BARINGS

REAL ESTATE

U.S. Real Estate: Powering Through Uncertainty with Caution

Real estate fundamentals strengthened in the second quarter as resilient demand and lower levels of new supply outweighed headwinds from economic uncertainty, slower demographic growth and resource constraints.

RESEARCH QUARTERLY

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Executive Summary

ECONOMY

- The U.S. economy remained resilient in the second quarter, supported by improved hiring, strong business investment and continued consumer and federal spending despite ongoing geopolitical uncertainty and policy volatility.
- Growth is led by a narrow set of demand drivers, including higher income demographics, AI and infrastructure capex and reindustrialization investment with strong business earnings.
- Interest rates remain a headwind for real estate. Markets have priced in Fed tightening, though a resilient economic outlook continues to support property demand and net operating income growth.

PROPERTY MARKETS

- Real estate fundamentals strengthened in the second quarter, with improving occupancy trends and continued benefits from lower levels of new supply. Demand increased for certain alternative property sectors, such as senior housing.
- Capital markets remained active, with CRE transaction volumes increasing 17% year-over-year and debt market liquidity supported by strong competition among lenders with tighter credit spreads.
- Dispersion remains a defining market feature, with performance increasingly driven by exposure to structural demand drivers and varying significantly across property types and markets.

Economy

U.S. real estate fundamentals strengthened in the second quarter, with positive absorption across the primary property sectors. The improvement was driven by continued economic expansion and a pick-up in hiring, with 334,000 jobs added over the past three months. Real GDP increased 1.5% in the quarter, led by strong business capital investments and solid consumer consumption **(Figure 1)**.

In addition, construction activity has declined significantly given higher building and financing costs. The improved balance between supply and demand led to positive real estate performance, with total returns up 10 bps quarter-over-quarter to 5.0% on a 1-year basis, according to the NCREIF NPI index.[1]

The economy has remained resilient, although investors continue to navigate significant geopolitical disruptions, shifting policies and other macro factors. Still, this creates opportunities in markets and assets positioned to benefit from structural sources of demand, placing greater emphasis on the distribution, rather than aggregate trends.

1. Based on the "NCREIF Property Index" that includes all covered properties. Source: NCREIF. As of July 25, 2026.

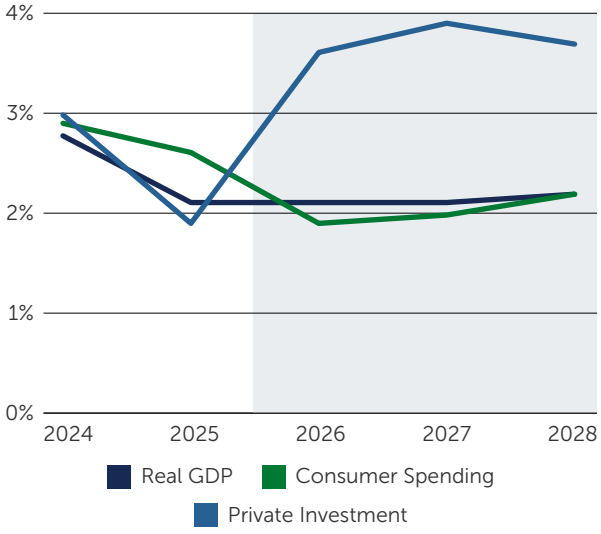
For example, while the aggregate U.S. population is forecast to grow by about 0.2% annually over the next five years, the population aged 70 years and older is expected to increase by 3.2% per year **(Figure 2)**. This trend has the most relevance for senior housing, though other parts of the residential sector also stand to benefit from increased renter demand driven by homeownership affordability issues and continued net migration, both nationally and at intra-metro levels.

A similar framing of the distribution extends to other property sectors. Performance is becoming increasingly tied to exposure to the AI and infrastructure build-out, the reindustrialization of the economy, higher income households leading consumer spending and other durable sources of demand.

However, improved labor markets and persistent inflation pressures continue to make interest rates a headwind for real estate. Although the core consumer price index decelerated from 2.9% to 2.6% year-over-year in June, recent U.S.-Iran re-escalations have weighed on the Fed's policy outlook given its price stability and employment mandates. The futures market has priced in roughly one 25 basis points (bps) Fed rate hikes by year-end.[2] While higher rates may continue to challenge valuations, the consensus forecast remains supportive, as a resilient economy is expected to increase real estate demand and, in turn, net operating income, with the recovery led by property fundamentals **(Figure 1)**.

