delinquencies at 11.1% as of September 2025.[18]

Figure 7: Office Vacancy Declined by 30 BPS with the Strongest Net Absorption Since 2021



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

14. Avg. of the financial, information, business services, and real estate industries. Source: WFH Research, Census Bureau. As of September 30, 2025.
15. Based on leases signed in Boston, New York City, San Francisco, and Washington DC. Source: Avison Young. As of September 30, 2025.
16. Source: CBRE EA. As of September 30, 2025.
17. Based on leases signed in Boston, New York City, San Francisco, and Washington DC. Source: Avison Young. As of September 30, 2025.
18. Source: NCREIF NPI, Trepp. As of June 30, 2025, September 30, 2025.

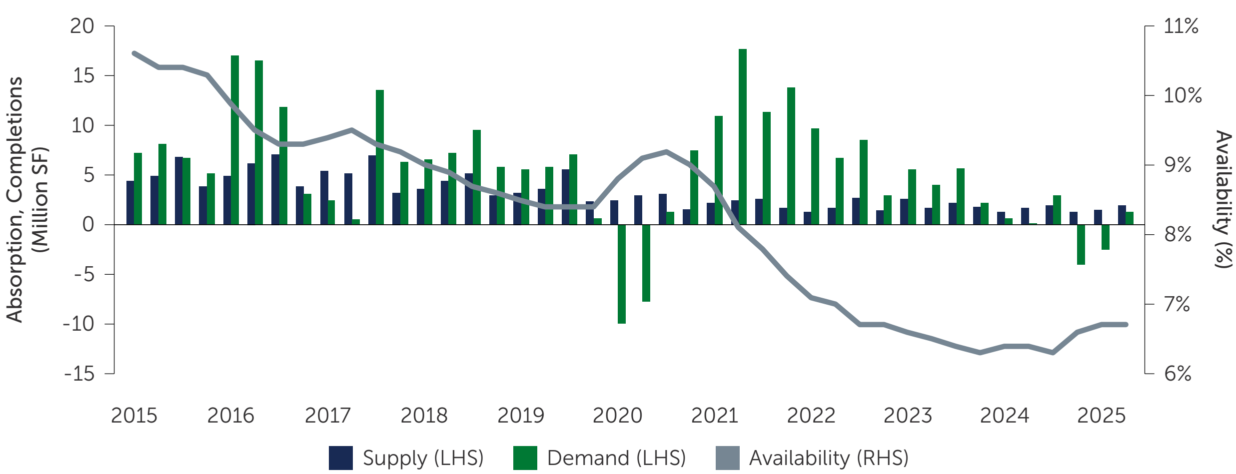
Occupier Markets

RETAIL SECTOR

Retail availability for neighborhood, community and strip (NC&S) shopping centers held steady at 6.8%, supported by improved tenant activity.[19] The sector's positive net absorption was concentrated in areas with strong population growth and higher-income demographics. NC&S has remained resilient in managing store closures from retail bankruptcies—most recently Claire's and At Home—while other retailers, such as Walgreens, Rite Aid, CVS and Advanced Auto Parts, have lowered their store counts. This resilience has been supported by a muted development pipeline, with only 2.0 million SF delivered during the quarter, which compares to a 10-year average of 3.2 million SF.

Consumers remain cautious amid a sluggish labor market, still-high inflation and general economic uncertainty. Still, retail spending—excluding gas stations—rose 5.5% year-over-year in August, driven largely by higher-income and older-aged households supported by record wealth levels.[20] However, financial strain persists among younger and lower-income borrowers, reflected in weaker credit performance amid rising loan delinquency rates.[21] Even so, NC&S centers are well-positioned for a range of economic scenarios given their largely nondiscretionary offerings—such as grocery stores—and limited new supply.

