



Real Estate Pulse
Q3 2025

A Reaffirmed Cycle Upturn – For Now



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Key takeaways

- Second-quarter US commercial real estate data reaffirmed the cycle upturn, yet support from solid economic growth over the quarters ahead remains in jeopardy amid tariff turmoil and faltering employment growth.
- Expectations for rising asset values in the year ahead improved sharply from the second to third quarter, and second-quarter property transactions were 7% higher in dollar volume versus the year-earlier total, supporting 2025's cycle-bottom designation.
- Momentum in vacancy rates and rent growth across the 50 largest metro areas remained positive in the second quarter. Only the industrial sector showed a notable increase in vacancy rates and weaker rent growth.
- Macroeconomic uncertainty along with historically high and unsettled import tariffs cloud the outlook for both net operating income growth and capital appreciation, but the lag in commercial real estate's response to the macroeconomy may be helpful.
- For investors, the current uncertainty may prolong the opportunity for acquisitions at cycle low pricing but only if the uncertainty is tolerable.

US commercial real estate (CRE) investment performance during the second quarter of 2025 showed no sign of the turmoil accompanying President Trump's policy directives. The data, however, are backward looking, and there could be policy impact ahead.

The CRE benchmark, the NCREIF National Property Index (NPI), posted positive total return for the quarter roughly in line with first-quarter results. The capital appreciation component of the NPI delivered a smaller gain (0.04%) versus the first quarter's revised 0.10%, but it nonetheless affirmed the continuation of the CRE cycle upturn. Positive appreciation resumed in this year's first quarter after ten negative quarters. Total return for the full year ending June was a positive 4.3%.

Performance across the four primary sectors was mixed. Industrial total return declined, reflecting a slightly negative appreciation component following three quarters of positive appreciation, with the industrial sector most vulnerable to tariff risk and weaker economic growth. Office total return slipped a bit as well also with negative appreciation, as structural challenges are slowly worked out. Residential and retail reported positive total return with strengthening positive appreciation.¹

The data incorporated into CRE investment performance metrics are comprised of property appraisals performed during the quarter along with property net operating income (NOI) data for the quarter. Appraisals are inherently backward looking. They incorporate sales prices of comparable assets along with assumptions for property occupancy, rents, expenses and capex for the years ahead as well as financial market assumptions embedded in a discount rate and exit cap rate. The NOI data reported to NCREIF is current for the quarter but is influenced by the leases in place, with some more reflective of current

market conditions than others. Altogether, the construction of the NCREIF-NPI benchmark explains the "lag" between property investment performance readings and current market conditions. The second-quarter NPI results are more reflective of the economy in late 2024 than of current conditions.

Current CRE market conditions are also slower moving than the macroeconomy because it takes time for economic conditions to feed through to CRE decision-making. The macroeconomy ultimately drives the demand for space, the availability and cost of debt to finance new supply, and the buy/sell activity of investors.

Support from solid economic growth now in jeopardy

The current macroeconomic environment is drenched in uncertainty stemming from the impact of Trump Administration policies on economic growth, inflation and interest rates. Imposition of historically high tariffs are especially concerning. Those policies are still in flux. Second-quarter gross domestic product (GDP) growth ticked up to a 3.3% rate, which reversed the first quarter's -0.5%, with both readings distorted by trade. In the first quarter, imports surged amid efforts to get ahead of tariff increases. The second-quarter reversal of this trend contributed to the bounce back in GDP growth. Tariff distortion also affected investment spending, as businesses loaded up on equipment in the first quarter, both to beat tariffs and to feed the AI boom. Consumer spending offers the clearest gauge of the strength of the economy; it showed tepid growth over the entire first half of the year. Inflation remained tame through the second quarter, with the headline CPI up 2.7% for the year ending June.