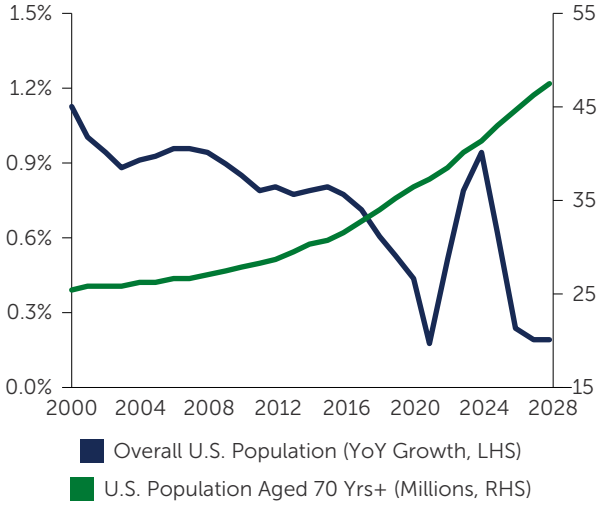
Bottom Line: Real estate fundamentals continue to improve despite macro uncertainty. As supply growth slows, property performance is increasingly being driven by structural demand trends and local market fundamentals rather than broad economic growth alone.

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



Source: Bloomberg. As of July 23, 2026.

Figure 2: U.S. Population Growth and Aging Trends



Sources: CBO; Census Bureau; BLS; Oxford Economics. As of January 31, 2026.

2. Sources: Bloomberg; ICE. As of July 30, 2026.

Valuations & Capital Markets

Commercial real estate (CRE) transaction volumes increased 17% year-over-year to nearly $130 billion in the second quarter **(Figure 3)**. All sectors—excluding office—recorded higher sales volume than a year ago, led by the multifamily ($37 billion) and industrial ($32 billion). Alternative property types also remained active, with strong transaction activity in data centers ($8 billion) and senior housing ($7 billion).

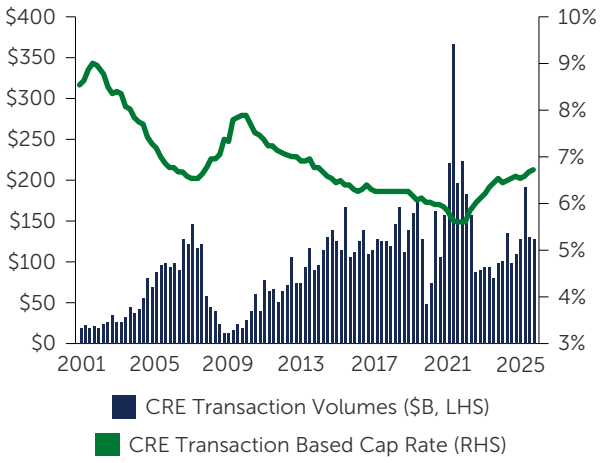
From a valuation perspective, transaction-based cap rates increased with 10-year U.S. Treasury yields in the second quarter, with both increasing about 20 bps quarter-over-quarter to 4.5% and 6.9%, respectively.[3] Property values rose 0.9% year-over-year as improved fundamentals and higher replacement costs benefit existing assets.[4]

CRE debt market liquidity remained strong in the second quarter, with significant competition across lenders. This led to more borrower-friendly loan structures and tighter pricing, particularly for higher-risk strategies **(Figure 4)**. For example, floating-rate spreads on bridge and construction loans narrowed 10 to 20 bps quarter-over-quarter, based on Chatham Financial data.

