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Real Estate Pulse
Q4 2025

Signals of Ongoing Cycle Upturn – and Uncertainty

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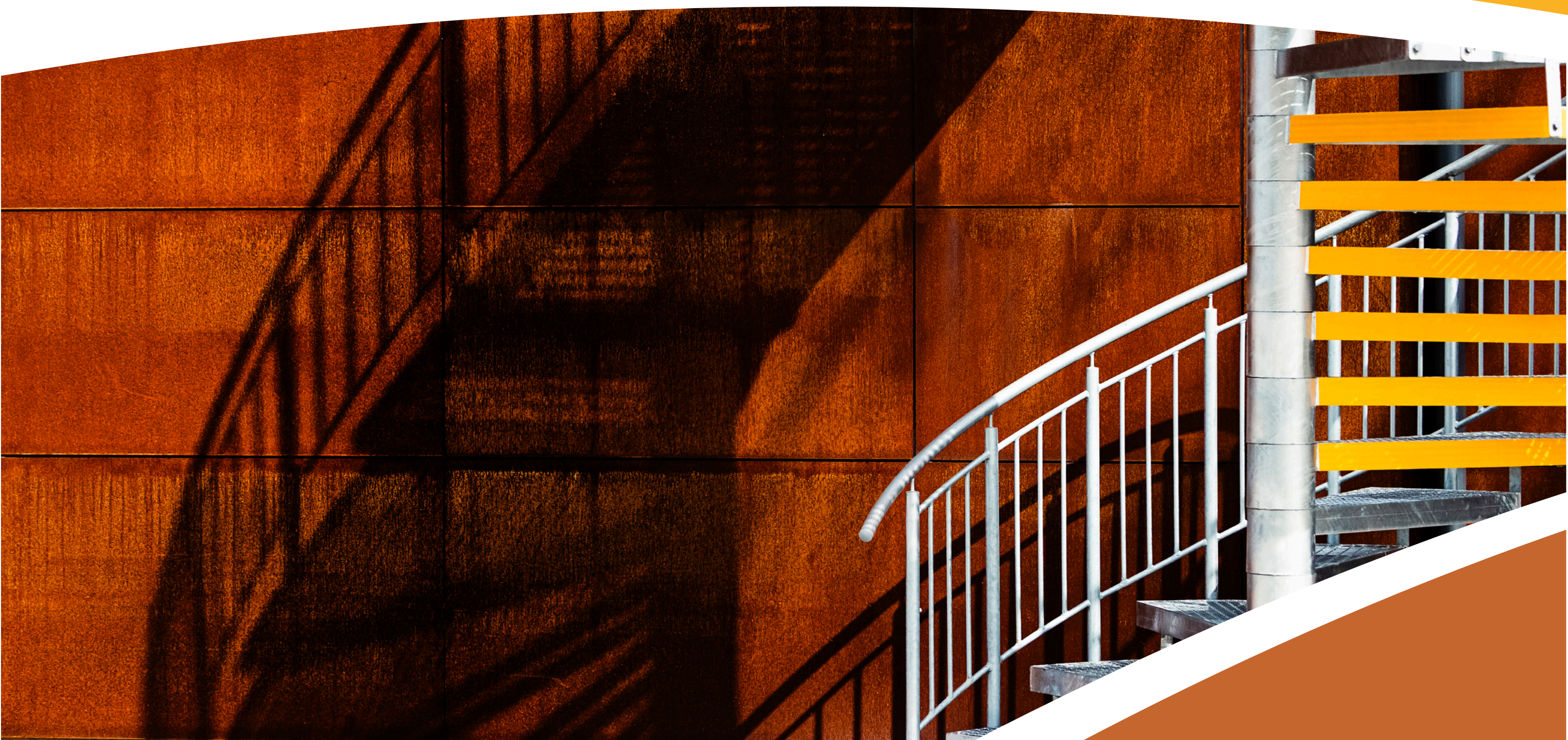