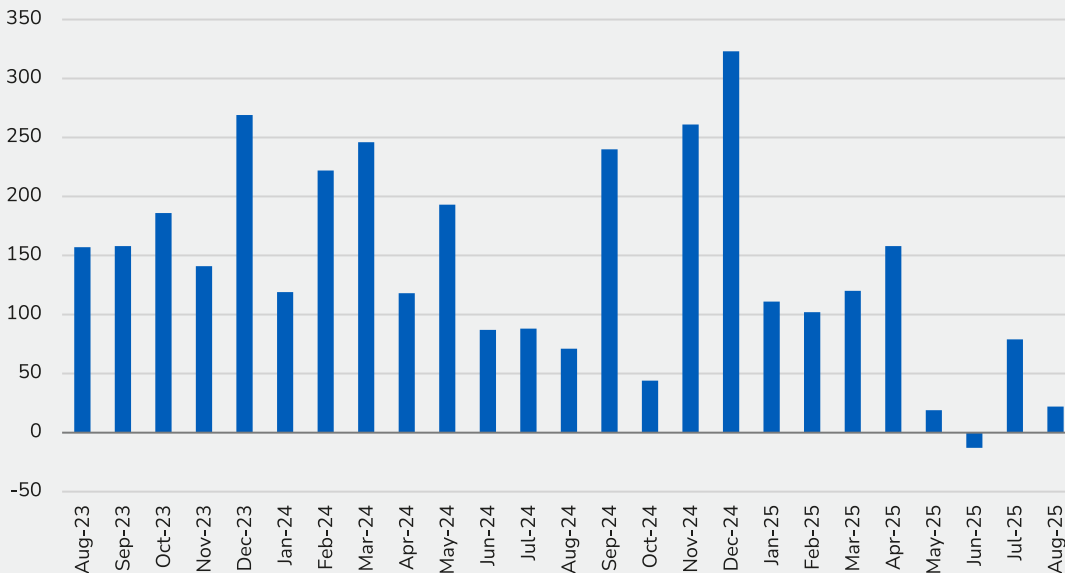
Reflecting both the first half economic environment along with the ongoing heightened uncertainty, the Federal Reserve made no change to its interest rate stance at either its June or July meetings, and then cut its benchmark rate by 25 basis points

at its September meeting. The Fed's own economic projections released in June show a reduction in 2025 median GDP growth expectations to a 1.4%, down from 1.7% in March, accompanied by higher inflation. The Fed's caution raised President Trump's ire, which contributed to further market uncertainty regarding the independence of the Fed from political influence.

Underneath the headline metrics, there are accelerating signs of policy impact. The Fed's Beige Book is a compilation of information gleaned from interviews with local businesses in each of the twelve Fed districts covering their recent experiences. The Beige Book released in July in preparation for the end of July policy meeting reported only two of the twelve districts citing slight or modest increases in business activity since late May, five with flat activity and two with declines. All districts reported "pronounced input cost pressures related to tariffs." The September Beige Book was similarly downbeat, with eight districts reporting flat or weaker growth and four reporting modest growth. All reported "tariff-related price increases" in September. Payroll employment data mirrored the weakness. Following the April announcement of severe tariff increases, payroll employment growth averaged a weak 27,000 new jobs per month from May through August. Over the first four months of the year, additions averaged 123,000 per month. The chart below illustrates the dimensions of the slowdown in job creation.

Figure 1 – Job creation is slowing

Nonfarm payroll employment over-the-month change, seasonally adjusted
August 2023 – August 2025



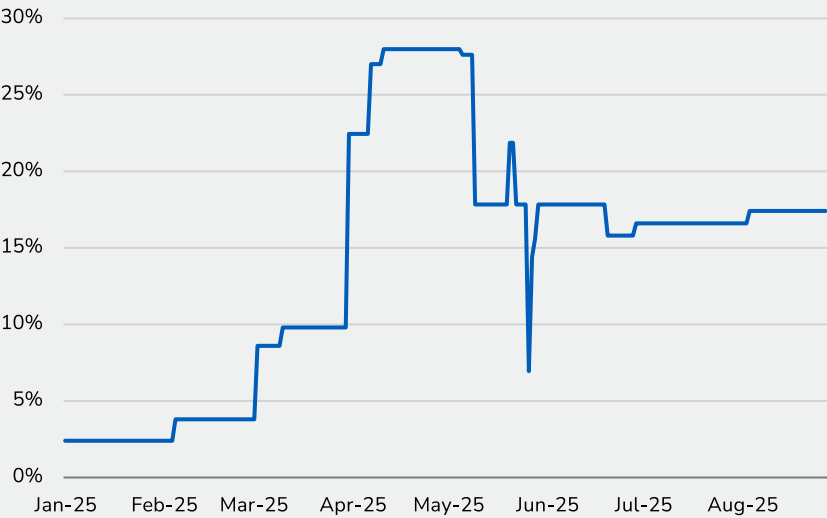
Source: BLS. Data as of September 5, 2025.

