BARINGS

REAL ESTATE

U.S. Real Estate: Gradual Recovery Supported by Low New Supply

The recovery is supported by solid fundamentals, but structural changes are putting greater emphasis on assets and locations that can benefit from—or remain insulated against—economic shifts and a narrower set of demand drivers.

RESEARCH QUARTERLY

Lincoln Janes, CFA

Director, Real Estate Research & Strategy

Executive Summary

ECONOMY

- The economy was resilient and supported by solid household balance sheets and ongoing AI and infrastructure investment, though uncertainty remains with significant changes in trade, demographics, and technology set to shape the outlook.
- The Federal Reserve remains cautious in its policy stance as it balances risks and trade-offs to its dual mandate, given the cooling labor market and inflation concerns. Still, the rate outlook is incrementally positive for economic growth.
- CRE construction activity has declined significantly, setting a favorable supply back-drop for recovering fundamentals.

PROPERTY MARKETS

- CRE transaction activity strengthened in the fourth quarter, with volumes rising to a three-year high and gains across all major sectors. Cap rates blended across sectors edged modestly higher—led by office—while overall property values held steady.
- Debt capital markets were active with increased originations across most lender groups, including record CMBS issuance. There was increased competition on pricing and structures for certain sectors, but overall underwriting standards remained sound.

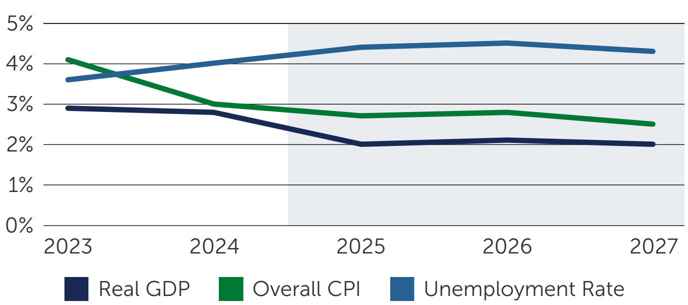
Economy

The U.S. economy continued its expansion in a year characterized by resilience amid uncertainty, though growth decelerated year-over-year as policy shifts and other unknowns weighed on business and consumer activity **(Figure 1)**. The economy's underlying fundamentals—including solid household balance sheets, ongoing AI and infrastructure investment and stimulative fiscal policy—are projected to support GDP growth in 2026. However, a narrower set of demand drivers and uncertainty will remain key market features.[1]

Despite the economic outlook, hiring activity is expected to remain modest, with the unemployment rate projected to stay relatively unchanged. Labor supply constraints from aging demographics and limited immigration are contributing factors. These dynamics have important implications for commercial real estate (CRE) demand, with certain property types and locations best positioned to benefit from structural changes in a market defined by dispersion.

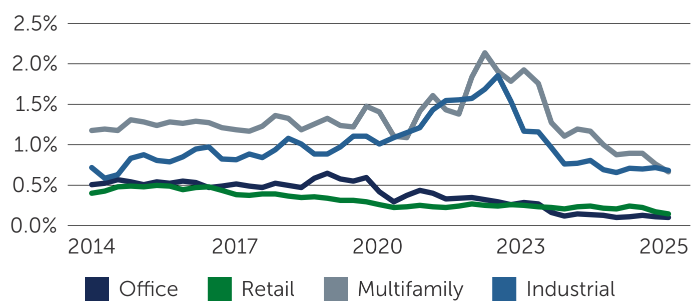
The supply outlook is more certain than demand and remains an important component of the gradual CRE market recovery led by fundamentals **(Figure 2)**. For example, multifamily and industrial construction activity has declined 65% to 70% since the peak in the fourth quarter, while office and retail space delivered represented just 5 basis points (bps) of the sectors' total inventory.[2] This "lower-for-longer" construction view is driven by higher barriers to new development, including increased financing and building costs. As a result, the supply backdrop remains favorable for the CRE market', providing support for fundamentals with income returns expected to be the primary driver of total returns in 2026, according to PREA's fourth quarter consensus forecast.[3]

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



Sources: Bloomberg; BEA; BLS. As of December 31, 2025.