Key takeaways

- US commercial real estate (CRE) investment performance maintained a positive trajectory in the third quarter of 2025, with capital appreciation returning to positive territory—the clearest indicator of the cycle upturn.
- The retail and residential sectors outperformed industrial and office. Transactions momentum was tepid overall but strengthened for office and retail properties.
- Economic growth remains positive but weaker than last year. Third-quarter CRE metrics do not reflect the full impact of the macroeconomic weakening, given the usual CRE lag.
- Lower interest rates, moderating construction and continuing AI investment activity bode well for CRE, though heightened uncertainty surrounds the impact of federal policies and the concentrated dependence of growth on AI.
- We are seeing the beginnings of improvement in the office sector, which has been the most troubled in recent years. Beyond office, the metro pattern of CRE fundamentals did not change notably in the third quarter.

The cyclical upswing in US commercial real estate (CRE) investment performance continued through the third quarter of 2025, with NCREIF-Expanded Index metrics confirming a well-established cyclical upswing.

The CRE benchmark, the NCREIF National Property Index (NPI), posted total return matching second-quarter performance, pushing the four-quarter total return to 4.7%. Capital appreciation strengthened in the third quarter, bringing the four-quarter capital performance to essentially flat for the first time since the fourth quarter of 2022.

The activity of tenants and investors influenced sector performances, with retail and residential sectors outperforming industrial and office. Retail reported the strongest four-quarter total return but with some slippage in the third quarter's capital appreciation. The residential sector, which includes apartments, reported the strongest third-quarter results among the four primary sectors, but it still lags retail on a four-quarter basis. Retail returns have been supported by constrained new supply, as the sector has grappled with space made obsolete by e-commerce and historical overbuilding. Residential is now recovering from overbuilding in response to COVID distortions.

The industrial sector was also disrupted by overbuilding in response to COVID distortions, but its investment performance has not recovered as much. Office was the weakest third-quarter performer. COVID work-from-home policies are winding down, but many employers are settling into a less than full workweek in the office. At the same time, office leasing is migrating to high-quality new space and leaving behind older less desirable space. Artificial intelligence (AI) is on the horizon as well and foreshadowing further disruption in office employment.

Softer leasing and tepid transactions momentum

We believe that investment performance of each sector in the quarters ahead will be influenced by the momentum of tenant and investor appetites now in play. Leasing momentum slowed in the third quarter for apartment and industrial sectors while increasing modestly for retail and soaring for office. As described in Figure 1, net leasing of office space returned to positive territory in the third quarter versus its year ago decline, establishing a strong tailwind. In contrast, industrial leasing was down sharply. More moderate activity was noted in retail leasing, which rose modestly, and apartment uptake, which slipped modestly.

Figure 1 – Leasing momentum soared for office in Q3
Sector momentum - top 50 metros - net absorption

Apartment	3Q2025 # units 88,343	3Q2024 # units 104,877	Change YoY -16%
Industrial	3Q2025 sq. ft. 19,431,458	3Q2024 sq. ft. 38,978,325	Change YoY -50%
Office	3Q2025 sq. ft. 14,838,838	3Q2024 sq. ft. -3,374,378	Change YoY >100%
Retail	3Q2025 sq. ft. 3,560,280	3Q2024 sq. ft. 3,254,635	Change YoY 9%

Source: CoStar, Q3 2025 vs. Q3 2024.

Transactions activity for all property sectors edged up in the third quarter, with welcome strengthening in office and retail. Apartment and industrial had been investor favorites, implying room for diversification to office and retail. Improvements in office leasing might have provided encouragement to do so. On balance, third-quarter activity demonstrates tepid momentum despite interest rate cuts.

