2025 Commercial Real Estate Mid-Year Review

– Phil McAlister, Head of Research

As we reach the midpoint of 2025, our outlook for the commercial real estate market remains consistent – that 2025 will likely present compelling opportunities across various commercial real estate sectors.

Moderating interest rates, waning inflation, and slow economic growth points to an overall sluggish near-term economic environment as highlighted in our ***2025 Commercial Real Estate Outlook: Capitalizing on a Generational Opportunity.*** Despite these lackluster conditions, commercial real estate has the potential to perform well. Given the recent reversal of valuation drawdowns, changing demographic trends, and strong sector-specific fundamentals, the stage remains set for what could be a standout year in commercial real estate.

Key Takeaways

- Macroeconomic activity has performed as expected given our outlook for slow growth and low inflation due to aging demographics and increased levels of debt.
- Real GDP declined at an annual rate of 0.5%[1] in the first quarter, driven by massive imports as businesses rushed to beat potential new tariff restrictions.
- Inflation continues to decelerate overall, with June 2025 CPI growth of 2.7%, which may be artificially high due to the shelter component, and which was slightly higher than May's reading due to tariff and geopolitical pressures.
- The commercial real estate market recovery has continued, with three consecutive positive quarters in the NCREIF ODCE Index.
- Transaction volumes are up year-over-year, suggesting a pick-up in market activity.
- Slow construction starts, affordability concerns, and migration patterns remain key trends to watch across the industry.

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Macroeconomic Conditions

Gross Domestic Product, Employment & Productivity

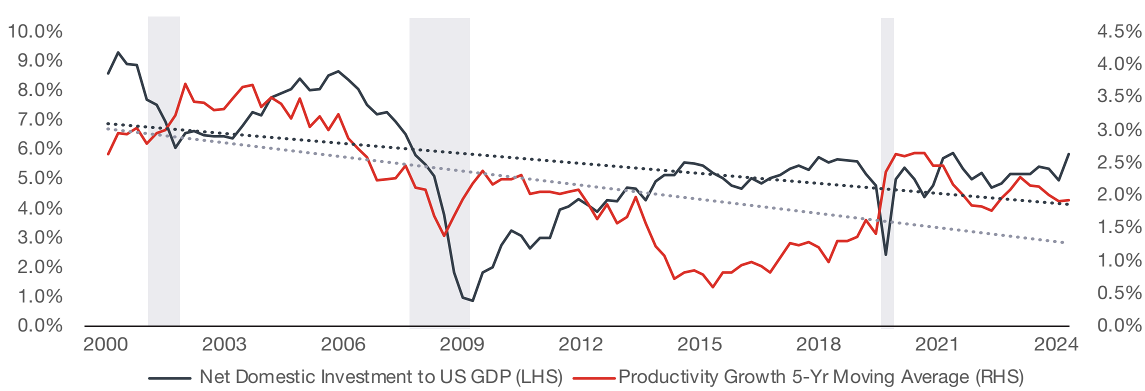
Our outlook for real gross domestic product (GDP) growth remains tepid, as both employment and productivity growth continue to face challenges. The country's low birth rate and aging population suggest that even with a very low unemployment rate going forward, employment growth may only contribute approximately 0.3 percent to GDP, compared to the 0.8 percent contribution from 2000 to 2019.[1] If we model a sensitivity analysis on the labor market using the Bureau of Labor Statistics estimate of a labor force of 173,300[3] by 2033, the current labor force of 170,510[4], and the current employment level of 163,366[5], we can apply a range of unemployment rates and compute their varying contributions to GDP. With an unemployment rate of five percent, the employment contribution is only 0.1 percent annually.

Employment Scenario Analysis[6]

	2033 Unemployment Rate	2033 Employment Level	Employment Contribution to Real GDP (CAGR)
Scenario 1	3.0%	168,101	0.3%
Scenario 2	5.0%	164,635	0.1%
Scenario 3	7.0%	161,169	-0.2%

This declining growth trend is also manifesting in productivity growth as it continues to experience a gradual decline. Typically, productivity falls in aging nations with large debt loads, particularly when debt-to-GDP reaches somewhere between 75 to 100 percent.[7] As of Q1 2025, the U.S. debt-to-GDP ratio stood at 121 percent.[8] Amplifying the issue is falling domestic investment (a key driver of productivity growth). Workers need access to better equipment, facilities, and technology to boost output. Notably, some research suggests that U.S. domestic investment and productivity growth exhibit a near 50 percent correlation, and have been trending down in tandem.

Net Domestic Investment to U.S. GDP & Productivity Growth[9]



Assuming productivity continues its downward trend, it's reasonable to infer that a likely range for approximate real GDP growth remains at 0.75 to 2.25 percent annually, with a midpoint of 1.50 percent.

Factors Potentially Boosting Productivity
Should these factors come to pass, we expect GDP growth to outpace our estimates over the long term.

1) A boom in domestic investment (as seen in the first quarter of 2025[11]) due to businesses bringing production capacity within U.S. borders.

2) Developments in artificial intelligence that may allow workers to do more with less time.

