May 2025

Update on the Geography of the Apartment and Industrial Investment Cycles

- The US CRE cycle appears to be at bottom according to recent data. As such, it is offering investors the opportunity to acquire attractive properties at favorable pricing.
- Cyclical conditions are different across sectors and metro areas. The focus here is on the apartment and industrial sectors which investors most prefer. Some metros are still digesting excess supply in these sectors, others are more balanced and producing rent growth.
- Selecting metro areas for apartment and industrial property acquisitions requires the assessment of supply-demand balance, new supply pipelines and the strength of demand drivers.
- US economic growth prospects affect demand for both apartments and industrial space. Intensified uncertainty among macroeconomic forecasters is a complication that may prolong the opportunity for attractively priced acquisitions.

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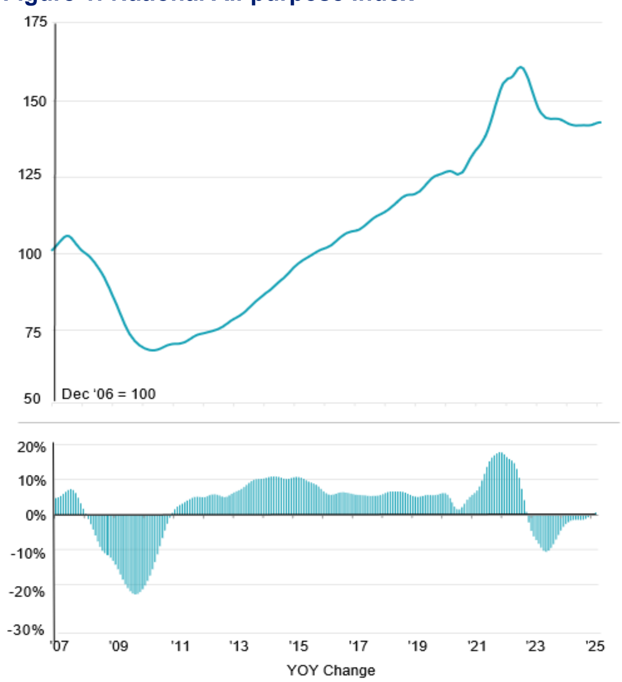
Top line cycle story for US CRE

As 2025 unfolds, US commercial real estate analysts are holding onto the view that the investment cycle is at bottom and offers attractive opportunity to acquire well-priced US properties. Well-discussed metrics supporting this view include the MSCI-RCA Commercial Property Pricing Index which is up 2% from its apparent cycle low in September 2024 (see Figure 1) and the NCREIF National Property Index which resumed positive total returns in Q3 2024 after seven quarters of negatives. The optimism is bolstered by the easing in interest rates initiated by the Federal Reserve in September along with the assumption that the macroeconomy and financial markets will provide solid growth and abundant credit despite Trump-2 volatility.

The cycle turn is welcome after the wild ride of the last few years. In 2020, property values edged down slightly as the COVID pandemic took hold. But the zero interest rates enacted by the Fed to fight the COVID recession were a boon to property investors. In addition, the industrial and apartment sectors benefited from pandemic-related shifts to online shopping and working from home.

Figure 1: National All-purpose Index



Source: MSCI RCA CPPI US Report. Data as of March 31, 2025.

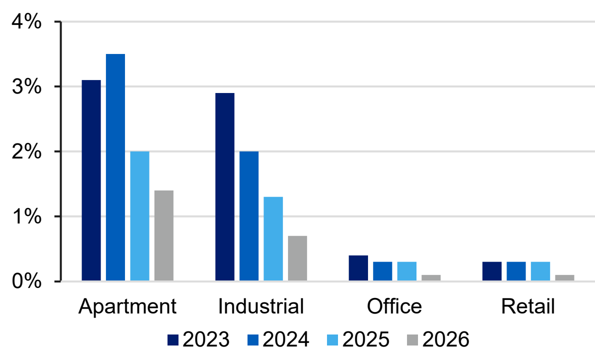
Demand for warehouse space and apartments jumped with the latter helped by a pop in household formation. Property values rose to produce the very visible bump in Figure 1. At the same time, rising demand and historically low interest rates propelled construction, especially in the industrial and apartment sectors.

