



L&G – Asset Management, America
US Real Estate Equity

2026 US Commercial Real Estate Outlook



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Key takeaways

- Investment performance for US commercial real estate (CRE) is solidly on the upswing, with CRE sector participants optimistic that the upswing will continue through 2026 and bring performance closer to long-term sector averages in the years ahead. Such expectations are reasonable and generally aligned with our own views.
- However, sector participants' optimism implicitly assumes that the US economy will provide a foundation for growth that is adequate to fulfill expectations for space absorption and rent growth. We believe substantial uncertainty surrounds that assumption and must be taken into account when making investment decisions.
- Risk to economic growth is concentrated on the downside, in our view, reflecting lopsided growth drivers associated with artificial intelligence (AI) activity and soaring AI-related stock values. Federal policies related to tariffs and immigration have been economically detrimental and erratic, complicating business decision making.
- The benefit to metro markets from AI activity is not uniform, suggesting that CRE investors evaluate the concentration of AI activity as part of metro targeting. Brookings offers tools for doing so, which we describe in the body of the report.
- In addition, CRE investors are well advised to evaluate the relative supply-demand balance as another component of metro targeting. If an economic downturn does materialize, we believe that metros with more balanced supply-demand conditions will fare better than those digesting excesses.

Introduction

Inside the realm of US CRE soothsayers, the outlook for 2026 is looking solidly positive. The most recent CRE benchmark, the NCREIF National Property Index (NPI) for the third-quarter 2025, showed the four-quarter total return nearing 5% as of September 2025, with a return to positive property appreciation for three consecutive quarters suggesting shrinking capital appreciation is at an end. The data also show sector net operating income (NOI) growing in three of the four major sectors and rent growth positive on average across the four major sectors in the top-50 metros defined by population size. Interest rate cuts have helped, along with slower construction activity.

In the face of these metrics, investors are demonstrating optimism through a solid pace of deal-making. We believe this foundation should provide a solid lift-off for US CRE in 2026. But the path ahead for the broader US economy is not so clear and suggests a dose of caution is warranted. Prospects for the US macroeconomy are muddled, monetary policy is unsettled, and global financial markets are anxiously watching these uncertainties.

Our own expectations encompass the positive forces underway in US CRE as well as macroeconomic uncertainty. When applied to investment strategy, our expectations for 2026 reinforce our interest in US multifamily, our potential interest in US industrial and our ongoing monitoring of office and retail. We expect government policy to remain erratic. We expect ongoing stock market volatility as the AI growth expectations play out. And we expect monetary policymakers to cut interest rates judiciously, as conditions warrant. In this complex environment, we believe that property investment opportunities will emerge, and flexible investors will potentially benefit.



Optimistic expectations for US CRE in 2026

Forecasts of US CRE performance surveyed quarterly by the Pension Real Estate Association (PREA) show ongoing strengthening in property total return, as measured by the NCREIF NPI benchmark. 2025 total returns are expected to sit at 5.2%, implying that fourth-quarter 2025 performance is roughly in line with the prior three quarters. For 2026, the 26 forecasts covered in the survey project an average total return of 5.9%, accomplished via an improved capital appreciation component of 1.0%. The office sector contributes most notably to this improvement, through a waning in its pace of capital depreciation from -2.7% expected for 2025 to -1.1% in 2026.

Figure 1: US CRE performance forecasts show ongoing strengthening in property total return

Average of respondents' forecasts of NCREIF Property Index (NPI) and sub-indices by property type

	Total return 2025 (incl. income)	Total return 2026 (incl. income)	Total return 2027 (incl. income)	Total return 2025-2029 (incl. income)
National, all property types (NPI)	5.2	5.9	6.9	6.5
Office	3.2	4.8	6.0	5.5
Retail	7.6	7.3	7.6	7.4
Industrial	5.5	5.8	6.7	6.5
Residential	5.2	6.3	7.5	6.8
Seniors housing	10.7	10.8	10.2	9.9
Self-storage	5.6	5.4	7.1	6.5

Source: Pension Real Estate Association Consensus Forecast Survey of the NCREIF Property Index, Q4 2025.