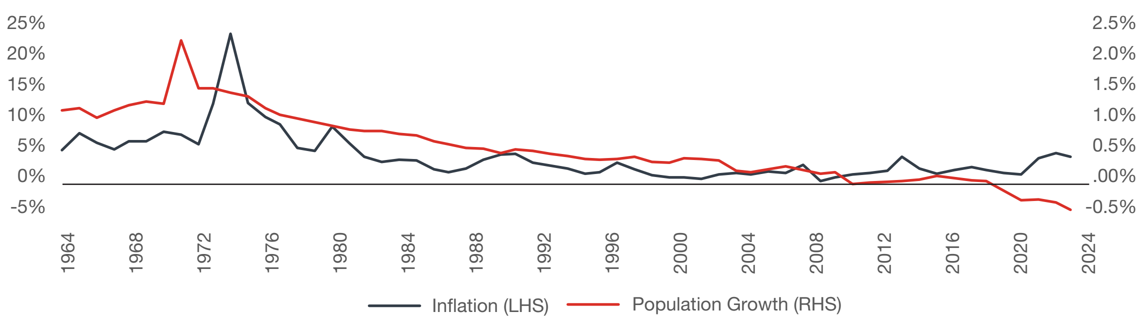
Near-Term Recession Risk

Increasing initial jobless claims, a lengthy inversion of the yield curve that is now re-steepening, and leading economic indicators nearing their recession threshold are compounding with first quarter GDP decline[10] and increased uncertainty around tariff and trade policies. These factors indicate a heightened risk of recession as we enter the second half of 2025, but it is by no means a foregone conclusion. The consumer has remained resilient, incomes continue to rise, and domestic investment saw a significant spike in the first quarter of 2025.[11]

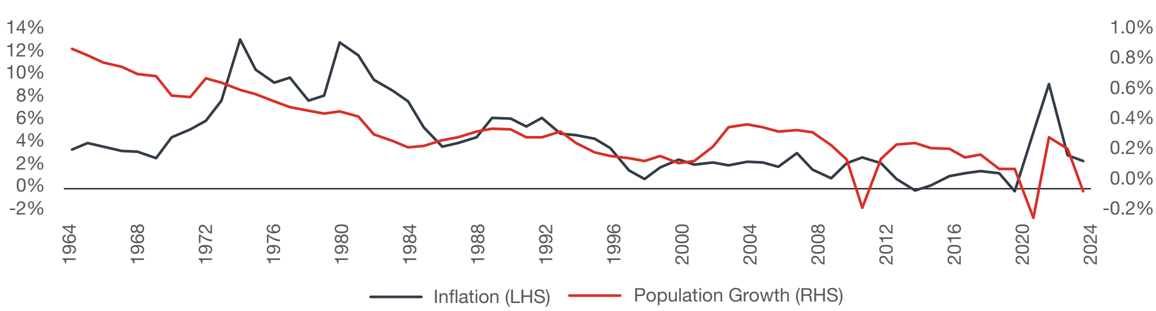
Inflation and Interest Rates

The trend toward disinflation continues as aging demographics and increasing debt loads outweigh inflationary impulses. It is typical of aging economies with low birth rates to exhibit weak consumption relative to productive capacity, along with a reduced propensity for private individuals to borrow and spend aggressively. Japan and Europe remain key examples of countries that have experienced severe government deficits with aggressive central banks yet generated very low inflation outside of the transitory spike due to the pandemic-related stimulus programs and supply chain disruptions.

Japan's Population Growth & Inflation[12]

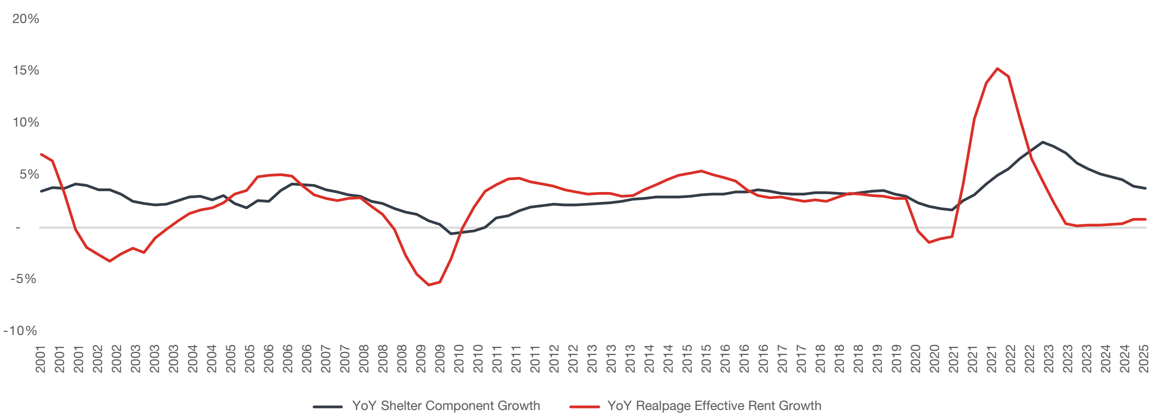


European Union's Population Growth & Inflation[13]