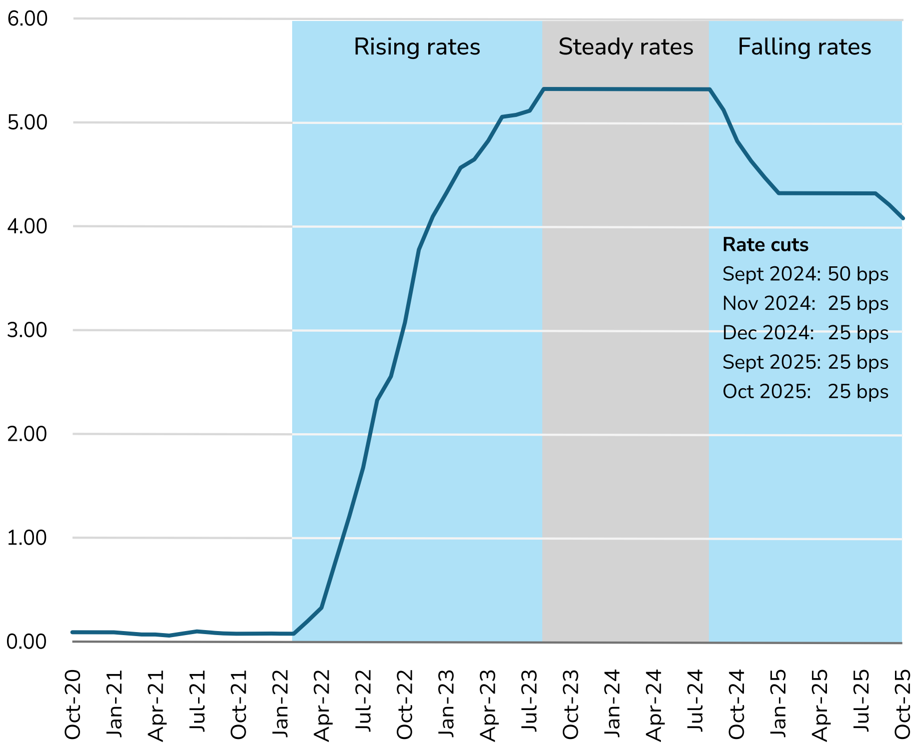
Weaker growth and heightened uncertainty may be catching up to CRE

CRE performance is propelled by the macroeconomy but with a lag. The lag implies that the third quarter's NCREIF metrics may not reflect the full impact of the macroeconomic weakening underway in 2025. Gross domestic product (GDP) data for the third quarter has not yet been released due to the government shutdown. But analysts estimate that it is in line with projections for full-year growth below 2%, as reflected in Federal Reserve projections. Moreover, the composition of growth is concerning.