The CMBS market remained a significant source of capital, with nearly $70 billion in issuance year-to-date, marking the most active first half of the year since the GFC. Other lenders—such as banks, life insurance companies, agencies and debt funds—also remained highly active. In addition, liquidity for warehouse and other types of back leverage financing was strong, with advance rates generally ranging from 65% to 80% and debt spreads compressing about 15 bps during the quarter.[5]

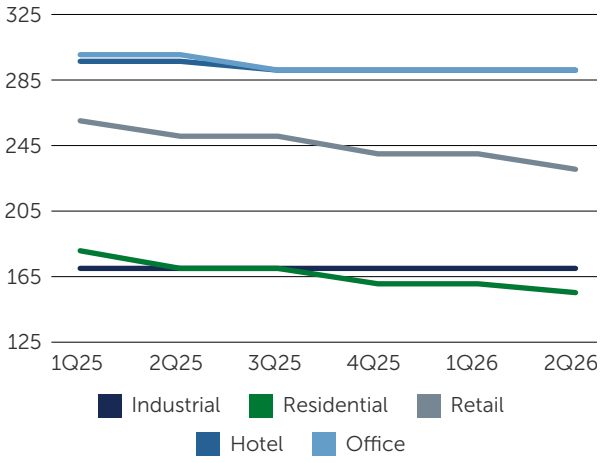
Bottom Line: Capital remains readily available for real estate. Improving liquidity and competitive lending conditions are helping support transaction activity and creating a more constructive backdrop for investment.

Figure 3: CRE Cap Rates and Transaction Volumes



Source: MSCI RCA. As of June 30, 2026.

Figure 4: Core Floating Rate Debt Spreads (bps)



Source: Chatham Financial. As of June 30, 2026.

3. Cap rates data is a simple average across core property types. Source: MSCI RCA. As of June 30, 2026.
4. Source: MSCI RCA. As of June 30, 2026.
5. Source: Chatham Financial. As of June 30, 2026.

Occupier Markets

APARTMENT SECTOR

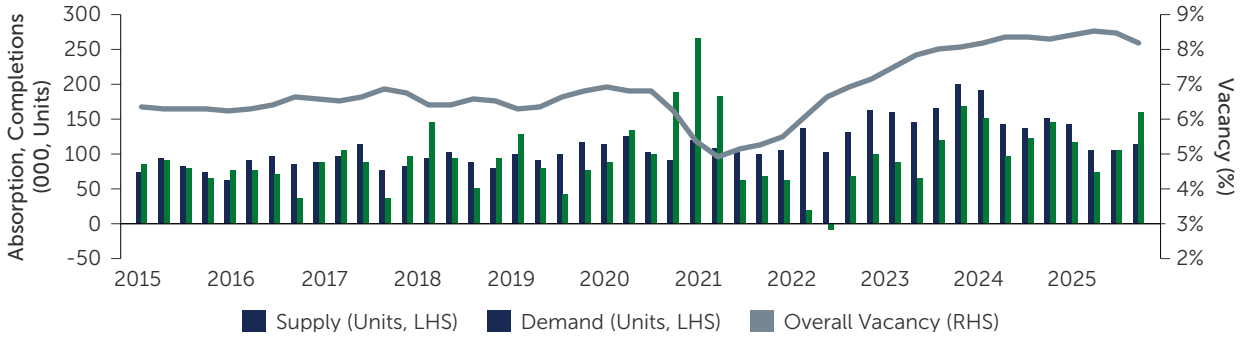
The apartment sector vacancy rate declined 20 bps to 8.2%, while rent growth increased from 0.3% year-over-year in the first quarter to 0.8% in the second quarter.[6] The improvement in fundamentals was supported by increased hiring activity, with absorption accelerating nearly 50% to 160,000 units, the highest level in two years.[7] The sector has also benefited from a slowdown in new supply, with apartment deliveries and construction starts down about 40% and 70%, respectively, from their recent peaks **(Figure 5)**.

Performance improved across both product types and geographies. Vacancy rates for higher-quality apartments declined 70 bps quarter-over-quarter to 10.2%, a category that includes many unstabilized assets still in lease-up. Vacancy rates for lower-quality properties declined 10 bps to 7.2%.[8] Regionally, apartment vacancy rates in the higher-growth, higher-supply Southern, Mountain West and Desert West markets declined 80 bps to 11.0%, while vacancy rates in the slower-growth, lower-supply Northeast, Midwest and West Coast markets declined 20 bps to 6.3%.[9]

The sector's long-term demand fundamentals remain strong, as homeownership affordability challenges remain significant despite the 21st Century ROAD to Housing Act. The legislation is primarily focused on increasing housing supply through regulatory, zoning and other reforms administered at the state and local government levels. For example, the average monthly cost of homeownership, including mortgage payments, taxes, insurance and other costs, increased from about $1,700 in 2019 to about $2,400 today, compared with a national average rent of $1,750 in the second quarter.[10]

Bottom Line: Apartment fundamentals appear to be turning a corner as demand accelerated and new supply recedes. Affordability challenges in the for-sale housing market should continue to support long-term renter demand.