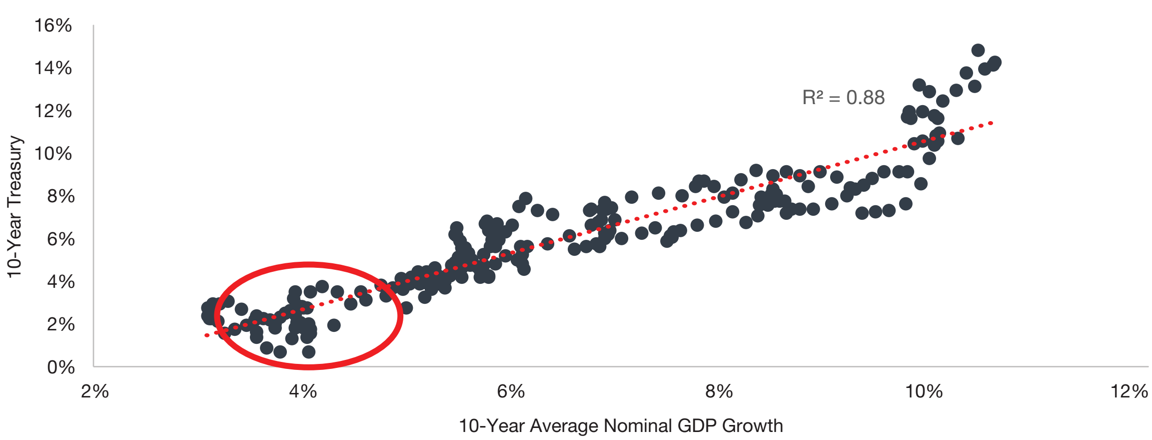
As of June 2025, the Consumer Price Index (CPI) excluding shelter sits at 2.0 percent, much lower than the shelter component of 3.8 percent. Headline CPI continues its deceleration, reaching 2.7 percent, slightly higher than the prior months due to modest tariff and geopolitical pressures, particularly seen in food and energy prices.[14] However, this number may be artificially high due to the collection method of the shelter component (demonstrated below by comparing CPI shelter growth to actual rent growth). We expect headline CPI to remain low and continue to decline over the long run.

Shelter Inflation Remains Elevated[14]



Ultimately, this low-growth, low-inflation environment is expected to be reflected in interest rates, both at the short end of the curve (controlled by the Federal Reserve) and the long end, which is driven by nominal GDP growth. This is beginning to play out as we suggested in our 2025 outlook, as the 10-Year Treasury rate has drifted lower in fits and starts. As of July 2025, the 10-Year Treasury rate is at approximately 4.4 percent, down from the 4.8 percent peak, seen in April.[15]

10-Year Nominal GDP growth & 10-Year U.S. Treasury[16]



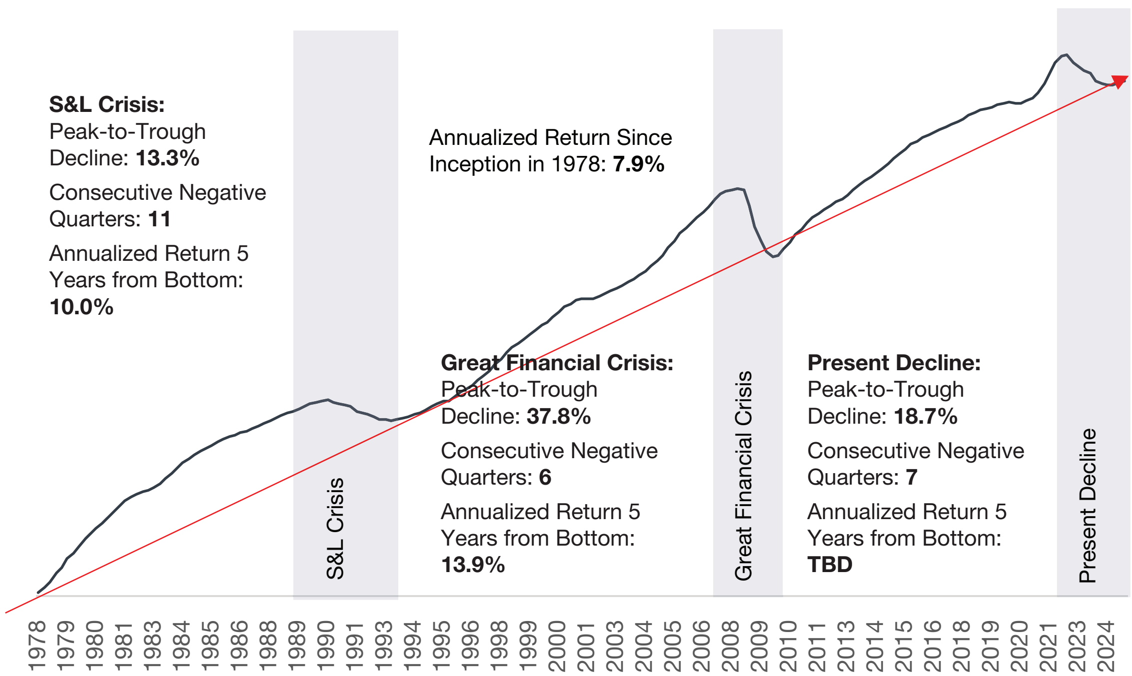
We expect to see moderately lower rates this year with the Federal Reserve likely to cut rates toward the end of the year as growth and inflation continue to show weakness. Over the long run we expect long-term rates to track GDP growth as can be seen in the chart above.