The music stopped in 2022 as interest rates were tightened to address inflation that had pierced its 2% guideline. With the federal funds rate boosted from essentially zero in mid-2020 to peak at 5.25% in mid-2023, property values plummeted, availability of debt collapsed and commercial mortgage refinancing risk soared. Vacancy rates rose as new supply was delivered and rent growth declined across property sectors as the cycle turned sharply negative. At the same time, rising construction costs slowed the flows of new projects into the property supply pipeline. As the pace of inflation eased back toward its guideline, the Fed began cutting rates in September 2024. By year end 2024, cuts totaled 100 basis points.

Federal Reserve projections released in December 2024 suggested three or four further rate cuts for this year. The expectation of ongoing interest rate easing combined with macroeconomic forecasts calling for solid economic growth in 2025 supported views that US CRE was at a cycle bottom. As mid-year 2025 approaches, positive expectations for US CRE are holding but uncertainty surrounding economic growth is intensifying due largely to unsettled tariff increases on US trading partners.

The macro-economy represents only a portion of the factors that drive "the cycle" and determine investment performance. Fundamental market and property performance are also factors. Currently, analysts are assessing the slowdowns in construction pipelines in the overbuilt apartment and industrial sectors and ongoing minor supply growth in the office and retail sectors as pointing to improving supply-demand balance across sectors.

Figure 2: Inventory changes by sector



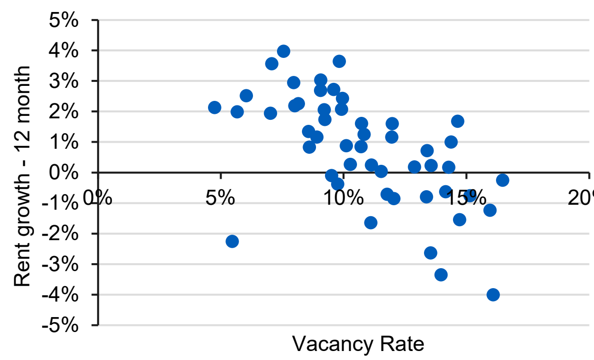
Source: Costar. Data as of March 31, 2025.

While supply growth is clearly slowing in the apartment and industrial sectors that investors most prefer, those metrics do not suggest that all metro markets in those sectors are at similar cycle lows; some are closer to the cyclical bottom than others. We turn next to recent data for the largest US metros which show this diversity of cycle positions.

Cycle geography of apartments varies across metros

Figure 3 shows the position of each of the top fifty metros for vacancy rate and 12-month effective rent growth for high-quality four-and-five-star apartment properties. New apartment supply is concentrated in the four-and-five-star segment where rent levels are high enough to justify construction costs. Supply deliveries in recent years have been difficult to digest in some metros requiring lower rent or other concessions to fill the new stock.

Figure 3: 4- & 5-star apartment vacancy and rent growth (Q1 2025)



Source: Costar. Data as of March 31, 2025.

For metros with supply pressures, cycle bottom occurs when rents stabilize indicating that supply pressure has dissipated. For the twelve metros showing double-digit vacancy rates and downward rent pressure in Q1 2025, a cycle bottom is not yet evident. But some of the twelve are closer to an equilibrium than others. As shown in the top panel of Figure 4 (highlighted in light blue), expected deliveries of new units are abundant through the end of 2025 in many of the twelve metros, but fall off notably in Jacksonville and Dallas. Over the first half of 2026, only Charlotte expects a more than 2.5% net inventory addition. Over the second half of 2026, only Jacksonville is expecting that much new supply. With their current double-digit vacancy, only the metros with sharply shrinking pipelines are likely to reach cycle bottoms in the foreseeable future.