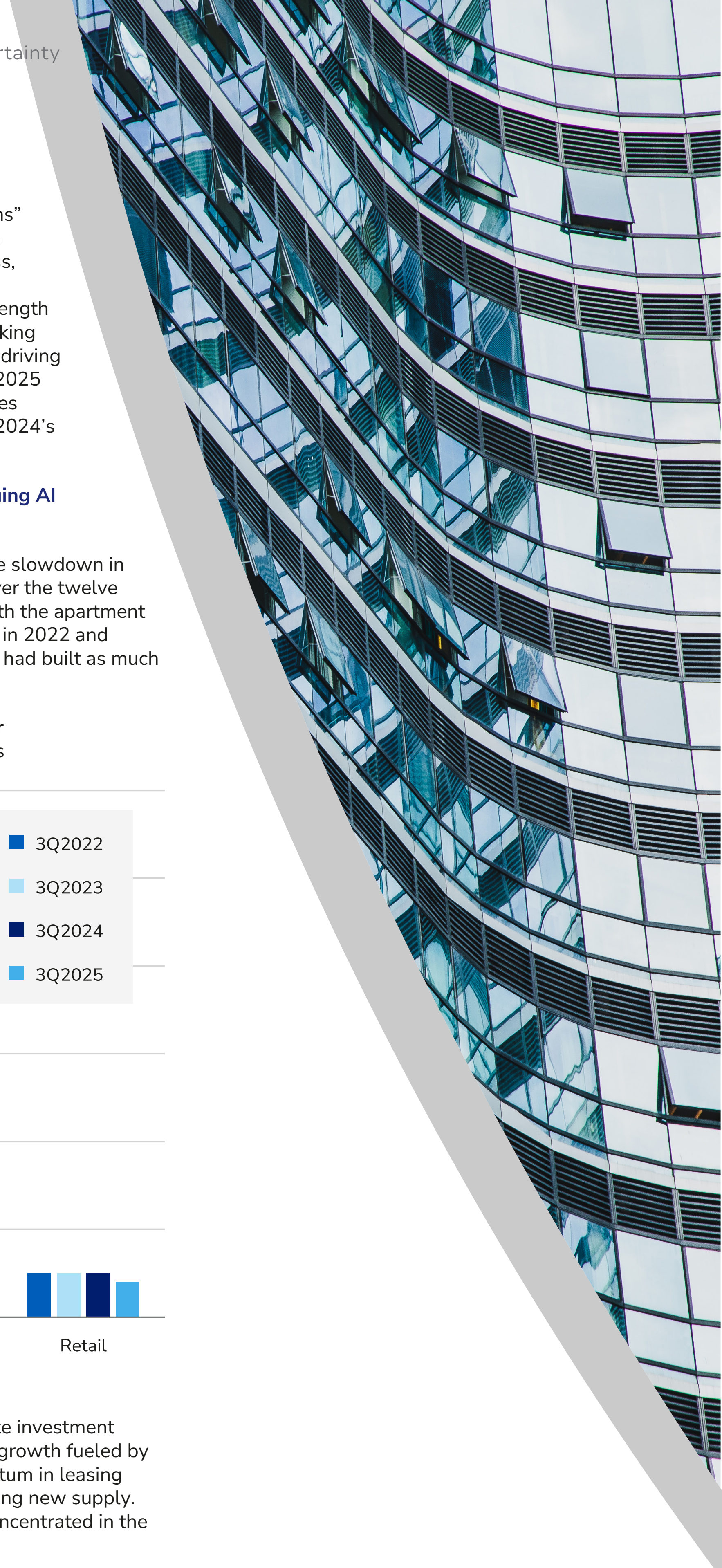
Consumer spending continued to grow through August, but growth appears to be concentrated among top-income households who commonly benefit from stock market gains. The more important driver of 2025 GDP growth is the investment sector, which captures the enormous surge in development of AI software, hardware and data centers. These activities are concentrated among a handful of top tech companies that are driving the stock market in a surge that some are calling a "bubble." Without this activity, economic growth would be much compromised and the stock market less frothy. At the same time, the spike in tariffs on imports and the volatility in tariff policies are weighing on economic decision making and pushing against AI euphoria.

Other data sources corroborate the weakening in growth. The Fed's Beige Book collects information from the twelve Fed districts on changing economic conditions leading up to each policy meeting. The October Beige Book reported that three districts had experienced slight growth, five were flat and four were down. At the same time, inflation has remained somewhat elevated but palatable, even with evidence of tariff-related price increases. Reflecting the weaker growth environment and acceptable inflation, the Fed eased by 25 basis points (bps) in both September and October, following its 100 bps of cuts in 2024. A further cut in December is expected but not guaranteed.

Figure 2 - The Fed has been lowering interest rates amid weakening growth
Federal funds effective rate