Commercial Real Estate Outlook

Given our expectations for lower interest rates, attractive valuations, and solid fundamentals driven by limited supply and demographic demand, we see current conditions pointing to a favorable environment for select real estate sectors in 2025.

After a pullback of almost 19 percent driven by spiking interest rates, the NCREIF ODCE Index is up 2.5 percent from its low, marking three consecutive quarters of positive performance. The compelling entry point highlighted in our 2025 outlook appears to be materializing as values stabilize. Such brief corrections in high-quality real estate have historically offered investors an opportunity to capture returns by entering near the trough.[17]

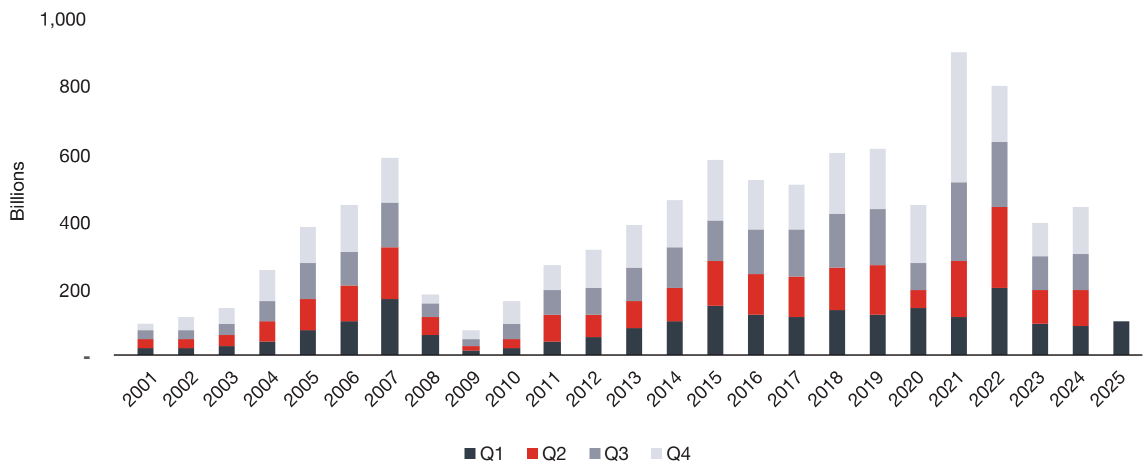
NFI-ODCE Index (Log Scale)[17]



	S&L Crisis	GFC	Present Decline
Peak-to-Trough	-13.3%	-37.8%	-18.7%
Duration (Quarters)	11	6	7
Annual Return 5 Years from Bottom	10.02%	13.9%	TBD *2.5% through 3 Q's
Outperformance (Over Since Inception Return)	2.01%	5.9%	TBD

Transaction volumes are also showing improvement, suggesting a continued improvement in market conditions, with volumes up more than 11 percent year-over-year in the first quarter of 2025.[18]

MSCI Transaction Volume[18]