Figure 2: Construction Start Rates by CRE Sector



Source: CoStar. As of December 31, 2025.

Nonetheless, the Federal Reserve (Fed) has signaled lower rates, with the market currently pricing in about two cuts to 3.2% by year-end, which provides incremental support. The Fed remains cautious in its policy stance as it balances risks to both its labor market and price stability mandate, given cooler hiring trends and still-high inflation with core PCE up 2.8% year-over-year in November. However, Chair Powell recently noted the "unemployment rate has shown some signs of stabilization" while inflation pressures are largely confined to tariff impacted goods.

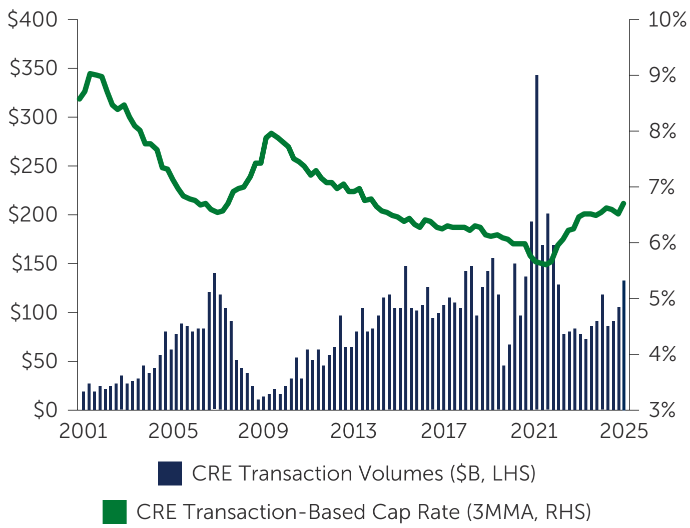
1. Sources: BLS; BEA; Bloomberg; Federal Reserve; Moody's; Equifax. As of December 31, 2025.
2. Source: CoStar. As of December 31, 2025.
3. PREA projects NCREIF NPI total returns of 5.9% in FY 2026 (4.9% income and 1.0% appreciation returns). Source: PREA. As of December 31, 2025.

Valuations & Capital Markets

CRE transaction volumes reached $133 billion in the fourth quarter, the highest quarterly amount in three years **(Figure 3)**. Property sales volumes were up across all property sectors: multifamily increased $5 billion to $51 billion, industrial increased $5 billion to $35 billion, office increased $6 billion to $27 billion and retail increased $3 billion to $21 billion.[4] Cap rates increased by 12 bps quarter-over-quarter—led by the office sector—while property values blended across all sectors were relatively unchanged.[5]

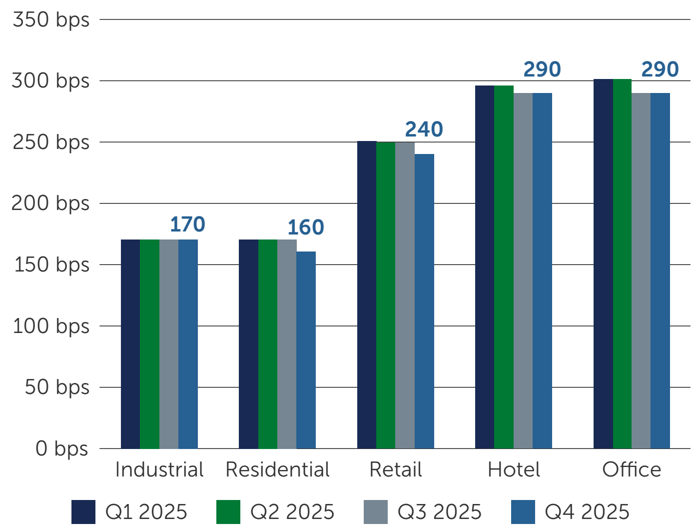
Debt capital markets remained active, supporting transaction and refinancing activity. CRE originations increased across most lender types, particularly banks, agencies, debt funds and CMBS (including CRE CLOs). As an example, CMBS issuance totaled more than $125 billion in 2025, up 18% year-over-year to a post-GFC record. Spreads were relatively unchanged quarter-over-quarter, though multifamily and retail loan pricing compressed 10 bps based on Chatham Financial core lending data **(Figure 4)**.[6] In addition, market participants note back-leverage providers remained active through warehouse and other debt financings in the fourth quarter.[7]