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

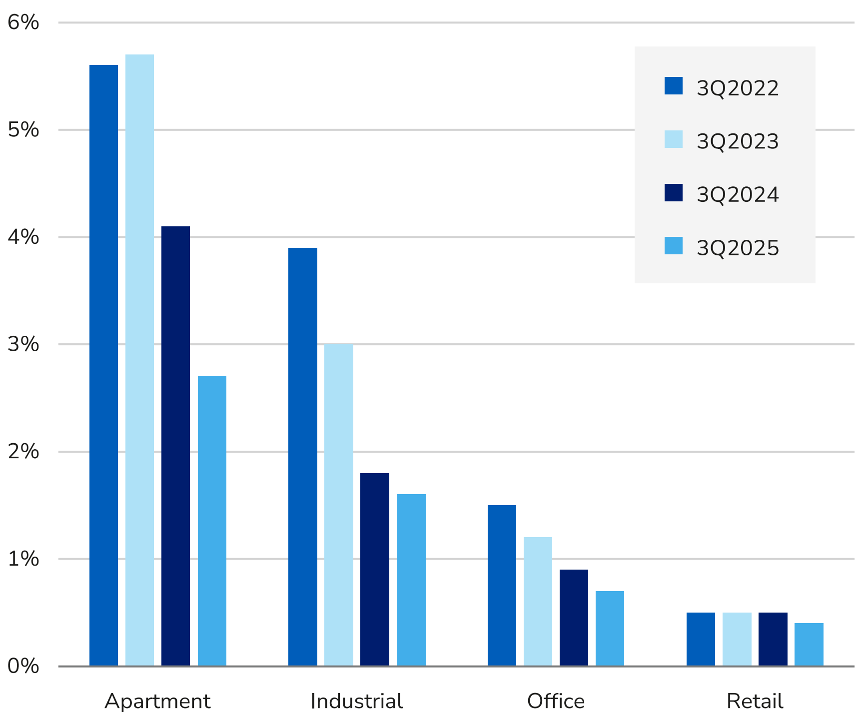


Despite the weaker growth environment, CRE top executives were more optimistic in the third-quarter Real Estate Roundtable survey than in the prior quarter. Such optimism reflects perceptions that “general market conditions” are improved from a year ago rather than an explicit view on the economic drivers of real estate performance. Nonetheless, with AI and data centers playing such a big role in economic growth, optimism for CRE is implicitly assuming ongoing strength in these activities. It may be well-founded. Green Street tracking of the major tech companies, called “hyperscalers,” who are driving the AI boom, shows increasing flows of capital spending in 2025 and plans for even more in 2026. For real estate, that includes continuing additions of new data centers, albeit fewer than 2024’s record deliveries.

Lower interest rates, moderating construction and continuing AI investment activity bode well

Lower interest rates are a source of optimism, along with the slowdown in construction activity show in Figure 3. Construction starts over the twelve months ending in the third quarter were sharply lower in both the apartment and industrial sectors versus the heady pace of construction in 2022 and 2023. Office and retail starts were down as well but neither had built as much excess.

Figure 3 - Construction activity slowed in the third quarter
Construction starts as % of inventory - 12 months



Source: CoStar.

Altogether, the cyclical upswing in US commercial real estate investment performance has benefited from ongoing positive economic growth fueled by AI investment and data center construction, positive momentum in leasing and property transactions, lower interest rates and moderating new supply. But uncertainty has mushroomed, as AI related growth is concentrated in the activities of a handful of major tech companies.

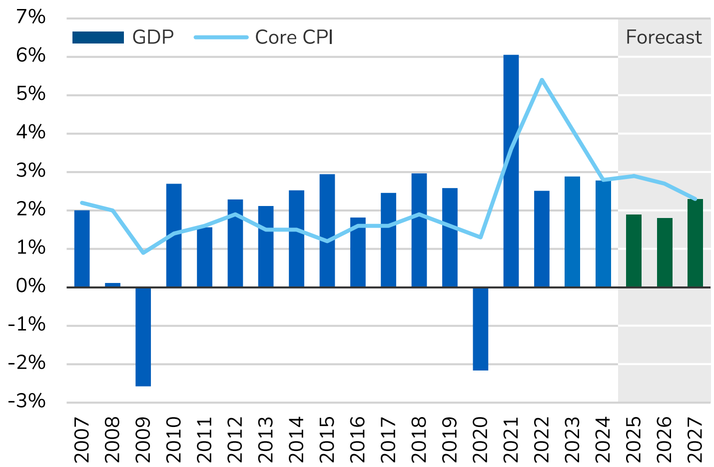
Macroeconomy

The path of economic growth in the quarters ahead will contribute materially to the investment performance of CRE but, of course, with a lag. During the US government shutdown, forecasters relied on non-government sources of information, including the ADP report on private sector payrolls. That report showed a small gain of 42,000 jobs in October following declines in August and September. For the first ten months of 2025, ADP data reported an average monthly increase of 59,700 jobs versus a 144,333 average monthly increase in 2024. Starker evidence of a weakening job market was the 22-year high in layoffs during October announced by the outplacement firm Challenger, Gray & Christmas. That report also cited the lowest level of planned hirings since 2011.