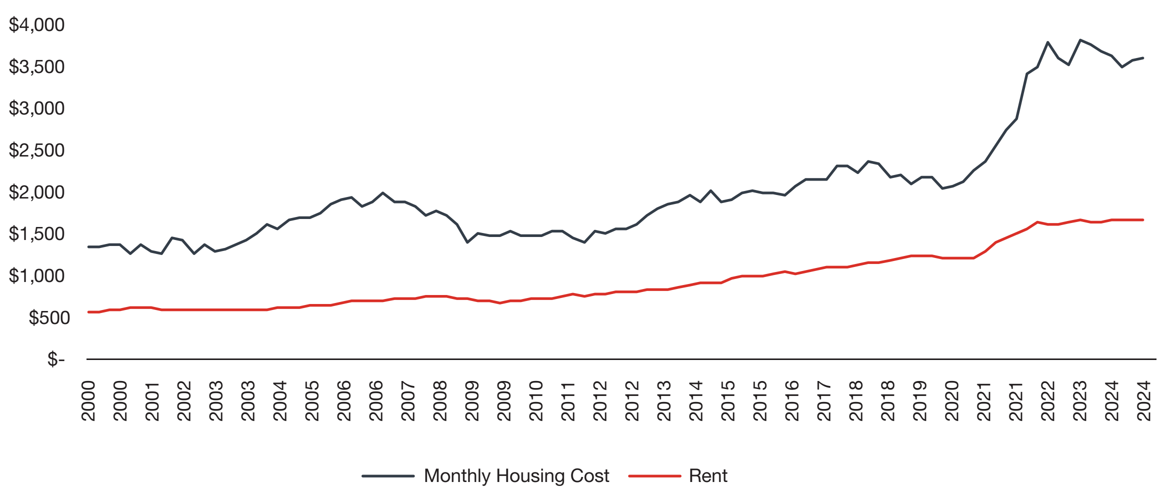


Strong Fundamentals Across High-Conviction Sectors

Residential

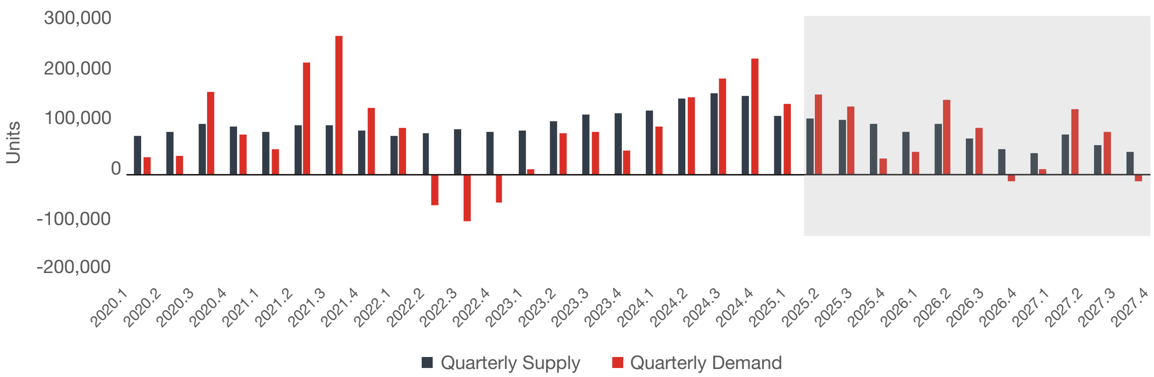
Housing affordability continues to drive residential rental demand, with the rent versus own calculation strongly favoring renting as home prices and interest rates remain elevated. Demographic trends from the millennial and baby boomer generations may have an outsized impact on residential rental demand. With millennials entering the household formation stage and baby boomers downsizing, the residential sector is experiencing strong absorption rates that have helped stabilize rents despite historically high levels of new construction.

Rent vs Own Comparison[19]



While new deliveries have seen record highs, the new supply pipeline is expected to slow considerably due to declining starts caused by higher interest rates and construction costs. This significant decrease in available units coupled with continuously strong demand, will likely give residential landlords the ability to grow rents at a strong pace in the coming years.

Multifamily Supply vs. Demand[20]

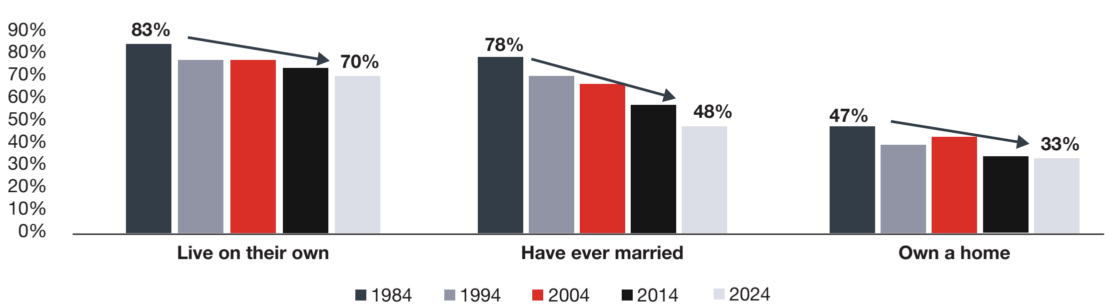


We believe build-to-rent (BTR) and manufactured housing communities (MHC), considered subsectors of residential, remain front and center in the real estate market. Each offers unique characteristics that lead to strong demand, thanks to shifting demographic trends primarily driven by our largest population segments – baby boomers and millennials. As baby boomers continue to retire, the 55-plus MHCs are positioned to receive a great deal of interest from those who want to live near like-minded people at a similar stage in life, while having affordable housing that gives them the financial flexibility to enjoy other aspects of their retirement.

Likewise, we expect to see many baby boomers downsize into BTR rentals, which will provide them with flexibility and eliminate some of the less attractive aspects of renting, like density, shared walls, and maintenance requirements.

Millennials, the largest population segment in the United States, are also finding BTR communities a compelling option. The lack of homeownership affordability is making renting a very attractive to this generation. BTRs, specifically, offer renters a unique opportunity to enjoy the best of both worlds: private space without the shared hallways, walls, sounds, and smells of apartment living combined with the amenities, affordability, flexibility, and lack of financial and time commitments associated with maintaining an owned home. Generational trends, as can be seen in the chart below, continue to drive demand into BTR, as younger generations, including millennials, struggle with home affordability and delay life events like moving out, owning a home, and getting married.