Figure 3: CRE Cap Rates and Transaction Volumes



Source: MSCI RCA. As of December 31, 2025.

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



Source: Chatham Financial. As of December 31, 2025.

4. Simple average cap rate blended across multifamily, retail, industrial and office properties. Source: MSCI RCA. As of December 31, 2025.
5. Source: Wells Fargo; Green Street. As of December 31, 2025.
6. Based on floating rate spreads for core loans. Source: Chatham Financial. As of December 31, 2025.
7. Source: Chatham Financial. As of December 31, 2025.

Occupier Markets

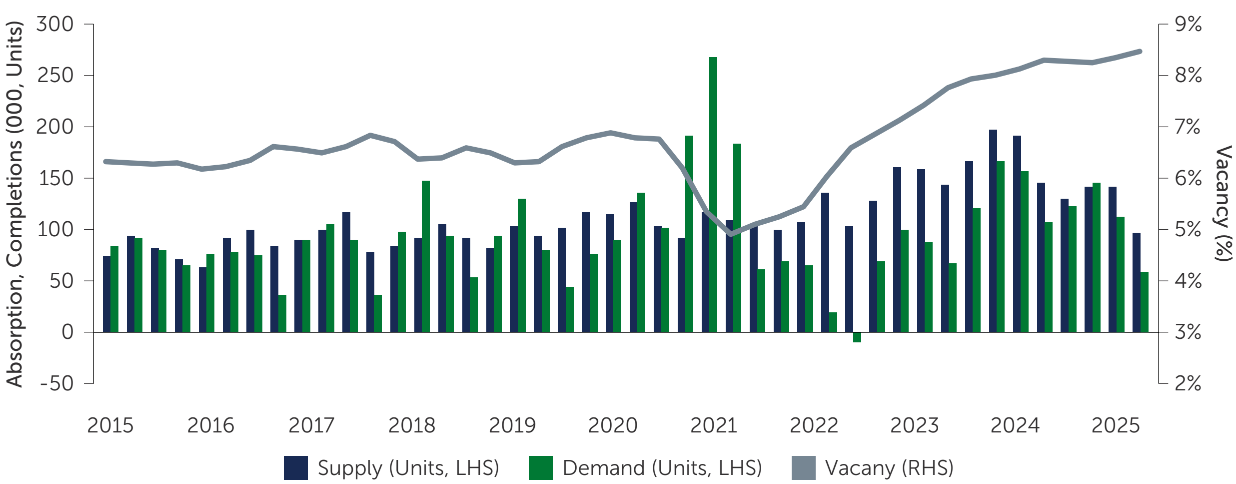
APARTMENT SECTOR

The apartment sector vacancy rate increased 15 bps to 8.5% in the fourth quarter.[8] New supply slowed, while renters turned more cautious given labor market concerns and economic uncertainty. The demand slowdown was most pronounced in the moderate- and lower-income segments of the market. For example, the Class A vacancy rate was unchanged in Q4, compared to about a 25 bps increase for Class B and C properties.