Figure 5: Apartment Vacancy Declined as Absorption Reached the Highest Level in Two Years



Source: CoStar. As of June 30, 2026.

6. Includes stabilized and unstabilized properties. Source: CoStar. As of June 30, 2026.
7. Source: Federal Reserve, BLS. As of June 30, 2026.
8. Higher quality apartments includes 4- and 5-star properties. Lower quality includes 1-3 star properties. Source: CoStar. As of June 30, 2026.
9. The regional analysis is based on the 60 largest apartment markets in the US. Source: CoStar. As of June 30, 2026.
10. Based on single-family mortgages that escrow property-tax and home-insurance payments. Source: ICE, WSJ. As of June 20, 2026.

INDUSTRIAL SECTOR

Industrial availability decreased 10 bps to 9.2% in the second quarter, marking the first quarterly decline since 2022.[11] The improvement was supported by stronger leasing activity in larger "big box" industrial formats and primary markets, such as Dallas (availability declined 80 bps), Atlanta (20 bps), Phoenix (20 bps) and Los Angeles (25 bps). Availability increased in other California markets, however, including Riverside and San Diego.[12] Among smaller markets, lower availability rates were most pronounced in Austin (declined 115 bps), Milwaukee (115 bps), Indianapolis (105 bps), El Paso (100 bps) and Columbus (60 bps).

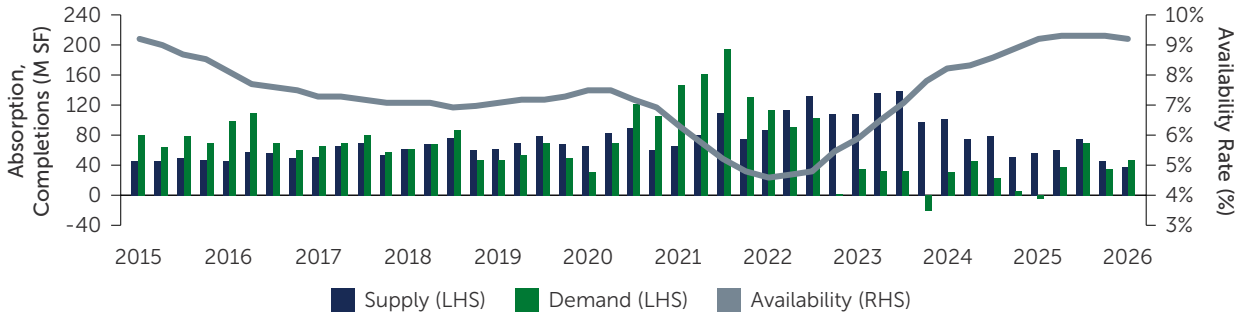
Absorption was driven by third-party logistics, e-commerce and manufacturing-related users, with demand strongest for newer buildings with higher clear-heights. Tenants also placed increasing emphasis on power availability and technology integration. Industrial fundamentals benefited from a significant slowdown in new supply, with completions down 73% from their recent peak.

Demand continued to be supported by resilient consumer consumption and significant capital spending to reindustrialize the U.S. economy. Much of this investment remains concentrated in the AI build-out, infrastructure and domestic manufacturing for supply chain resiliency in strategically important industries, such as pharmaceuticals, energy and automotive manufacturing. As a result, combined manufacturing and data center construction spending exceeded $230 billion in 2026, up from about $90 billion pre-pandemic.[13]

Trade policy remains a headwind, although average U.S. tariff rates declined from about 12% at the peak to 7% in July. Companies are adjusting to uncertainty, while imports have increased for key trade partners with lower tariff rates. For example, imports of goods from Mexico—with a weighted average 4% effective tariff rate despite USMCA headwinds—have increased 7% since "Liberation Day." By contrast, imports from China—with a 22% tariff rate—have declined 41% over the same period.[14]

Bottom Line: Industrial fundamentals are stabilizing as tenant demand outpaced new supply. Markets tied to manufacturing, infrastructure and AI-related investment and durable consumer spending remain particularly well positioned.

Figure 6: Industrial Availability Declined as Tenant Demand Outpaced New Supply



Source: CBRE EA. As of June 30, 2026.