In comparison, the bottom panel of the table (highlighted in grey) shows the twelve metro areas with the lowest four-and-five-star vacancy rates, all under 9%. These are shown to illustrate metros where cycle bottom is clear. All are producing rent growth indicating absence of supply excesses. These metros are also experiencing supply inflows this year; their average 1.7% additions are equal to the average additions in the twelve high vacancy metros. But their markets are absorbing the inflows as shown by ongoing rent growth.

Figure 4: Inventory changes by sector

	Vacancy rate	Expected deliveries as % Q1 25 inventory				Rent growth
Metro	Q1 2025	Q2-4 2025	Q1-2 2026	Q3-4 2026	Q2 2025-Q4 2026	Q1 2025-12mos
Memphis	16.5%	4.9%	0.8%	0.9%	6.7%	-0.3%
Austin	16.1%	3.1%	1.3%	1.7%	6.1%	-4.0%
Jacksonville	16.0%	1.8%	2.5%	3.0%	7.3%	-1.2%
Charlotte	15.2%	6.3%	3.7%	2.4%	12.5%	-0.8%
San Antonio	14.7%	2.4%	0.4%	1.1%	4.0%	-1.5%
Raleigh	14.2%	3.9%	2.0%	1.3%	7.2%	-0.6%
Denver	14.0%	2.6%	1.2%	1.3%	5.0%	-3.4%
Phoenix	13.5%	3.8%	2.1%	1.1%	7.0%	-2.6%
Atlanta	13.4%	2.9%	1.3%	1.4%	5.7%	-0.8%
Dallas	12.1%	2.2%	1.2%	1.6%	5.0%	-0.9%
Orlando	11.8%	4.4%	2.1%	1.7%	8.2%	-0.7%
Las Vegas	11.1%	2.6%	1.5%	0.3%	4.4%	-1.6%
Cleveland	14.7%	3.1%	1.0%	0.1%	4.2%	1.7%
Saint Louis	14.4%	1.4%	1.0%	2.0%	4.4%	1.0%
Nashville	14.3%	5.8%	1.8%	3.2%	10.9%	0.2%
Salt Lake City	13.6%	5.3%	1.5%	1.9%	8.8%	0.2%
Indianapolis	13.4%	2.7%	2.0%	1.4%	6.0%	0.7%
Louisville	12.9%	1.8%	2.5%	0.3%	4.6%	0.2%
Tampa	12.0%	4.6%	2.3%	3.2%	10.1%	1.6%
Philadelphia	12.0%	3.8%	1.4%	1.7%	7.0%	1.2%
Sacramento	11.5%	2.9%	0.8%	0.7%	4.5%	0.0%
Houston	11.1%	1.7%	0.6%	0.9%	3.1%	0.2%
Minneapolis	10.8%	2.7%	0.9%	1.3%	4.9%	1.2%
Richmond	10.7%	4.5%	2.7%	2.5%	9.7%	1.6%
Inland Empire	10.7%	5.6%	1.9%	2.6%	10.1%	0.8%
Portland - OR	10.3%	2.0%	0.6%	0.7%	3.2%	0.3%
No New Jersey	10.1%	5.2%	5.1%	2.9%	13.2%	0.9%
Detroit	10.0%	3.2%	1.6%	0.8%	5.5%	2.4%
East Bay	9.9%	1.3%	0.7%	1.0%	3.0%	2.1%
Kansas City	9.8%	3.1%	4.2%	2.4%	9.7%	3.6%
Ft Lauderdale	9.8%	5.3%	3.6%	1.2%	10.1%	-0.4%
Baltimore	9.6%	1.5%	1.0%	1.0%	3.5%	2.7%
San Diego	9.5%	4.1%	2.4%	2.0%	8.5%	-0.1%
Seattle	9.2%	2.7%	1.5%	1.2%	5.4%	1.7%
Columbus - OH	9.2%	3.0%	1.9%	2.4%	7.3%	2.1%
Wash - DC	9.1%	2.3%	0.8%	0.5%	3.6%	3.0%
Pittsburgh	9.1%	4.5%	0.0%	2.9%	7.4%	2.7%
Honolulu	5.5%	0.0%	0.0%	0.0%	0.0%	-2.3%
Miami	8.9%	5.8%	4.0%	1.5%	11.3%	1.2%
Los Angeles	8.6%	2.6%	1.2%	1.1%	4.9%	0.8%
Cincinnati	8.6%	5.6%	2.4%	2.1%	10.1%	1.3%
Boston	8.2%	1.8%	3.4%	1.5%	6.8%	2.3%
Norfolk	8.0%	1.4%	0.7%	0.6%	2.6%	2.2%
San Jose	8.0%	3.5%	0.6%	0.0%	4.0%	2.9%
San Francisco	7.6%	3.3%	0.8%	2.0%	6.1%	4.0%
Chicago	7.1%	2.3%	1.5%	1.7%	5.5%	3.6%
Long Island	7.0%	2.0%	0.8%	1.6%	4.4%	1.9%
New York	6.0%	3.3%	2.0%	2.1%	7.4%	2.5%
Orange Cty - CA	5.7%	2.8%	2.6%	1.1%	6.5%	2.0%
Providence	4.8%	4.7%	0.0%	0.7%	5.3%	2.1%