As of early September, the average US tariff imposed on imports increased from 2.4% at the beginning of the year to 17.4%. The current level is the highest since 1934; further increases are threatened. Compounding the actual tariff burden is the ongoing uncertainty associated with the day-to-day changes in tariff policies illustrated in Figure 2. The unsettledness makes it difficult for businesses facing investment and staffing commitments.

Reflecting the uncertainty, sentiment among CRE investors has been gyrating, as pessimism in the second quarter gave way to optimism in third quarter. Expectations for rising asset values in the year ahead improved sharply from the second to third quarter, accompanied by perceptions that debt availability had improved, as Figure 3 shows.

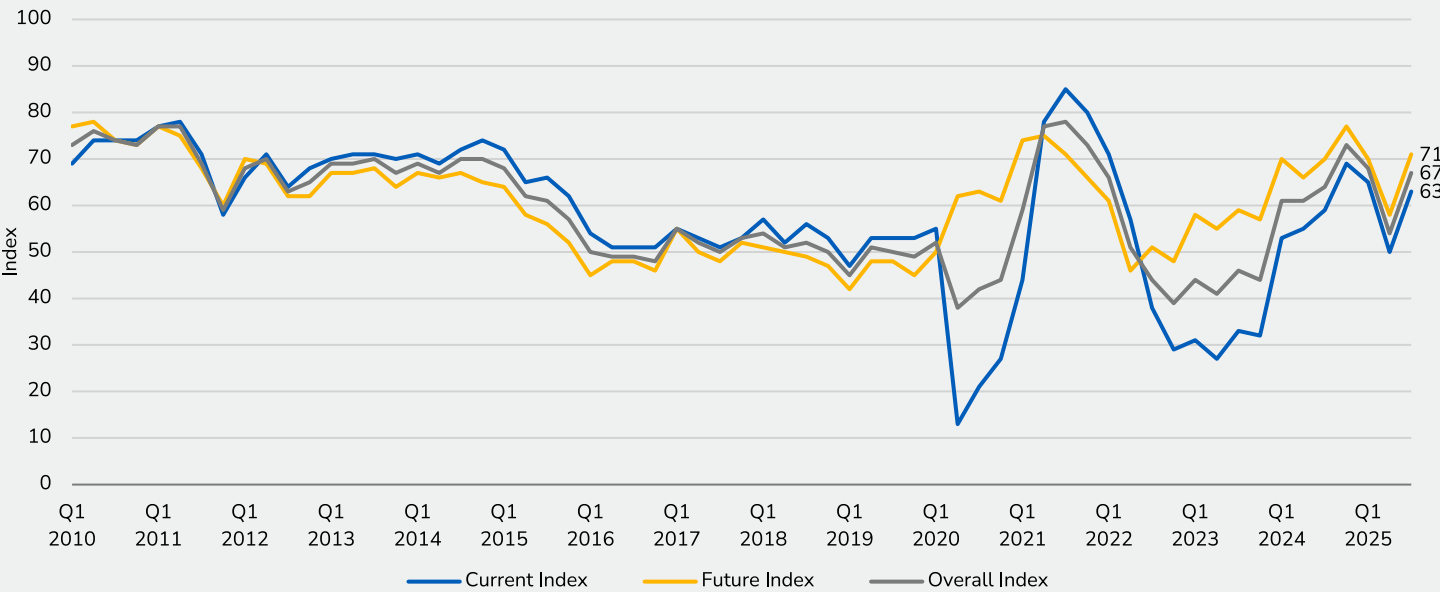
The gyration in the sentiment index is also apparent in property transactions during the second quarter. MSCI/RCA reported an uptick in volume of 7% versus last year, despite an 11% pullback in May transactions. The office sector enjoyed the strongest increase, perhaps indicating that prices have at last become attractive enough to warrant attention. July was not as active, with transactions down 7% from a year ago.