11. Source: CBRE EA. As of June 30, 2026.
12. "Big box" is defined as industrial properties with 500,000+ square feet. Source: CBRE EA, JLL, Cushman & Wakefield. As of June 30, 2026.
13. Source: Census Bureau. As of May 31, 2026.
14. Source: Census Bureau. As of April 30, 2026.

OFFICE SECTOR

Office vacancy declined 20 bps to 18.4% in the second quarter, down from a post-pandemic peak of 19.0%.[15] The sector had its ninth consecutive quarter of positive net absorption, despite a modest decline in office-using employment over the past three months.[16] Even with recent hiring weakness for this sector, employment in professional, financial and other business services industries remains 1.4 million jobs above pre-pandemic levels, while return-to-office trends continue to improve.

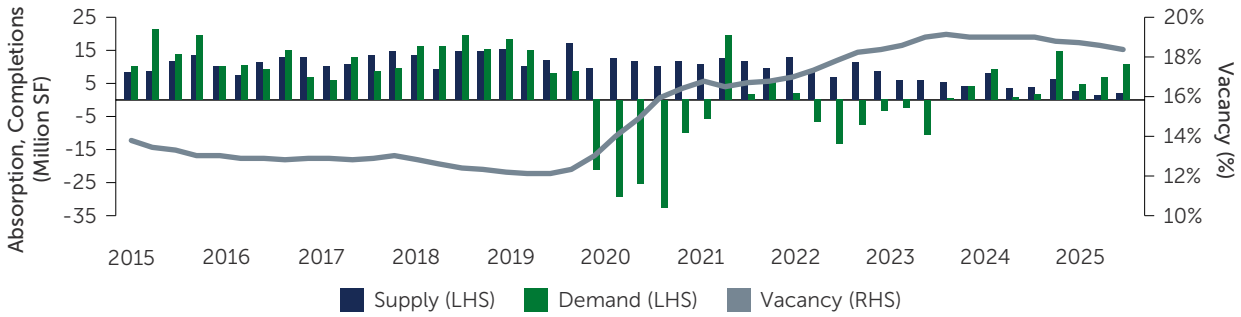
For example, the share of employees working either full-time in the office or under hybrid work arrangements increased from 77% in the first quarter to 80% in the second quarter. At the same time, hybrid employees are spending more days in the office per week, supporting occupier demand.[17] The sector's recovery has also been aided by lower rates of new supply, with just 2.1 million square feet delivered in the quarter, representing 5 bps of inventory, as well as the continued removal of obsolete office space.

Limited new supply has increasingly redirected demand toward non-prime office assets in several markets. Prime office vacancy rates in New York City, Miami and San Jose are below the national average, while net absorption of non-prime office has increased, suggesting that some tenants are trading down to lower-quality buildings as availability of the highest-quality space becomes limited increasingly constrained. In San Francisco, prime office vacancy is similar to the national average, yet the metro has recorded some of the strongest absorption rates for non-prime assets, reflecting tenant demand from less-capitalized startup companies seeking more affordable rents. Conditions remain more challenging in other markets, including Seattle and Denver.

At the same time, office micro-location is critical, with significant dispersion in fundamentals within major metropolitan areas such as Dallas, San Francisco, San Jose and Charlotte. According to Barings research, these markets contain some of the strongest- and weakest-performing office submarkets in the country, despite being within the same metropolitan area.[18]

Bottom Line: The office recovery remains uneven, but broad conditions continue to improve. Market and submarket selection remain critical, as performance can vary significantly even within the same metropolitan area.

Figure 7: Office Vacancy Declined for the Fourth Consecutive Quarter



Source: CBRE EA. As of June 30, 2026.

15. Source: CBRE EA. As of June 30, 2026.
16. Source: BLS. As of June 2026.
17. Based on financial, information, business services and real estate industries. Source: WFH Research, Census Bureau. As of June 30, 2026.
18. Based on an analysis of ~325 submarkets within ~20 major metros. Source: CoStar, Barings. As of June 30, 2026.