The Real Estate Roundtable 4Q2025 Sentiment Index supports these expectations, with the Future Conditions index running above the Current Conditions index. Both have picked up since midyear but remain weaker than readings from 2024 that look ahead to 2025. Still, the deal-making environment is nonetheless seen as positive, especially as interest rates ease further.

Comments embedded in the current report point to continued strength in residential sectors, alongside steady improvement in retail and signs of stabilization emerging in top-tier markets. Debt capital availability is said to have improved in 2025 by 78% of respondents, with 56% expecting further improvement in 2026. At the same time, respondents express an improvement to “guarded optimism” from the “caution” expressed in prior surveys, even as US tariff policy and its unsettledness are cited as continuing to add difficulty to decision making.

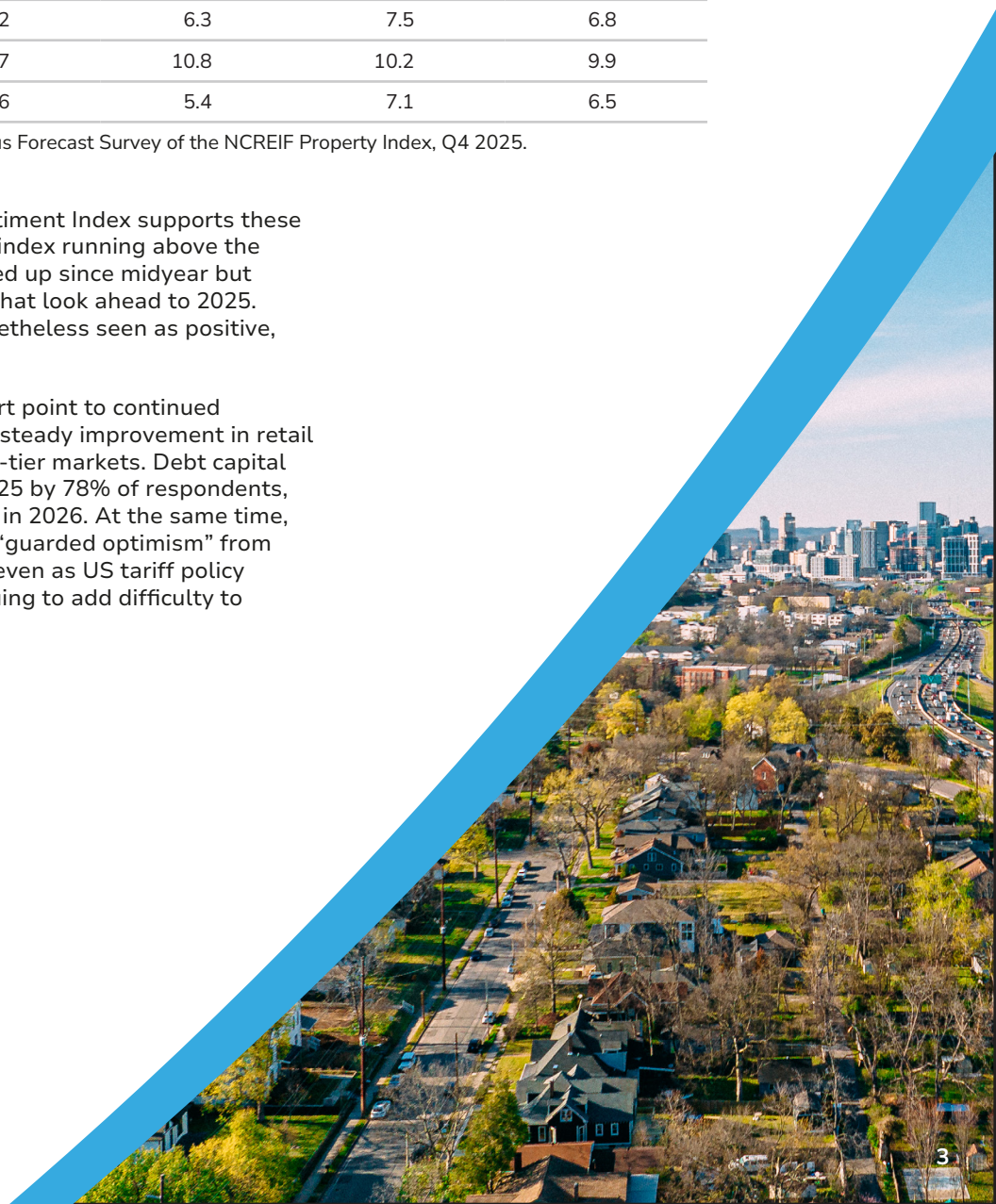
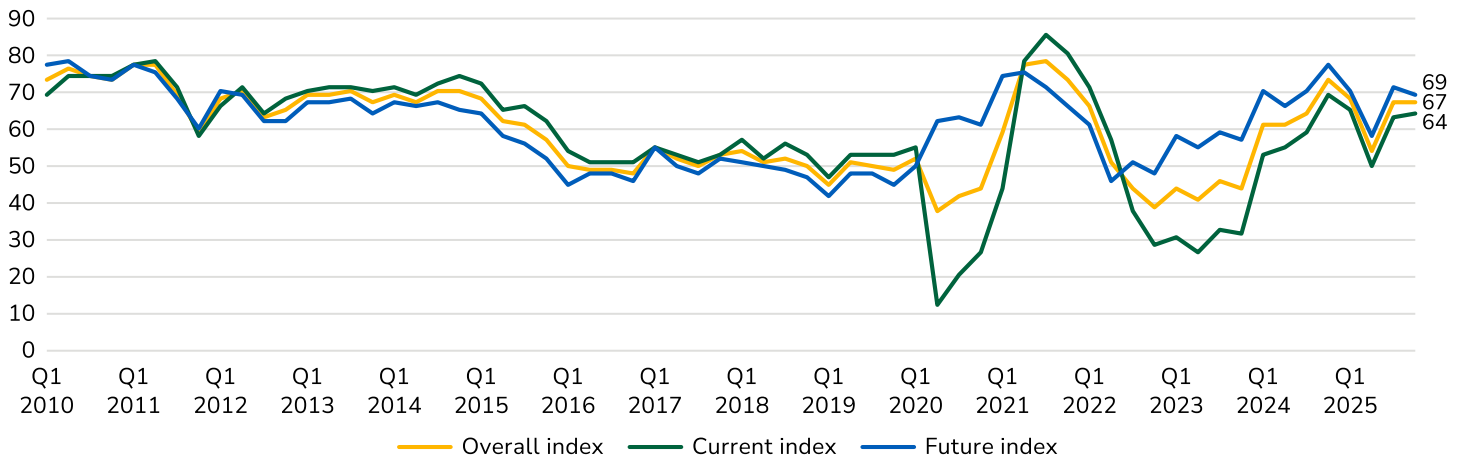


Figure 2: Sentiment is higher around future conditions

The Real Estate Roundtable Sentiment Index (Aggregate)



Source: The Real Estate Roundtable, Sentiment Index, 4Q2025.

These expectations are echoed in the ULI Emerging Trends 2026 report, which cites the highest “buy” rating for 2026 in the past twenty years.¹