Apartment leasing activity was strongest in Southern markets—such as Charlotte, Austin and Phoenix—but significant development in recent years weighed on the region's rent growth compared to more supply constrained traditional markets such as San Francisco, New York City and Chicago. The market continues to absorb elevated new inventory delivered in recent years, but the development pipeline has slowed significantly, with construction starts down more than 70% from the 2022 peak.[9]

The apartment sector's long-term fundamentals remain strong despite the recent slowdown. For instance, the number of young adults aged 18 to 34 years old living at home reached a record 25.2 million in 2025, suggesting substantial pent-up demand for rental housing.[10] Although the Trump Administration has made several housing affordability proposals, significant housing shortfalls remain a challenge. Since 2010, household formation has outpaced growth in housing stock by 4.5 million, illustrating that rental demand structurally exceeds supply.[11]

Figure 5: Apartment Increased as Cautious Demand Was Outpaced by Slowing but Sizable New Supply



Source: CoStar. As of December 31, 2025.

8. Includes stabilized and unstabilized apartment properties. Source: CoStar. As of December 31, 2025.
9. Source: CoStar. As of December 31, 2025.
10. The 25.2 million young adults living at home represents about one out of three such individuals. Source: Census Bureau. As of December 31, 2025.
11. Sources: Federal Reserve; Census Bureau. As of September 30, 2025.

Occupier Markets

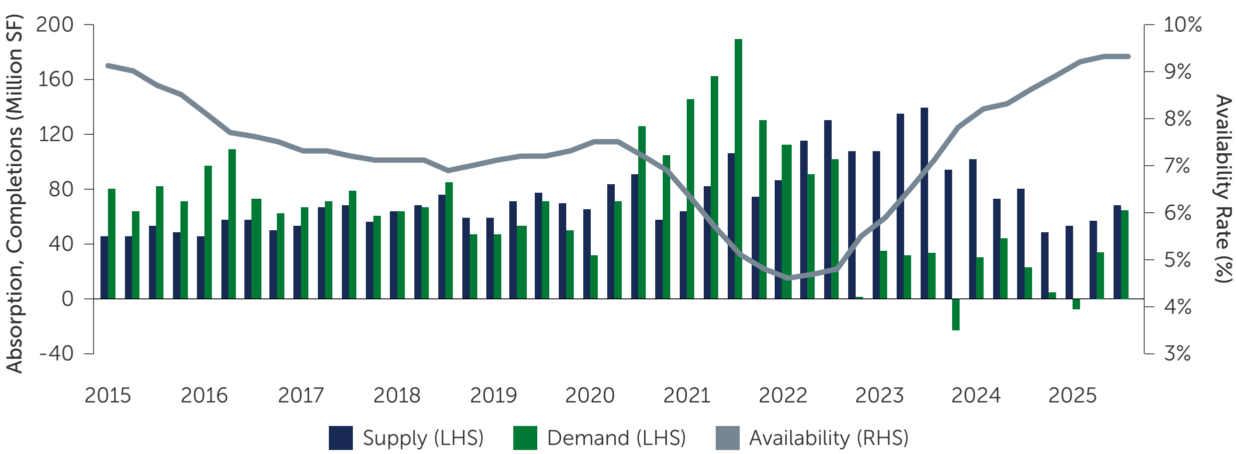
INDUSTRIAL SECTOR

Industrial availability was unchanged at 9.3%—following over three consecutive years of quarterly increases—with declines concentrated in Southern and Midwest markets.[12] The sector benefited from greater occupier demand, as absorption reached its highest level since Q4 2022, led by increased leasing from third-party logistics providers, e-commerce firms and manufacturing-related users. There is increased tenant focus on supply chain optimization, driving demand for modern logistics space. Leasing activity indicates a shift toward consolidating operations into newer facilities and away from older facilities with less desirable features such as lower clear heights. Although completions remained high in Q4, construction starts declined 66% from the peak, and pre-lease rates increased—which supports the sector's stabilization.[13]