Figure 2 - Tariff policies are constantly changing
U.S. average effective tariff rate since January 1, 2025, baseline (pre-substitution, percent of goods import)



Source: Yale Budget Lab, State of US Tariffs. Data as of September 4, 2025.

Figure 3 - Sentiment among CRE investors has improved recently
The Real Estate Roundtable Sentiment Index (aggregate)



Source: Real Estate Roundtable. Data as of September 5, 2025.

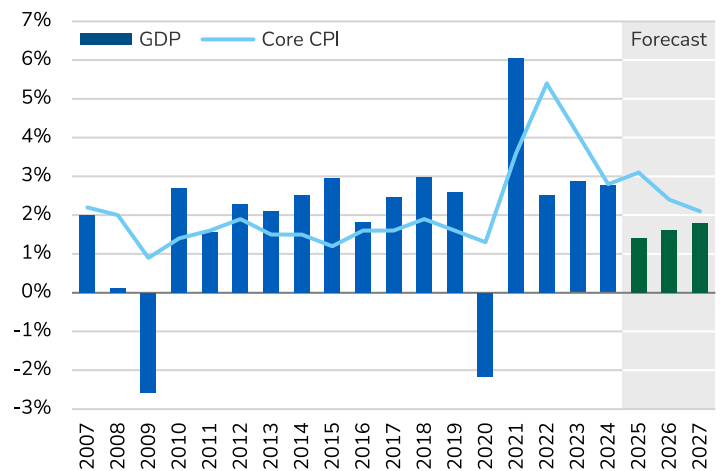
Macroeconomy

Economic forecasters are rethinking their projections for US economic growth over the second half of 2025. Even before the hefty downshift in employment growth, the June Fed economic projections reduced 2025 and 2026 GDP growth expectations to 1.4% and 1.6%, respectively, down from the 1.7% and 1.8% reported in March. The drop reflected the weakness in consumption and investment spending growth revealed in the first half of the year along with the uncertainty associated with tariffs. While a 1.4% real GDP growth rate is not low enough to be defined as “recession,” it is low enough to render the economy fragile and vulnerable to further shocks.

The outlook for inflation was boosted in the Fed’s June projections, with core personal consumption expenditures showing a 3.1% inflation rate in 2025 and a 2.4% rate in 2026. In March, these projections were at 2.8% and 2.2%, respectively. The projections also include a stronger pace of projected inflation accompanied by a higher expected federal funds rate despite weaker economic growth. In other words, the projections reveal that the Fed was expecting to confront “stagflation” in the period ahead that will require tighter monetary policy than otherwise.

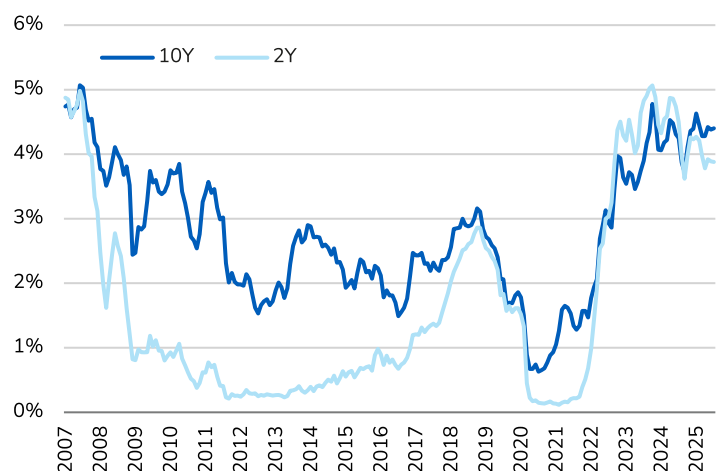
Treasury yields mirror these expectations, as shown in Figure 5. The 10-year Treasury has not slipped below 4% since the beginning of the monetary easing cycle in September 2024.

Figure 4 – US real GDP and core PCE (annual)



Source: Federal Reserve Bank of Philadelphia, Second Quarter 2025 Survey of Professional Forecasters; St. Louis FRED (June 2025).