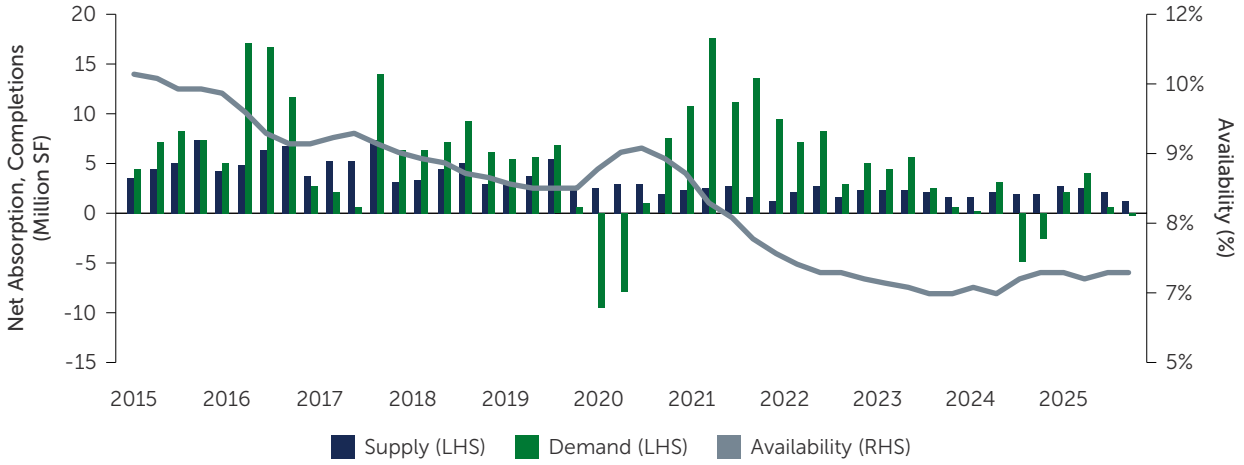
RETAIL SECTOR

Retail availability for neighborhood, community and strip (NCS) shopping centers was unchanged at 6.8% in the second quarter, remaining near all-time lows.[19] The sector continued to benefit from resilient consumer spending, with retail sales (excluding gas stations) increasing 5.7% year-over-year in June, supported by improved hiring activity and household wealth.[20]

NCS fundamentals also remain supported by minimal new supply. Only 1.4 million square feet was delivered in the quarter, the lowest quarterly total on record. This supply-constrained environment has enabled property owners to increase lease rates, with rents rising 2.4% year-over-year, while also creating opportunities to enhance asset performance through redevelopment projects.[21]

Bottom Line: Retail remains one of the most supply-constrained property sectors, providing landlords with pricing power and opportunities to enhance value through redevelopment and active asset management.

Figure 8: Retail Availability Relatively Unchanged as New Supply Reached its Lowest Level on Record



Source: CBRE EA. As of June 30, 2026.

19. Source: CBRE EA. As of June 30, 2026.
20. Source: Census Bureau. As of June 30, 2026.
21. Green Street analysis shows about 85% of retail center visit growth across 3 public REITs is attributed to properties with a disclosed redevelopment project. Source: Green Street. As of December 31, 2026.