Industrial absorption was driven by resilient consumer spending and e-commerce growth, as companies responded to customer demand and adapted to continued economic and trade policy uncertainty. The final outcome is unknown, with the Supreme Court expected to rule on President Trump's use of IEEPA tariffs in the near-term while the Administration is also renegotiating multiple trade agreements.[14]

Despite this uncertainty, trade flows have already evolved as companies shift supply chains to countries with lower import duties, stronger geopolitical alignment and favorable demographic trends. For example, China's market share of total U.S. imports declined five percentage points to 9% since "Liberation Day", while other Asian countries have collectively increased their share by about the same amount.[15] These shifts suggest that port market trade activity will be nuanced, while in-land markets may be more insulated, supported by a range of demand drivers from regional manufacturing and distribution hubs to "last mile" fulfillment centers.

Figure 6: Industrial Availability Declined as Tenant Demand Reached its Highest Level in Three Years



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

12. Source: CBRE. As of December 31, 2025.
13. The sector's pre-lease rate was 31% in Q4 2025 compared to 27% the prior quarter. Source: CBRE. As of December 31, 2025.
14. The International Emergency Economic Powers Act (IEEPA).
15. Includes US imports from April 2025 to October 2025 (most recent available data). Source: Census Bureau. As of October 31, 2025.

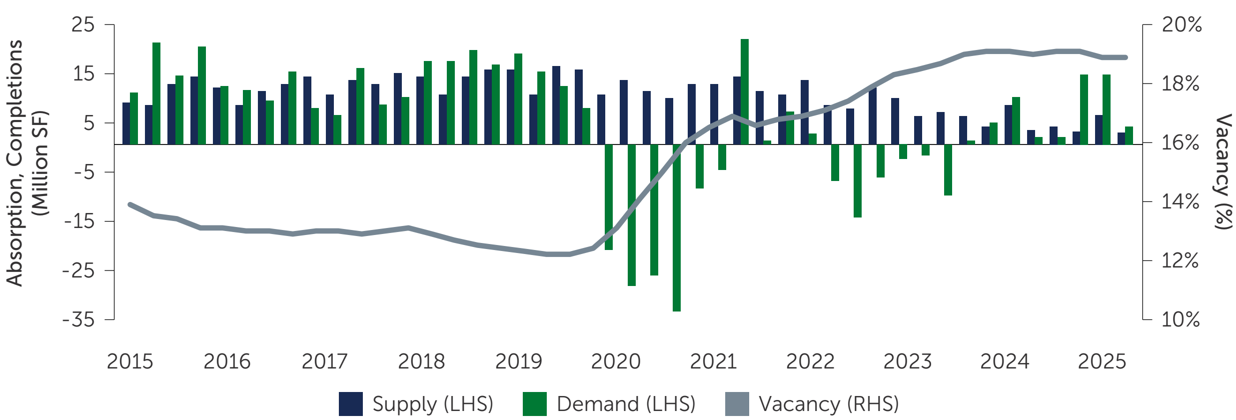
Occupier Markets

OFFICE SECTOR

Office vacancy was unchanged at 18.8% during the quarter and 20 bps below its peak reached earlier this year.[16] Gross leasing volume reached a post-pandemic high in Q4, while absorption remained positive despite a cooling labor market. Tenant demand was supported by gradual return-to-office trends, driven by more full-time onsite and hybrid work arrangements. Over the past year, the percentage of office employees working fully remote declined from 22% to 19%, while the share of non-remote workers increased from 78% to 81%.[17] Hybrid workers also appear to work more days in the office per week. Financial services companies remained the largest office using industry in 2025, increasing their share of total leasing by about two percentage points to 27%.[18] The technology industry—supported by stronger return-to-office requirements—increased its share of total leasing by eight percentage points year-over-year to 19%, making it the second-largest contributor to total office leasing.