The slower pace of job creation supports the outlook reported in the Philadelphia Fed's Fourth Quarter 2025 Survey of Professional Forecasters (shown in Figure 4). The median of the 33 forecasts covered in the Survey pegs 2025 real GDP growth at 1.9%, down from 2024's 2.8% actual. For 2026, the median forecast is 1.8%. Inflation is expected to remain elevated, with the core personal consumption expenditures index (excluding volatile food and energy prices) rising 2.9% over the four quarters of 2025 and 2.7% in 2026. In 2027, an improvement to 2.3% is expected but that is still above the 2% target.

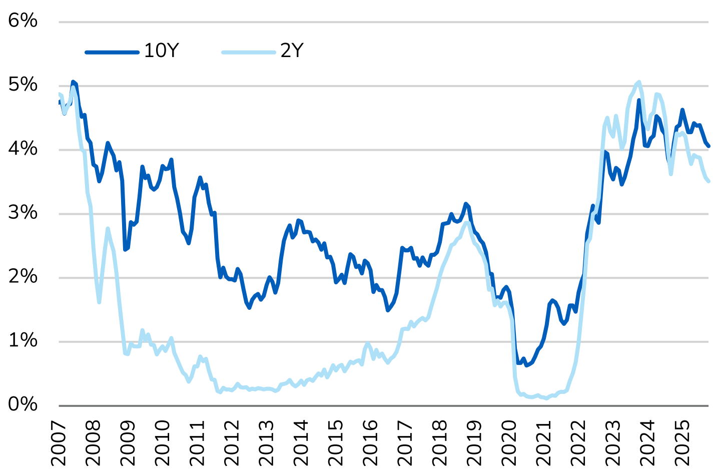
Weaker growth expectations and the September and October rate cuts helped to push the 10-year Treasury yield below 4% but only briefly. The 10-year yield is down from its 4.79% high in January. This is a plus for CRE investors, but the yield is still elevated in relation to the weak current growth environment. This is a reminder that financial markets remain concerned with inflation prospects and with the potentially inflationary impact of tariff policies. At the same time, tariff policies remain volatile and under judicial review.

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



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

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

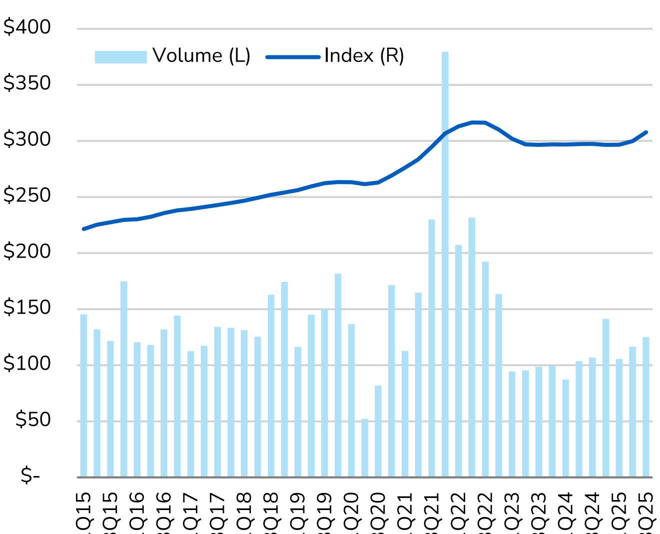


Source: St. Louis FRED. Data as of October 2025.