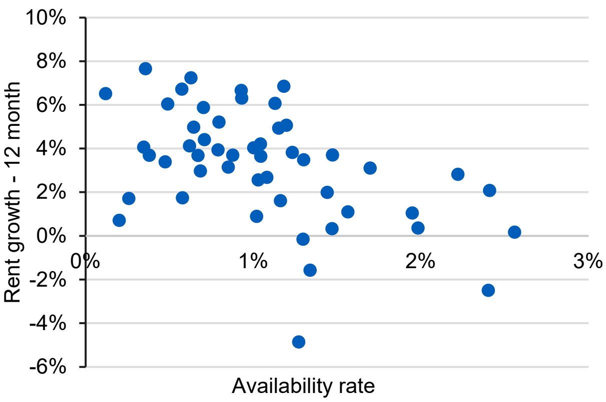
Source: Costar. L&G – Asset Management, America calculations. Data as of March 31, 2025.

The story behind these metrics becomes obvious when looking at the identity of the metros in the two groups. The high vacancy areas are in the “sunbelt” areas that have enjoyed relatively strong population growth in recent years attracted by relatively lower housing costs and job opportunities. They are also locations where construction is easier allowing developers to over-estimate market needs. The lower vacancy rate metros have been growing more slowly or even losing population in recent years. The Silicon Valley metros in California (San Francisco and San Jose) are in this category reflecting population declines in recent years as their high-tech sectors are restructuring. Other metros in this category such as Boston, New York, and Los Angeles have high living costs and tight building constraints. When building is harder, supply is more constrained, and developers are less likely to overshoot.

Industrial is different

For the industrial sector, the slowdown in construction nationally in the context of declining interest rates and strengthening values suggests a similar cycle bottom. However, metro area fundamentals do not reveal a cycle bottom opportunity as starkly as they do for the apartment sector. The key metric for the industrial sector is subleasing which allows tenants with long-lived leases to move to new higher quality space and off-load their lower quality space. The availability of sublease space is solidly correlated with metro rent growth; a coefficient is 0.5 versus a 0.3 correlation coefficient for rent growth and overall industrial space availability.

Figure 4: Industrial sublet availability and rent growth



Source: Costar. Data as of March 31, 2025.

But as shown in the chart, most metros have very low supply of subleased space, generally availability is around 0.5-to-1.0% of inventory or less. The data does show that when sublease availability rises to 1.5%-2.0% of stock, rent growth is weaker.