Figure 5 – US 10-year and 2-year Treasuries (monthly yields)



Source: St. Louis FRED. Data as of May 2025.





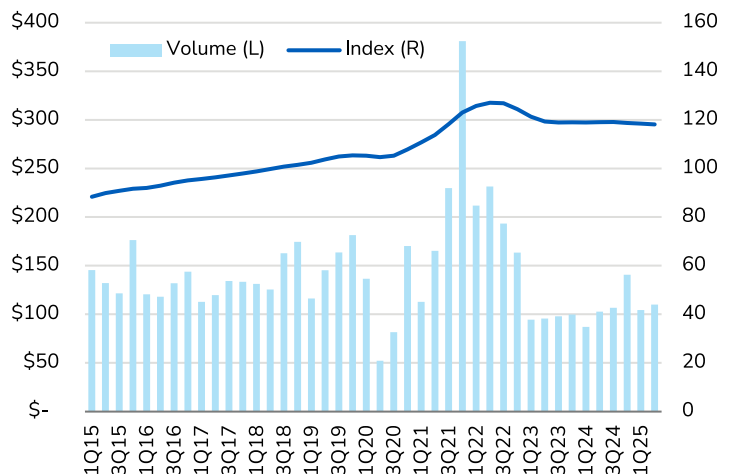
CRE transactions and pricing

Second-quarter property transactions were 7% higher in dollar volume versus the year-earlier total, supporting 2025's cycle-bottom designation. The office sector volume soared 51% as investors took advantage of hefty value declines during prior quarters. Retail followed with a 30% increase in volume.² The more favored industrial and apartment sectors were more subdued, with industrial volume up only 1% and apartment volume down 14%.³ It bears mentioning that there is a significant lag between negotiating a transaction and closing it; accordingly, second-quarter closings reported in this data were probably negotiated before investor sentiment deteriorated.

Property pricing changed little in the second quarter, according to the MSCI-RCA Commercial Property Price Index. The all-property index declined a slight -0.3%, pulled down by a -0.1% decline for office and a -0.2% decline for apartments. Industrial prices increased 0.5% and retail inched up 0.1%. The minor change in pricing accompanied by rising transactions volume reinforces the cycle-bottom designation, suggesting that buyers and sellers were finding enough agreement to make deals in a relatively stable pricing environment. At the same time, the volume of distressed assets dropped in the second quarter after nine consecutive quarterly increases, adding further positive notes.

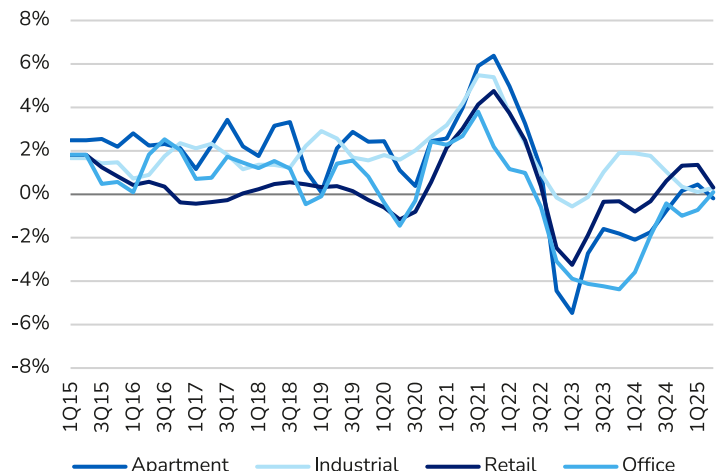
Credit conditions were somewhat less accommodating in the second quarter than earlier in the year. Senior bank loan officers reported somewhat tighter lending standards and weaker demand for CRE credit in their July report. The pace of securitization activity was rocky, with a pull-back in April, a recovery in May and another sag in June before springing back in July with tighter spreads on conduit packages.

Figure 6 – Transaction volume (quarterly, \$b)



Source: Real Capital Analytics. Data as of July 2025. Index = RCA CPPI Core Commercial Index.

Figure 7 – RCA CPPI (% change quarter-over-quarter)



Source: Red Capital Analytics. Data as of July 2025.