CRE transactions total up along with property prices

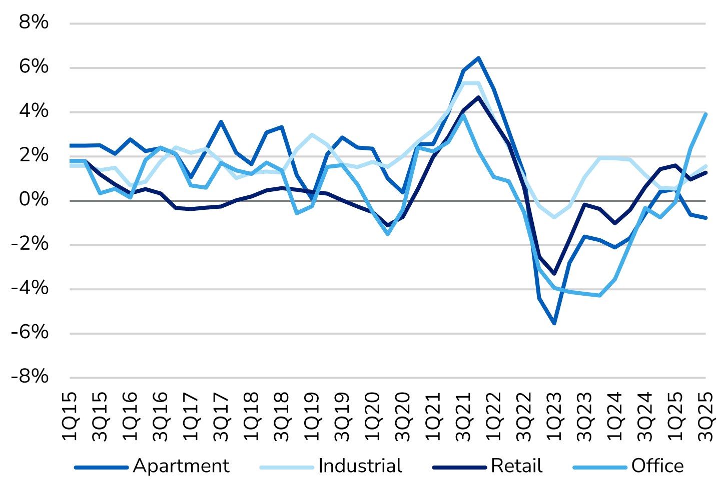
All-property transactions were up in the third quarter versus a year ago, but the strength of the increase varied across sectors. As shown in Figure 6, transactions volume popped in the fourth quarter of 2024 after the September 2024 interest rate cut and then receded, remaining below that pace for all three quarters of 2025. Yet the improvement quarter-to-quarter is indicative of the cautious optimism of CRE investors.

Figure 6 – Transaction volume (quarterly, $b)



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

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



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

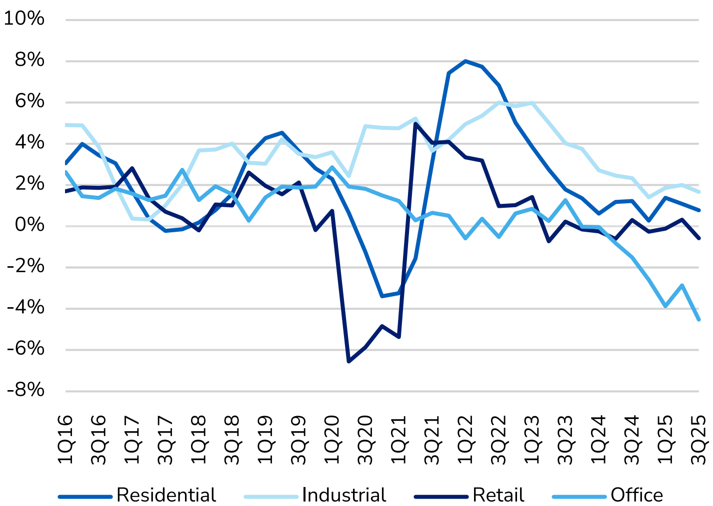
That optimism is boosting property prices from cycle lows, as shown in Figure 7. Among the three primary sectors, only apartment prices slipped into negative territory in the third quarter. The office sector showed the strongest price increase for the quarter, indicating some improvement in sentiment regarding office property prospects. Green Street's price estimates have shown stronger recovery due to methodological differences. Its October reading showed a 3% overall price increase over the past year. Even with that increase, property prices remain 19% below the 2022 peak, with office separately 36% below its peak.

Cycle upturn evident in property NOI and capital return

The four-quarter growth in net operating income (NOI) shown in Figure 8 refers to the properties in the NCREIF-expanded index. For the four quarters ending in September, industrial and residential (including apartments) properties reported the strongest NOI growth, while office properties reported declines and retail bounced around flat NOI.