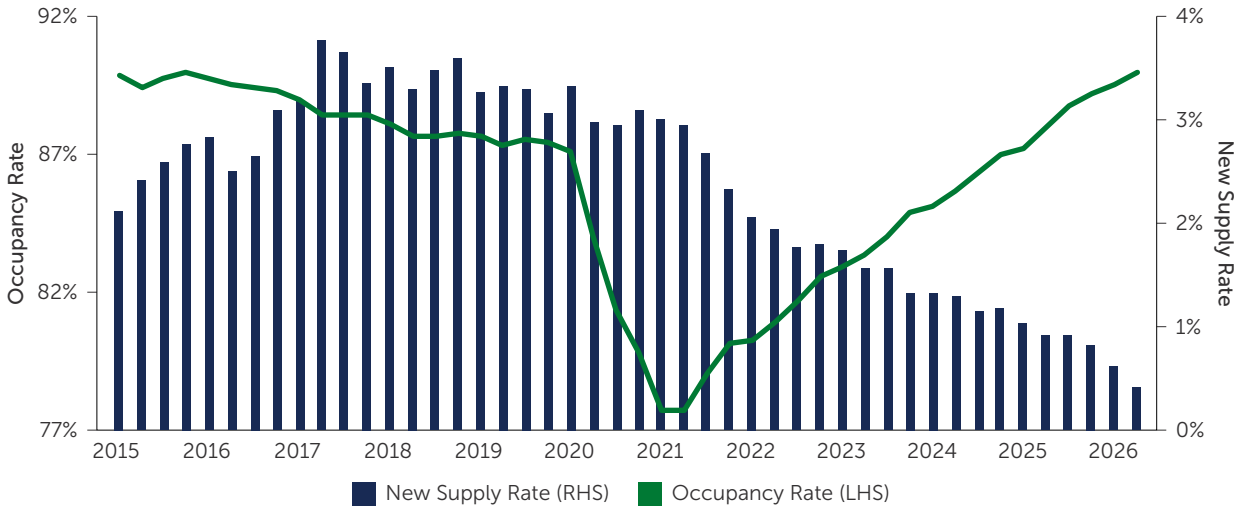
SENIOR HOUSING SECTOR

Senior housing occupancy increased 40 bps to 89.9% in the second quarter, marking the 20th consecutive quarter of resident gains.[22] The improvement was geographically broad-based, with occupancy increasing in all eight U.S. regions. Occupancy also reached or exceeded 90% in 15 of 31 primary markets covered by NIC.

Demand is driven by aging demographics, with the population aged 80 and older projected to grow by about 5% per year through 2030, compared with roughly 0.02% for the overall U.S. population.[23] Senior housing fundamentals are also supported by lower rates of new supply, with market inventory up 0.4% year-over-year as of the second quarter, well below the long-term average **(Figure 9)**.

Bottom Line: Senior housing continues to benefit from one of the clearest demographic tailwinds in real estate. Strong demand and limited new construction are supporting occupancy growth.

Figure 9: Senior Housing Occupancy Climbed Higher with Limited New Supply



Sources: Bloomberg; NIC MAP. As of June 30, 2026.

22. Source: NIC MAP. As of June 30, 2026.
23. Sources: Green Street. As of May 2026. Oxford Economics. As of June 2026.

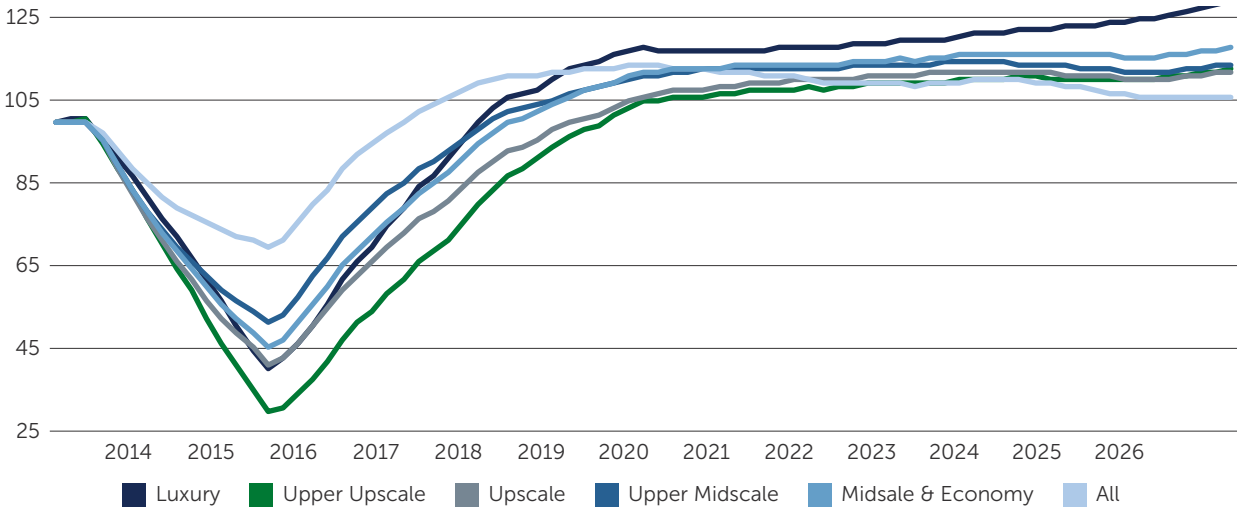
HOTEL SECTOR

Hotel RevPAR increased 1.1% in the second quarter, with ADR and occupancy up 0.8% and 20 bps, respectively.[24] Host cities benefitted from World Cup-related demand, while performance continued to be led by the higher-price segments. "Luxury" hotel RevPAR increased 1.8% year-over-year, while the "upper upscale" posted 1.1% growth. By contrast, midscale and lower-priced segments reported softer growth.