Figure 8: Retail Availability and New Supply Near Record Lows With Improved Demand



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

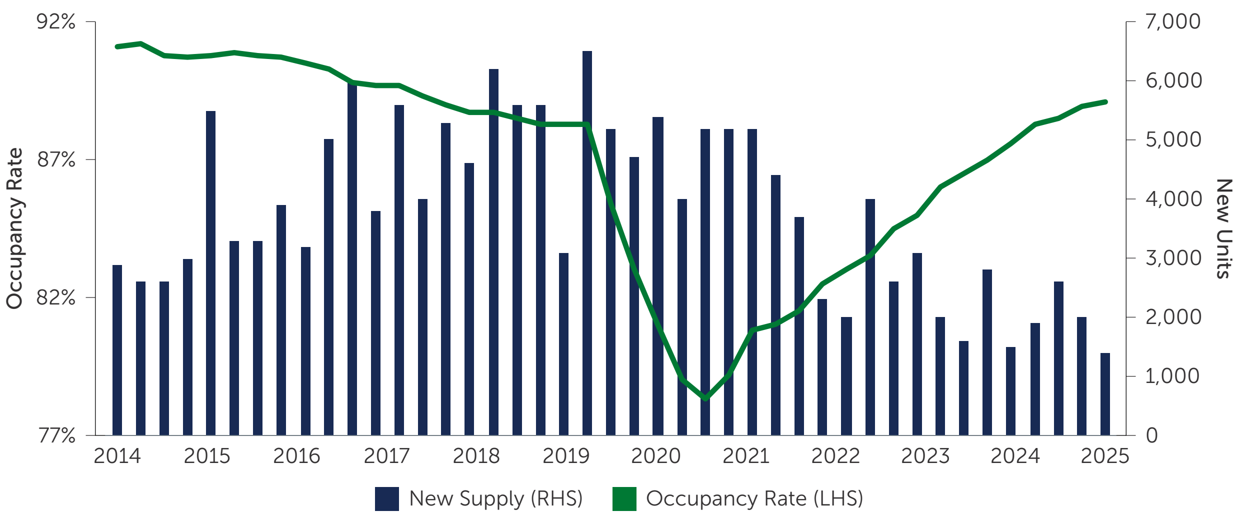
19. Source: CBRE EA. As of September 30, 2025.
20. Source. Census Bureau. As of August 31, 2025.
21. Source: Federal Reserve Bank of New York, Equifax, and Fitch. As of June 30, 2025, September 30, 2025.

Occupier Markets

HEALTHCARE SENIOR HOUSING

Senior housing occupancy rose to 89.1% in the third quarter—the highest level since 2017—while rents increased 4.3% year-over-year.[22] The sector's performance was driven by strong absorption across all product types, reflecting diverse housing needs based on healthcare requirements, cost and lifestyle preferences. Aging demographics continue to fuel demand: the population aged 65 and older has increased by 8.6 million since 2020, reaching 62.9 million in 2025. Fundamentals have also benefited from limited new supply, with newly delivered units representing just 0.6% of inventory in the third quarter, compared to a pre-pandemic average of 2.5%.

Figure 9: Senior Housing Occupancy Increased on Strong Supply-Demand Fundamentals



Source: NIC MAP, Green Street. As of September 30, 2025.

22. Source: NIC. As of September 30, 2025.

Occupier Markets

SELF STORAGE SECTOR

Self-storage vacancy held steady at 7.2%, roughly in line with the 2014–2019 average, as the sector stabilizes.[23] New supply has weighed on fundamentals in recent years, but customer move-in rents have improved even as existing user rents have softened somewhat.[24] Slower home sales—driven by mortgage rates still near 6.25%—have also impacted the sector, as housing turnover is a key demand driver. However, many households are outgrowing their current home space, as homeowner mobility has slowed given mortgage-rate lock effects, providing another meaningful source of self-storage demand. Looking ahead, the sector is also set to benefit from slower new supply, with development expected to fall to 1.5% of existing inventory this year—down from 2.0% in 2024 and 5.1% in 2019—helping support fundamentals.

Figure 10: Self Storage Occupancy and Rents are Stabilizing Near Pre-Covid Levels

*Q3 2025 data estimated based given data availability. Source: Green Street. As of September 30, 2025.

23. Source: Green Street. As of September 30, 2025.
24. Source: Yardi Matrix. As of September 30, 2025.

Conclusion

The U.S. real estate market is transitioning toward a fundamental-driven environment, where asset-level quality, location and adaptability increasingly determine performance. While macroeconomic and policy uncertainty persists, resilient demand, slowing new supply and structural shifts—such as hybrid work, technology, aging demographics, and e-commerce—are reshaping sector dynamics. As the market changes, opportunities are emerging for investors who position assets to capture long-term demand tailwinds.

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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