Austin is an anomaly in that supply has so exploded. Of the 50 top metros, Austin has modest sublease space, but overall availability is 16.9%, the highest among the 50 metros. Rent growth over the last twelve months was -1.6% and the under-construction pipeline is roaring. Los Angeles and adjacent Orange County are also anomalies with modest sublet space, modest overall availability and negative rent growth. Anecdotally, the explanation is perhaps over-leasing in response to the e-commerce surge.

Selecting metro markets for investment

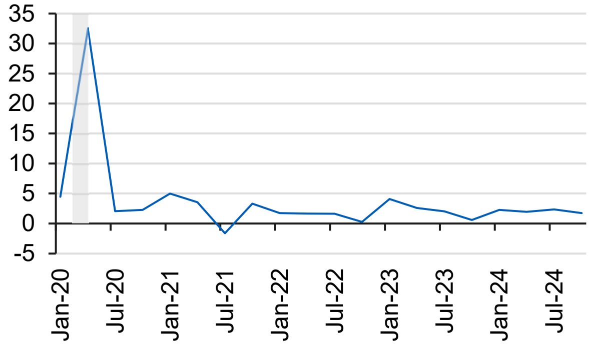
Investors looking for cycle bottom opportunities in the apartment and industrial sectors are well advised to consider metro area data carefully along with the larger context of metro area economic and demographic drivers.

For apartments, metro area targets will depend on the flexibility of investors’ timing. Near-term acquisitions of high-quality properties should perhaps be targeted to metros where that market segment is in rough supply-demand equilibrium. Characteristics would include ongoing moderate rent growth, segment vacancy rates near historical averages and a modest construction pipeline. Metros with growing population in younger, highly educated cohorts will offer the best long-term prospects for investment returns. While such properties will have the benefit of pricing in the current cycle low environment, they are not likely to offer hefty pricing discounts. Investors with a flexible plan for deploying capital might select metros where excess supply is still pressuring rents. In this environment, there might be more negotiating room. But the key will be careful consideration of construction pipelines in the context of current macroeconomic uncertainty. Weaker economic growth prospects in the quarters ahead could slow absorption of excess supply and discourage investors. If so, cycle bottom pricing might prevail longer than otherwise.

For industrial property acquisitions, a focus on metros with a tight supply of sublet space and a manageable construction pipeline would appear to be a reasonable strategy. Metro characteristics driving demand for industrial space are of course important with port adjacent locations and access to population density paramount in the long term.

Historically, performance of industrial property nationally has been highly correlated with GDP growth and with the GDP cycle. Economic growth is synonymous with growth in the flow of goods which pass through industrial space. The COVID years were anomalous in that industrial space demand exploded as the pandemic boosted online shopping (see Figure 5). For the US, net absorption of industrial space more than doubled in 2021 versus 2020 with a somewhat slower but similar pace in 2022 before dropping precipitously in 2023. Rents soared through those years, especially for space in the Los Angeles and the Inland Empire metros. With growth in online sales normalized, expectations for industrial space demand should refocus on economic growth.

Figure 5: Ecommerce retail sales



Source: US Census Bureau via FRED. Data as of December 31, 2024. Shaded area indicates US recession.

In recent months, uncertainty regarding economic growth prospects has intensified as Trump-2 policies are introduced. The most concerning for industrial property is trade policy. Tariffs affect the flow of goods and the path of goods. In the face of intensified uncertainty, some investors will stockpile capital intended for industrial space until federal policies are clarified. Their reticence will diminish competition for purchases. Properties with long-term high-quality leases in place and tight metro supply should remain attractive despite the uncertainty. More aggressive investors might look for pricing opportunities in desirable metros suffering the most threat. Such investors will be betting that uncertainty is now at its peak.

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Martha Peyton is a Research Consultant to L&G – Asset Management, America'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.