Percentage of US 30-Year-Olds Reaching 'Adult' Milestones[21]



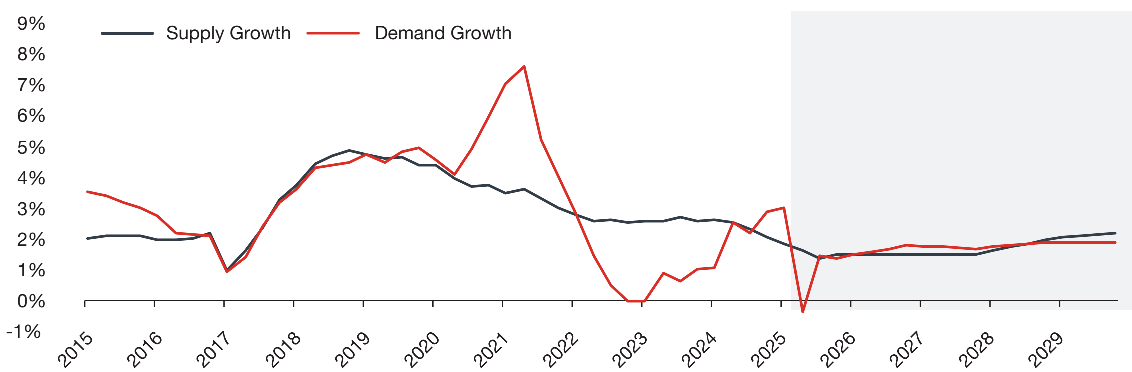
Self-Storage

Self-storage rents boomed from 2020 to 2022 as pandemic-related dynamics caused major dislocations in the housing market. However, over the last two years rents have fallen, in what can be best described as a retracement back to more reasonable levels. We see some indications suggesting that 2025 may be the year that growth resumes across the sector, due to a falling construction pipeline and a more balanced market with recovering demand. Several markets are already notching solid gains; Chicago, Tampa, Raleigh, and others are among those growing rents, while markets like Las Vegas and Austin that received new supply and the highest influx during the pandemic are continuing to search for a bottom in rents.[22]

Demand for self-storage is primarily driven by housing transactions, as people move, form new households, or adjust their living situations. The “barbell effect”of millennials entering the household formation stage and baby boomers downsizing is positioned to support the sector. Key drivers include household formations, a skew toward renting apartment units that often lack storage options, and an accumulation of belongings after life events such as death and downsizing, which often leaves people with more belongings than they have space for.

This type of demand tends to be resilient regardless of broader economic conditions, offering a long runway for growth as demographic trends continue to unfold. These dynamics are creating favorable tailwinds for the sector and point to a potential compelling investment opportunity in the second half of the year.

Self-Storage Supply vs Demand[23]



Student Housing

While on the surface student housing faces demographic challenges due to declining college age population after the millennial boom, the sector has unique dynamics in place that cause the impact to be felt at lower-teir schools.

Demand for premier (top-tier) educational institutions with strong academics and elite athletic conferences (Power 4) remains robust. We use the Power 4 data as a proxy for top-tier institutions for data simplicity. Throughout the last decade, Power 4 schools have seen enrollment growth of 1.4 percent, roughly three times the rate of non-power schools.[24] These schools have have also seen applications far exceed acceptance rates, with higher preleases on student housing properties in the area. This in addition to one degree-granting university closing each week on average in 2024, further bolsters our belief in the sector. Additionally, the U.S. continues to lead the world by a large margin as the top destination for international students.

Thus, student housing assets at top-tier universities continue to generate strong preleasing, occupancy, and rent growth compared to the rest of the student housing market.

We believe that well-located assets at top universities that continue to have strong enrollment growth over time will support the sector's potential to generate consistent cash flow. Demand for student housing is less correlated to economic activity, providing the sector with strong countercyclical characteristics that are attractive in a low-growth environment.

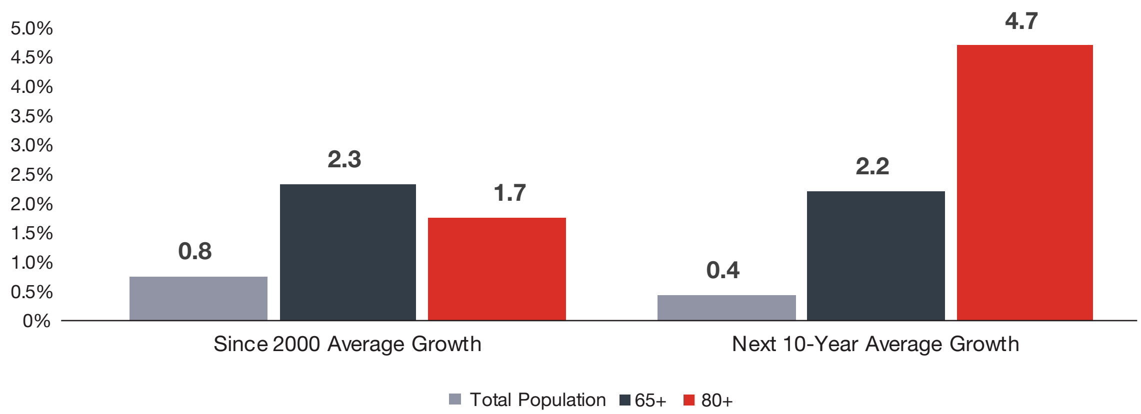
2014 - 2024 Averages[25]