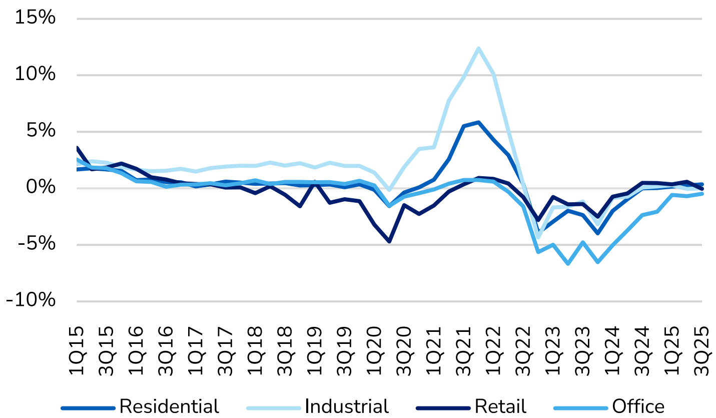
NOI growth is the metric that best describes the fundamental performance of property. It reflects the rollover of leases and re-leasing to current market rents, which are influenced by availability of supply and the strength of demand. Office properties have relatively long leases that take time to catch up to market rents, which have been dropping. For industrial properties, long-lived leases are turning to the higher market rents generated by the COVID disruptions; this is bolstering NOI growth even with overbuilding in some metros. Apartment leases are short term with little to no timing distortion; apartment NOI responds quickly to market conditions.

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



Source: NCREIF. Data as of October 2025.

Figure 9 – NCREIF-Expanded NPI capital return



Source: NCREIF. Data as of October 2025.

NOI growth is one of the drivers of the capital value component of NCREIF total return. On top of NOI growth, capital appreciation is determined by the cap rate pricing of property cash flows, which is, in turn, influenced by (but not determined by) interest rates. Cap rates reflect investor appetite for the risk embedded in property ownership. Capital appreciation returning to positive territory is the clearest indicator of the US CRE cycle upturn. The improvement is evident across all four property sectors.

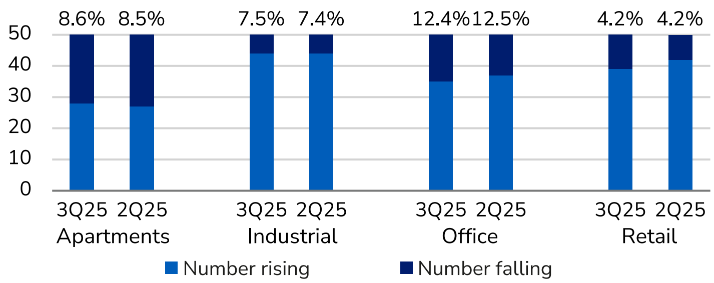
Stable vacancy rates and downside rent pressures prevail

Figures 10 and 11 are designed to show the strength and pervasiveness of fundamental supply-demand metrics for the top 50 metro areas. The bars show the numbers of metro with “rising” and “falling” readings for each metric compared to the prior quarter. For each metric, the 50-metro average is shown at the top of each column.

Note first that the 50-metro averages did not change materially for any of the sector vacancy or rent metrics. Minor changes are apparent, however, in the numbers of metros showing rising or falling measures. In addition, note the smaller number of metros with rising office and retail vacancy rates compared to the increasing number of metros with rising apartment vacancy rates and a stable number for industrial. It is also worth pointing out that rent increases are somewhat more pervasive in the third quarter, except for in retail.

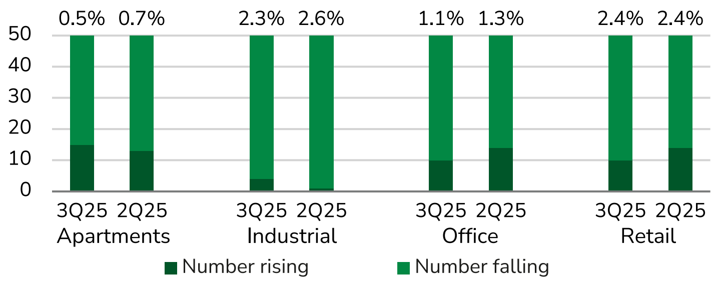
The metrics show the beginnings of improvement in the office sector, which has been the most troubled in recent years. That improvement is also apparent in the leasing data, transactions and pricing data discussed above. Beyond office, the metro pattern of CRE fundamentals did not change notably in the third quarter.

Figure 10: Vacancy rate changes (top 50 metros)



Source: CoStar, Q3 2025 vs. Q2 2025.

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



Source: CoStar, Q3 2025 vs. Q2 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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