Property performance positive through second quarter

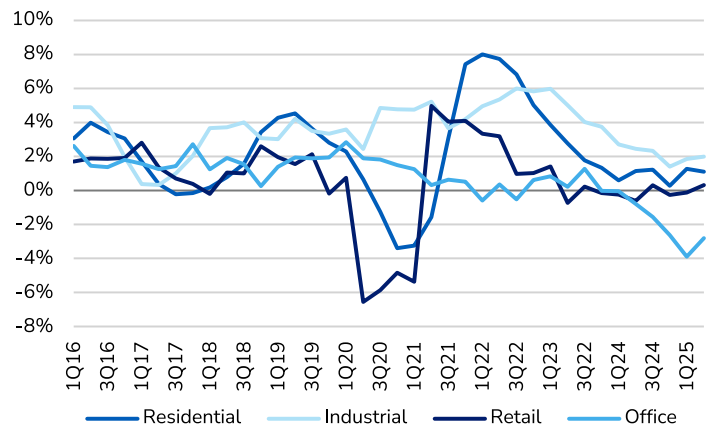
The uptick in NCREIF-NPI one-year total return to 4.3% in the second quarter, from 2.8% in the prior quarter is not the result of material strengthening in property performance. It is rather the effect of arithmetic. By replacing the weak -0.23% total return for the second quarter of 2024 with the stronger 1.23% for the second quarter of 2025, the four-quarter average improved a lot.

Property performance has been strengthening, as shown in net operating income growth, but at an anemic pace. Industrial sector NOI growth has been the strongest, but it is diminishing as the impact from prior rent growth feeding through to turning leases recedes. A more hopeful metric is the turnaround in office sector NOI growth; while still negative, it showed improvement.

The more important driver of total return in recent quarters is the return to positive capital appreciation. As shown in Figure 9, the turnaround to positive capital appreciation occurred in third quarter of 2024, when the Fed began easing interest rates. The office sector still lagged the return to positive appreciation in the second quarter, but it is getting closer to positive territory.

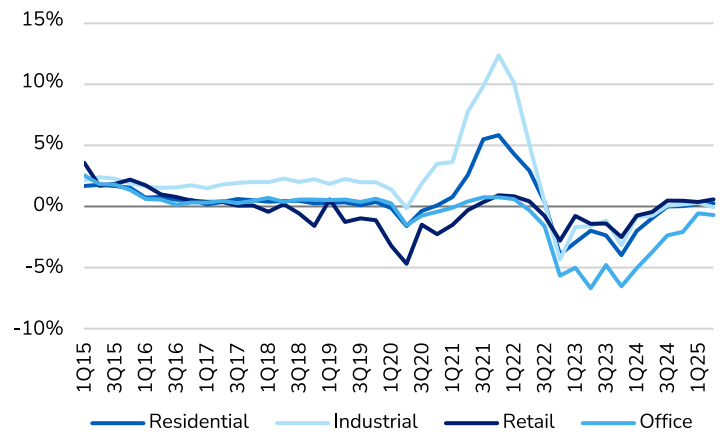
The macroeconomic uncertainty along with historically high and unsettled import tariffs cloud the outlook for both NOI growth and capital appreciation. Weaker economic growth has negative implications for leasing and rent growth, while higher inflation may delay further cuts in interest rates and impair property appreciation. The uncertainty itself can discourage leasing, slow transacting, and keep a lid on property appreciation. But the lag in CRE's response to the macroeconomy may be helpful. The lag reflects the slow-moving nature of commercial real estate decision-making, which protects against erratic day-to-day panic as policy announcements change.

Figure 8 – Expanded NCREIF-NPI growth (rolling four-quarter average)



Source: NCREIF. Data as of April 2025.

Figure 9 – NCREIF-NPI capital return



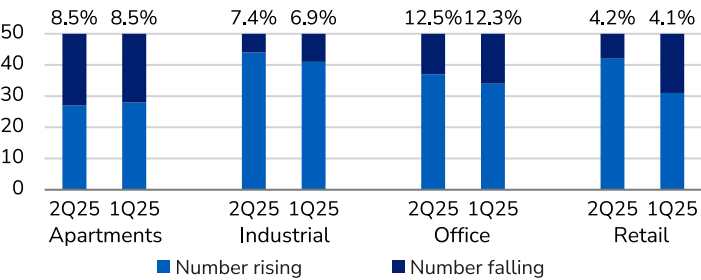
Source: NCREIF. Data as of July 2025.