Metric	Non-Power 4	Power 4
Enrollment Growth	0.5%	1.4%
Acceptance Rate	71.7%	60.5%
Vacancy	7.8%	6.9%
Rent Growth	2.5%	3.0%

Healthcare

The U.S. will experience a significant demographic shift in the coming years with the exponential growth of older population cohorts, thus buoying the senior housing and medical outpatient building sectors. The 80-plus age group is expected to increase 4.7 percent annually on average over the next decade, compared to just 0.4 percent growth for the population at large.[26]

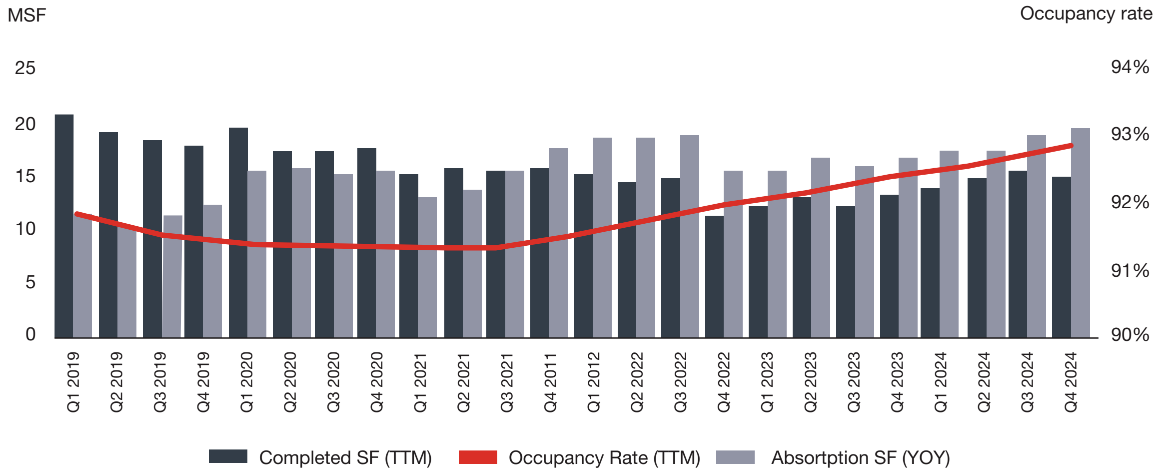
Average Growth of Population by Age Tranche[26]



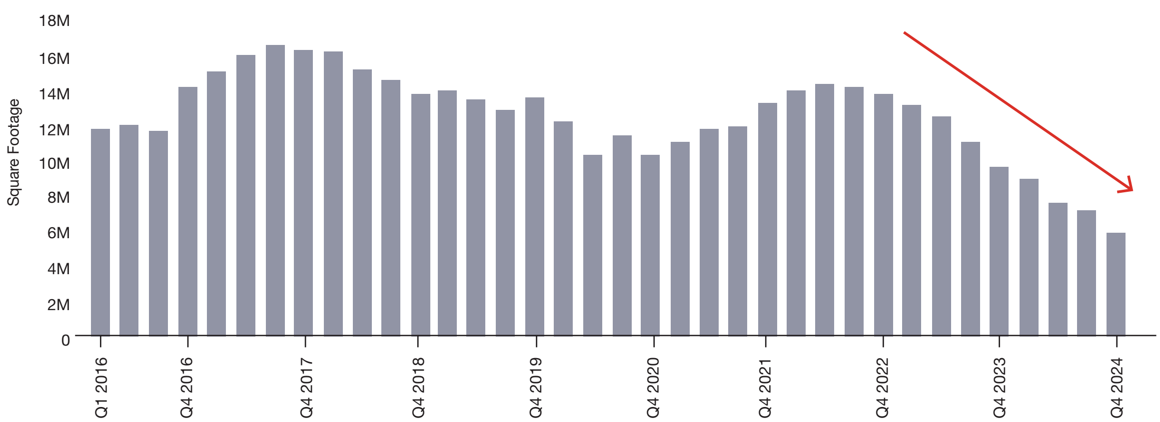
Medical Outpatient Building

Medical outpatient building (MOB) demand is strengthened by health systems and specialty providers (i.e., dermatologists, psychiatrists, ophthalmologists, orthopedics, gastroenterologists, and OBGYNs).[27] MOB tenants tend to be more stable than other sectors due to significant buildouts and expensive, cumbersome equipment such as X-Ray machines, MRI machines, and exam tables. Occupancy rates for the MOB sector is sitting at approximately 93 percent, up from the low of 91 percent seen during the pandemic. Over the last 14 quarters, absorption has outpaced new supply. These factors led MOB rents to achieve a high near $25 per square foot in Q4 2024,[28] that adjusted down slightly in Q1 2025.[29]