The office recovery has also been supported by muted construction activity, while roughly 40 million SF of office space was removed in 2025 for conversion or redevelopment. As a measure, only 2.4 million SF delivered during the quarter—the lowest amount since 2012 and 74% below the average since then.[19] The sector's performance continues to be characterized by dispersion with significant differences in supply-demand fundamentals based on office quality, transit connectivity, skilled labor, lifestyle and related features. For example, New York, San Francisco and Dallas each contain some of the strongest and weakest performing office neighborhoods despite being in the same metro, based on Barings' analysis of about 300 submarkets in over 20 major office markets. This dispersion creates a compelling opportunity to benefit from the basis reset in recent years—with office values down roughly 40% since 2022—by identifying strong micro-locations and assets with long-term value.

Figure 7: Office Vacancy was Unchanged as Demand Edged Out New Supply



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

16. Source: CBRE EA. As of December 31, 2025.
17. Avg. of the financial, information, business services, and real estate industries. Source: WFH Research, Census Bureau. As of September 30, 2025.
18. Based on office leasing in Boston, Chicago, Manhattan, San Francisco, Washington, D.C. Source: Avison Young. As of December 31, 2025.
19. Source: CBRE EA. As of December 31, 2025.

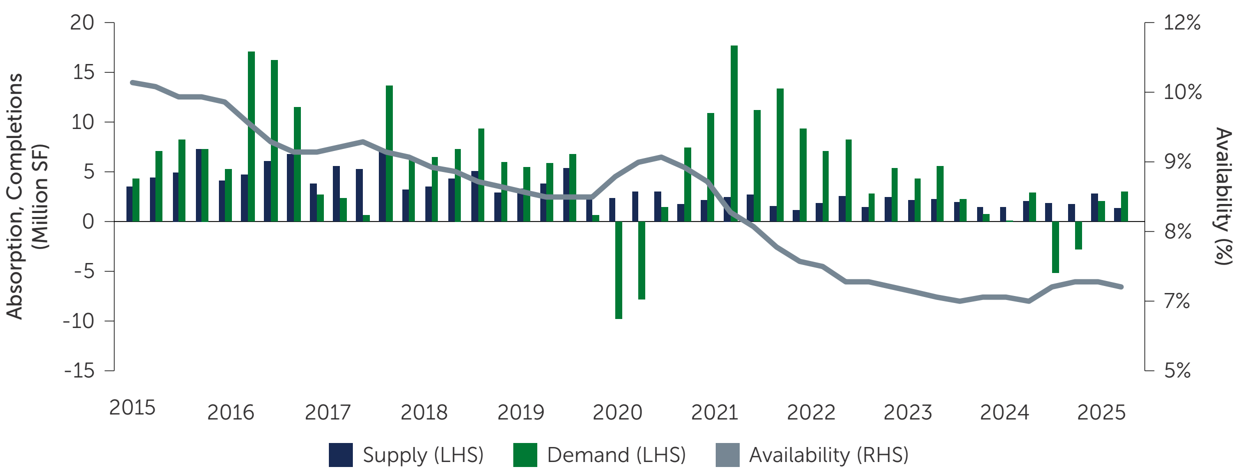
Occupier Markets

RETAIL SECTOR

Retail availability for neighborhood, community and strip (NC&S) shopping centers declined 10 bps to 6.7%, supported by solid tenant demand.[20] As a measure, median time to lease retail space declined to a historic low of under seven months, with high-quality locations often leasing in less than five months.[21] The sector's positive absorption was concentrated in trade areas with strong population growth and higher income demographics. NC&S fundamentals were also supported by limited new supply, with only 1.4 million SF delivered during the quarter—just 5 bps of the market's total inventory.

Despite low consumer confidence and a slow labor market, spending remained resilient, particularly among higher income households. For example, retail spending increased 3.3% year-over-year in November, and holiday sales reached a record high.[22] However, consumers have become more price conscious given cost of living and inflation pressures.[23] Economists anticipate tax refund season to be higher this year, but the labor market will be most impactful for overall household spending, as many consumers cite financial concerns. According to the New York Fed, about 15% of consumers expect to miss a debt payment over the next three months—the highest level since the pandemic—with younger and lower-income individuals reporting the highest concerns. Although economic uncertainty remains elevated, the NC&S segment is well positioned given strong supply-demand fundamentals and its focus on nondiscretionary offerings.