Macroeconomic expectations positive, but with downside risk

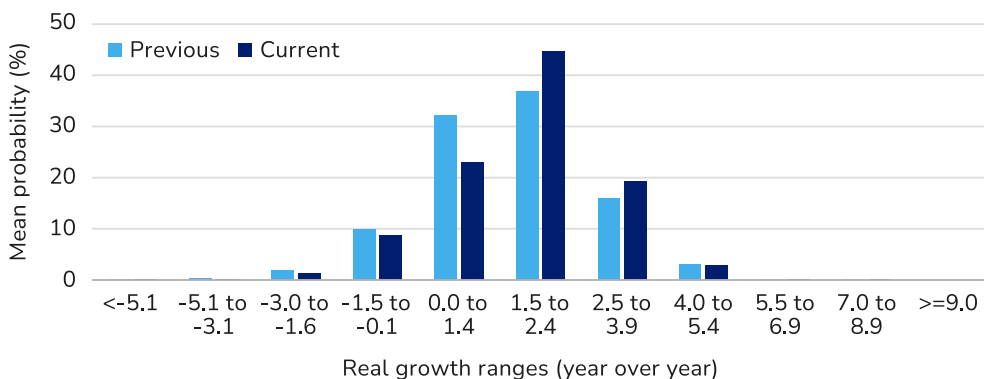
The optimism in US CRE 2026 forecasts is not out of line with expectations for US economic growth. The 33 forecasters surveyed by the Philadelphia Federal Reserve Bank report a median real gross domestic product (GDP) growth expectation of 1.8% in 2026, following 2025's 1.9%. In 2024 GDP growth registered a more potent 2.8%. The Survey also shows slowly declining inflation, which should support some further interest rate easing. Nonetheless, the Survey shows more downside risk than upside potential, as illustrated in Figure 3.

There are numerous sources of downside risk, including uncertainty itself a major source of risk. The US government shutdown during October and into November interrupted the regular flow of government metrics that forecasters need. Without this crucial data, forecasters relied on private sector readings that are not as robust. The end of the shutdown in mid-November reactivated data collection but the first look at third-quarter 2025 GDP was not released until the end of December. That report, showing a 4.3% annual growth rate for the third quarter, was surprisingly strong, reflecting robust consumer spending growth said to be fueled by high-income households enjoying stock market euphoria.

In addition to uncertainty, downside risk is also embedded in the lopsided nature of economic growth in 2025. Through midyear, investment in AI software, hardware and data center construction drove US economic growth. According to calculations released by Harvard economist Jason Furman, information processing equipment and software alone kept growth positive over the first half of 2025. Without them, GDP would have registered only a 0.1% annualized increase. These activities were concentrated among the handful of major tech companies called “hyperscalers” that are leading AI development. According to Green Street, their investment spending through the third quarter was up 65% from last year, and a further increase is projected for 2026.

Figure 3: Survey data show more downside risk to GDP growth in 2026

Mean probabilities for real GDP growth in 2026



Source: Federal Reserve Bank of Philadelphia, 4Q 2025 Survey of Professional Forecasters.

The US stock market's soaring performance can also be attributed to this handful of companies. At the same time, the record performance of stocks is benefiting the small slice of US households who own stocks and is supporting their spending growth. Most households do not own stocks, and their spending growth has been only tracking inflation according to Federal Reserve (Fed) analysis.²

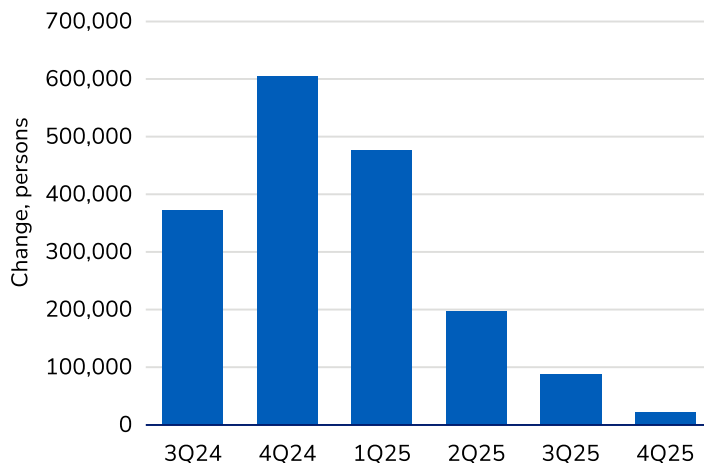
These conditions leave Fed policymakers with a conundrum: Inflation is still running above the 2% target, but the economy is weak except for AI and AI-related stocks. Interest rate cuts have been cautious through year-end, but optimistic CRE expectations implicitly assume that the Fed will do just enough rate cutting to support growth.