Metro market vacancy rates and rent growth in line with Q1

Figures 10 and 11 are designed to portray the momentum in the top 50 metro area markets as defined by changes in vacancy rates and rents by property sector. The figures show little change in vacancy rate and rent growth results across the largest 50 metro areas during the second quarter. Average vacancy rates were little changed, except for a jump in the industrial sector to 7.4% from 6.9% in the first quarter and the pervasiveness of rising industrial vacancy across metro markets. The COVID explosion in online shopping propelled both excess leasing and excess construction; both have been dissipating. The pervasiveness of shrinking industrial rent growth across metros is noteworthy, but the average was still a solid 2.6%, down from 3.3% in the first quarter.

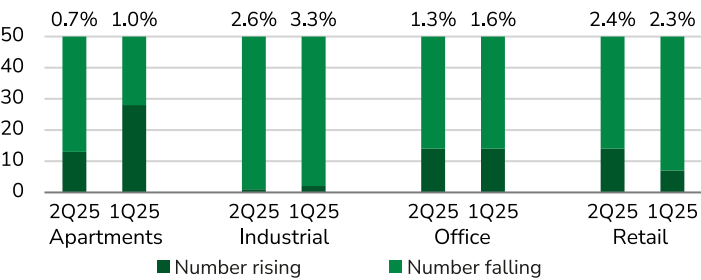
When viewed as a whole, the figures suggest that momentum behind US CRE cycle upturn remained positive in the second quarter but not yet powerful. For investors, the current uncertainty may prolong the opportunity for acquisitions at cycle low pricing but only if the uncertainty is tolerable.

Figure 10: Vacancy rate changes (top 50 metros)



Source: CoStar, Q2 2025 vs. Q1 2025.

Figure 11: YoY rent growth changes (top 50 metros)



Source: CoStar, Q2 2025 vs. Q1 2025.



Footnotes

1. NCREIF.
2. Real Capital Analytics. Data as of July 2025.
3. Real Capital Analytics. Data as of July 2025

Our assessment process

Analysis of real estate investment prospects commonly starts with a review of recent and expected macroeconomic performance. That starting point reflects the importance of the macroeconomy as a driver of the supply and demand forces that determine property investment performance. The macroeconomic environment influences those drivers and propels a national real estate cycle. That cycle is the dominant influence on performance with property sector and local geographic influences following in importance. At the same time, the idiosyncratic characteristics of specific properties and their specific locations combine with the national cycle feeding each property's bottom line. These diverse influences encourage investors to evaluate both the "top-down" macro environment and the "bottom-up" characteristics of each individual investment under consideration.

Economic growth affects property sectors through varying channels. For apartments, demand drivers include employment and income growth that enable maturing young people to form households along with the absolute number of that population cohort. Interest rates are also important as they influence the cost of buying a home versus renting. Stronger economic growth fuels both employment and income growth. Employment and income growth along with population growth also influence prospects for the retail sector. But growth that is too strong can promote inflation leading to rising interest rates which put a lid on growth.

The industrial sector depends on the widest definition of GDP including the international trade sector. Industrial space demand reflects the flow of goods through the domestic economy. Industrial space demand is very responsive to the macroeconomy in part because the sector can build new space quickly when compared with other types of structures. This responsiveness contrasts sharply with office space where construction lags dampen responsiveness to the macroeconomy.

But, at the same time, there are structural forces of various strengths affecting each sector. For apartments, the strongest is the ongoing shortfall in the supply of housing due to weak construction following the 2008 recession. For industrial, the adjustment to more online shopping and demand for faster delivery is an ongoing tailwind. For office, work-from-home appetite is still uncertain and space obsolescence is a mounting concern. Finally, the retail sector is enjoying a tailwind from disparate population growth contributing demand for space in growing localities while the headwind of excess space in declining areas and shrinking venues is ongoing.



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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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