Figure 8: Retail Availability Edges Lower on Improved Demand and Modest New Supply



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

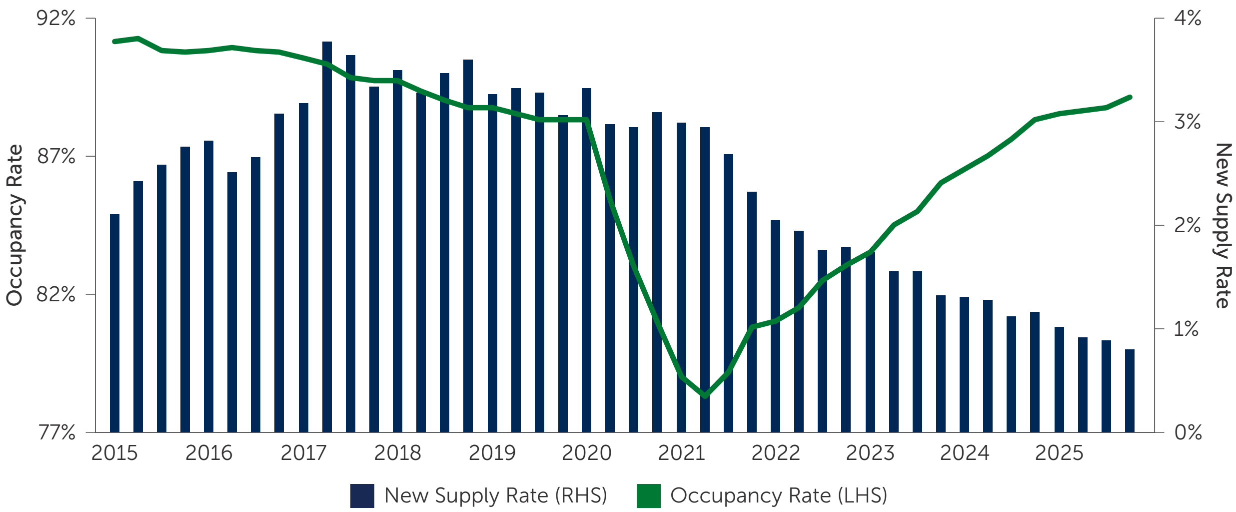
20. Source: CBRE EA. As of December 31, 2025.
21. Source: CoStar. As of December 31, 2025.
22. Source: Census Bureau, CNBC, NRF. As of November 30, 2025, December 31, 2025.
23. Source: Banks of America. As of December 31, 2025.

Occupier Markets

HEALTHCARE SENIOR HOUSING

Senior housing occupancy increased to 89.1% in the fourth quarter—up 40 bps quarter-over-quarter—while rents jumped 4.4% year-over-year.[24] The sector's performance was driven by increased occupancy across independent living (90.6%), assisted living (87.7%) and nursing care (86.5%) properties, reflecting a range of housing needs based on healthcare requirements, cost and lifestyle preferences. The sector's demand is driven by aging demographics with greater healthcare needs. For example, about 51% percent of all adults have two or more chronic medical conditions, up four percentage points from 2015.[25] Fundamentals have also benefited from limited new supply, with senior housing starts representing 0.8% of inventory in the fourth quarter.

Figure 9: Senior Housing Occupancy Increased on Strong Demand Across Property Types



Source: NIC MAP, Green Street. As of December 31, 2025.