With 2026 economic growth prospects so closely tied to AI, downside risk is amplified by concern that AI is over-hyped and AI stocks overvalued. According to a McKinsey survey of AI use, 88% of the businesses queried reported using AI for at least one function in mid-2025. This is up from 78% one year earlier. For the companies using AI, improvement in innovation is reported by 64%, while benefits related to business costs, revenue and/or profitability are reported by less than 30%. In addition, less than 20% of the companies using AI reported staff cuts in 2025 as a result, while 32% expect such cuts next year. The McKinsey survey describes expanding adoption of AI across a wide variety of sectors but with no sign yet of revolutionary results. While the strong expansion in use indicates that further benefits are anticipated, the absence of users yelling "WOW" feeds fear of a bubble.

Downside risk is also emerging from the ongoing erratic path of US fiscal policy, especially with regards to tariffs. In mid-November, the Yale Budget Lab calculated a 16.8% effective tariff rate, the highest since 1935 and a sharp increase from 2024's 2.4%. Beyond their high level, the tariffs have not been stable since the initial announcements in April 2025 imposed a 28% effective levy. Since then, country-by-country "deals" have been cut and product-by-product exemptions negotiated, with the latter comprising a list 98 pages in length posted by the White House. A recent KPMG survey of senior business executives reports that nearly 40% of businesses have

paused hiring due to tariff uncertainty.³ The pullback is evident in the decline in monthly private sector employment growth over the second and third quarters, as shown in Figure 4.

Figure 4: Businesses have paused hiring amid tariff uncertainty
Total nonfarm payroll employment



Source: Automatic Data Processing, Inc., FRED.

Adding to the uncertainty is the possibility that the Supreme Court may deem the tariffs unconstitutional. Beyond tariff policy, immigration policies are deporting workers concentrated in agriculture, construction and food processing, and eroding labor force growth, which is also contributing to the slowdown in employment growth and impairing macroeconomic growth prospects.



Metros' relative AI exposure and supply-demand balance key for CRE investors

With AI driving economic growth prospects for the foreseeable future, we believe that CRE investments will benefit in the metros with the strongest AI activity feeding their local economies. Earlier this year, Brookings published a report identifying those best-positioned metros. In "Mapping the AI Economy," Brookings researchers used three criteria to assess metro area AI activity: local AI talent concentration, AI innovation activity and AI adoption. They ranked the top 195 metro areas with populations of at least 250,000.

Two metros, San Francisco and San Jose, are identified as dominating AI in the US and are deemed "superstars." They accounted for 13% of AI job postings in the first quarter of 2025 and 11% since 2010, while accounting for only 2.7% of total US metro employment. The metros account for 34% of AI patents, with research anchored at major universities and tech companies. Brookings estimates that the Bay Area is home to 31% of private AI startups and 32% of venture capital funding.

The next group includes 28 metros deemed "Star Hubs." They enjoyed 54% of AI job postings, while accounting for 46% of total metro employment. This group includes large metros such as New York, Miami, Dallas, Chicago, Los Angeles, Seattle, Boston and Minneapolis along with smaller metros such as Austin, Salt Lake City, Raleigh, San Diego, Washington, DC, and Boulder. These metros account for 51% of AI patents and 53% of AI venture capital funding. Finally, fourteen metros are defined as "Emerging Centers," showing outperformance on two of the criteria but underperformance on a third. Detroit, Nashville, Tampa and Pittsburgh score the best of the fourteen.

While the relatively better growth prospects offered by AI concentrations should be attractive for CRE investors, they are not a sufficient basis for recommending property acquisitions, in our view. Metro property market fundamentals are also important considerations. Metros with more balanced demand-supply characteristics are more likely to translate AI-related economic growth into property rent and value growth. Metros digesting property market excesses are less likely to produce such benefits until balance is restored.