This performance reflects broader economic trends, including increased consumption from less price-sensitive group customers and higher-income households. For example, household wealth for the top 10% of income earners increased by $9.8 trillion year-over-year, compared to $2.8 trillion for households in the 10th to 50th percentiles and just $0.3 trillion for households in the bottom 50%, based on Federal Reserve data.

Bottom Line: Hotel performance remains supported by resilient travel demand from higher-income and less price-sensitive customers. Results continue to favor higher-end properties that can capture premium leisure and group demand.

Figure 10: Hotel Revpar Edged Higher and Led by the Higher-End Segment of the Market



Sources: CoStar; STR. As of June 30, 2026.

24. Sources: CoStar; STR. As of June 30, 2026.

SELF-STORAGE SECTOR

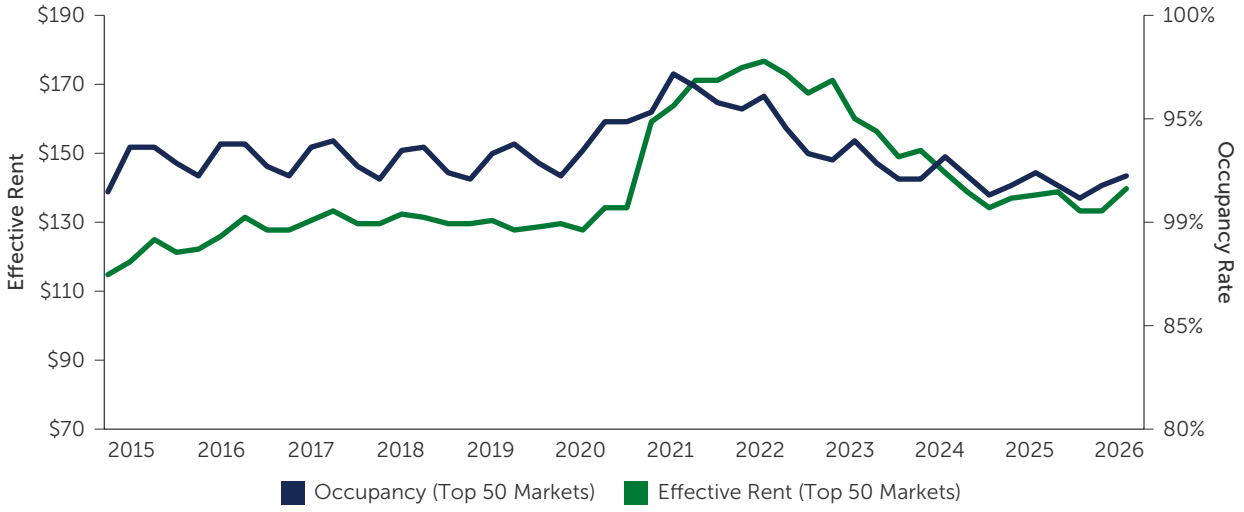
Self-storage demand remains highly seasonal, and occupancy was relatively unchanged year-over-year at 92.3% in the second quarter, while move-in rents continued to stabilize **(Figure 11)**.

A key source of demand, new renters from home sales activity, remained muted as existing property sales in June were about 20% below their long-term average, with mortgage rates hovering near 6.5%.[25] However, the sector continues to benefit from consumers seeking additional space in their current homes. Mobility has declined in part due to the mortgage "rate-lock effect," leading some households to use self-storage to free up space for home offices or accommodate growing families.[26]

Similar to other real estate sectors, self-storage fundamentals have also been supported by a slowdown in construction activity. Inventory is expected to increase 1.5% in 2026, well below the approximately 4.1% annual growth rate recorded from 2017 to 2021.[27]

Bottom Line: While housing market activity remains subdued, self-storage fundamentals have shown signs of stabilization. Moderating supply growth should help support operating performance as demand gradually improves.

Figure 11: Self-Storage Fundamentals Relatively Unchanged and Constrained by Low Home Sales



Source: Green Street. As of June 30, 2026.

25. Sources: Bloomberg; NAR; Federal Reserve; Freddie Mac. As of June 30, 2026.
26. Sources: Liebersohn; Rothstein "Household Mobility and Mortgage Rate Lock" JFE. As of February 2025.
27. Sources: Green Street; Yardi. As of May 2026.

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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