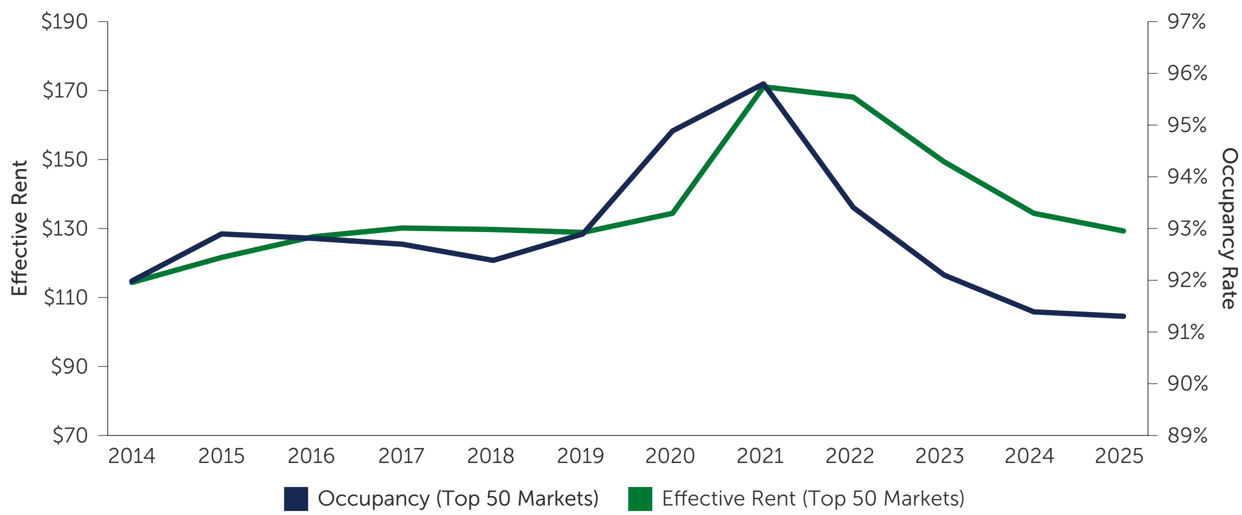
24. Source: NIC MAP. As of December 31, 2025.
25. Source: NIH. As of December 31, 2023.

Occupier Markets

SELF STORAGE SECTOR

Self-storage occupancy declined 30 bps quarter-over-quarter to 91.3%.[26] The sector has been challenged by new supply, as market inventory increased by about 3% per year since 2018, but has decelerated to 1.5% over the past 12 months. Weak home sales activity—driven by mortgage rates still above 6% and high prices—remain a key demand driver and have prolonged lease-up periods to 3 years on average. However, REITs note a stabilization in operations as the sector benefits from other sources of demand—ranging from households outgrowing their current home space to small business inventory storage—that has supported customer leasing.

Figure 10: : Self Storage Fundamentals Challenged by Lower Home Sales Activity



Source: Green Street. As of December 31, 2025.

26. Source: Green Street. As of December 31, 2025.

Conclusion

The U.S. commercial real estate market enters 2026 on firmer footing, supported by a resilient economy, sharply reduced construction activity and gradually stabilizing demand across most sectors. While fundamentals remain shaped by modest hiring, tight labor supply, and lingering economic uncertainty, the supply backdrop is increasingly favorable—helping multifamily, industrial, office, retail, senior housing and self-storage segments absorb recent volatility at different speeds. Capital markets activity has also strengthened, with rising transaction volumes and steady property values despite incremental upward pressure on cap rates. Against this backdrop of dispersion, opportunities continue to favor high-quality assets and micro-locations positioned to benefit from long-term demographic, economic and structural shifts.

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.

Lincoln Janes, CFA
Director, Real Estate Research & Strategy

Barings is a $481+ billion global asset management firm that partners with institutional, insurance, and intermediary clients, and supports leading businesses with flexible financing solutions. The firm, a subsidiary of MassMutual, seeks to deliver excess returns by leveraging its global scale and capabilities across public and private markets in fixed income, real assets and capital solutions.*

LEARN MORE AT BARINGS.COM

**As of December 31, 2025*

26-5172138