Figure 5 shows relative property market balance for the top 50 metros by population. We offer these metrics to inform investors of the enduring overbuilding in certain apartment and industrial markets. The 10 metros with the highest apartment vacancy rates saw only minor decline in vacancy rates over the year ending in September and a sizable 3.5% of inventory under construction. For industrial, the improvement in vacancy has been more substantial at 1.9%, but 2.9% of inventory is in the construction pipeline.

Figure 5: There is enduring overbuilding in certain apartment and industrial markets

Market balance, top 50 metros

	Vacancy (vac) rate 3Q25	Change in vac rate 3Q25 vs 3Q24	Under- construction as % of inventory
Apartment			
Lowest 10 vac rate	4.6%	-0.3%	2.2%
Middle 30 vac rate	8.5%	0.1%	3.3%
Highest 10 vac rate	12.9%	0.3%	3.5%
Industrial			
Lowest 10 vac rate	4.7%	0.2%	2.3%
Middle 30 vac rate	7.4%	1.1%	1.7%
Highest 10 vac rate	10.9%	1.9%	2.9%
Office			
Lowest 10 vac rate	7.9%	-0.3%	1.0%
Middle 30 vac rate	12.1%	0.4%	0.5%
Highest 10 vac rate	17.9%	0.4%	0.9%
Retail			
Lowest 10 vac rate	3.0%	0.3%	0.8%
Middle 30 vac rate	4.2%	0.2%	0.4%
Highest 10 vac rate	5.7%	0.2%	0.4%

Source: Costar, L&G – Asset Management, America calculations.

The office sector has a weaker pipeline of new space at 0.9% of inventory, but the ten highest vacancy rates are quite high at 17.9%, with only modest decline in the past year. For these metros, the average office vacancy rate has not been this high in the last 25 years. Finally, the retail sector metrics show the highest degree of balance, with relatively low vacancy rates and sparse construction pipelines.

These sector balance metrics also identify the metros with the most vulnerability to a macroeconomic downturn. Digesting excess supply becomes ever-more prolonged when economic growth plummets.



Closing thoughts

Expectations for US commercial real estate investment performance and opportunity in 2026 are optimistic. The cycle upswing underway in 2025 is viewed as setting the stage for further good times in 2026. But the larger environment is threatening that optimism. In this review, we itemize the dimensions and sources of downside threats. In particular we note that risk to 2026 US macroeconomic growth is concentrated on the downside. If growth does falter, US CRE investors will need to rethink their strategies to stress the more resilient property sectors and metro markets that we identify in this analysis.

Footnotes

1 ULI-PWC, 2026 Emerging Trends in Real Estate,” November 2025.

2 Federal Reserve Bank of Boston, Consumer Policy Perspectives, “Why Has Consumer Spending Remained So Resilient?” April 13, 2025.

3 KPMG, PMG LLP Survey: U.S. Businesses Grapple with Tariff Fallout Six Months In, October 2, 2025.



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Martha Peyton is a Research Consultant to the firm's Real Estate Equity team. In this role, she is responsible for US economic and property market research, which is a foundation for the team's investment strategy.

Between 2018 and mid-2023, Martha was Managing Director of Applied Research for Aegon Real Assets US, primarily responsible for the development and application of research to real asset strategies. Between 1993 and 2016, Martha was Managing Director, Head of Real Estate and Global Real Assets Research for TIAA-Nuveen. While at TIAA, she built and oversaw the research function for the commercial mortgage loan and real estate businesses. This included managing research staff, setting the research agenda, conducting ongoing monitoring and analysis of the investment environment and asset class performance and authoring white papers and research publications.

Martha earned her BA, MA and PhD in Economics from Fordham University. She is a Counselor of Real Estate (CRE) and is a Fellow and past president of the Real Estate Research Institute.



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