MOB Supply vs. Demand[27]



MOB Development Starts[28]



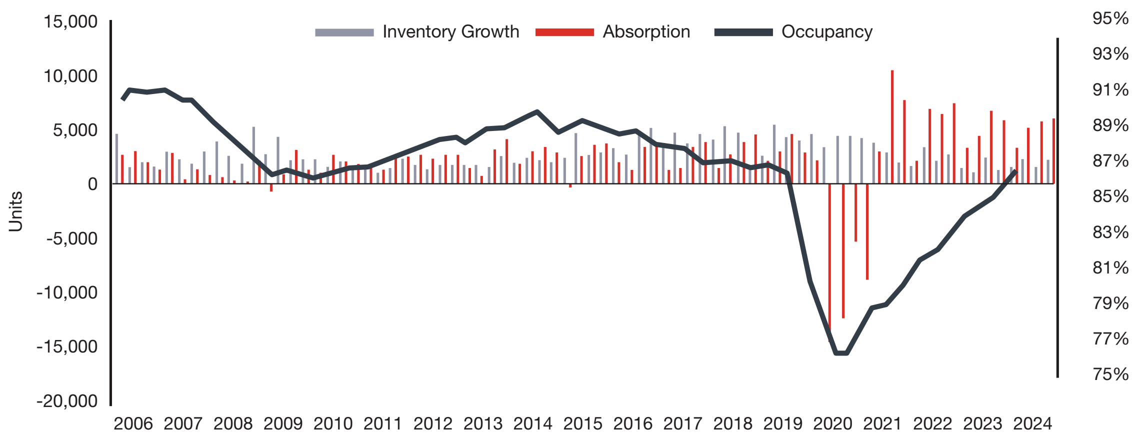
Nationally, development starts have been decreasing since early 2022 as construction costs continue to rise.[28] Growing markets with limited new construction should outperform, as demand outstrips new supply. Fueling this demand is the shift from inpatient to outpatient settings thanks to advancements in medical technology, especially minimally invasive techniques.

Given this backdrop, we expect well-located MOB assets to perform well over the long-term.

Senior Housing

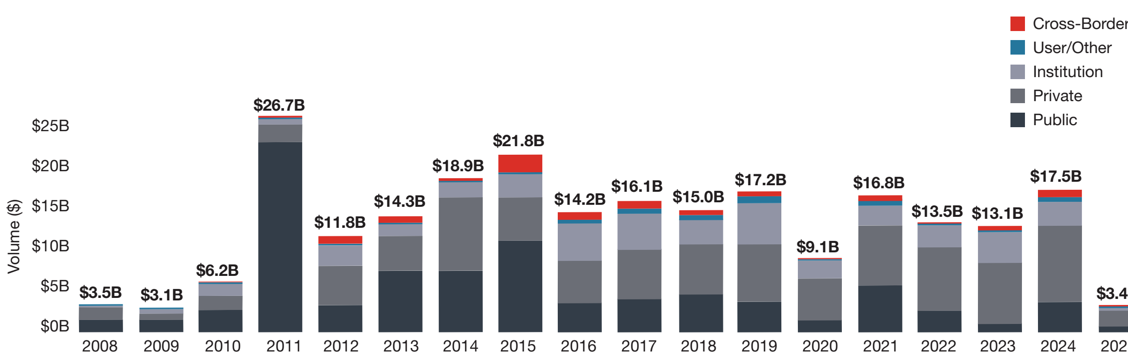
Demand for senior housing has outpaced new supply over the last few years with occupancy rates rising back to pre-pandemic averages, and penetration rates increasing from a low of 7.7 percent during 2020 to eight percent[30] today. Rents have followed a similar pattern, recording strong rent growth north of three percent following the elevated new supply and uncertainty of 2020.

Supply vs. Demand[31]



Unlike other real estate sectors, senior housing transaction volume did not skyrocket following the pandemic, due in part to the difficulty of operations, and has stayed rather stable over the past decade. 2024 was the most active year since 2015, and 2025 is off to a typical start.

Transaction Volume[32]



We believe favorable demographic demand trends centered around the expansion of the elderly population in the U.S., combined with solid fundamentals that include a significant supply/demand imbalance, are creating a lasting tailwind of potential outperformance for senior housing in the years ahead.

The Bottom Line

Despite major global disruptions, including ongoing geopolitical tensions, tariff/trade wars, and barring any future military escalations, 2025 is largely unfolding in alignment with our expectations outlined in our 2025 outlook. The macroeconomic environment has developed as anticipated, with interest rates moderating, inflation easing, and broader economic activity continuing at a slower pace. These dynamics are largely influenced by factors such as an aging U.S. population, elevated debt loads, and a persistently tight labor market, all of which have restricted economic growth.

Against this backdrop, the outlook for the commercial real estate market remains promising. Certain alternative real estate sectors stand to benefit from strong demographic tailwinds, limited new supply pipelines, and the possibility of a lower interest rate environment. We believe these forces are potentially creating compelling opportunities in commercial real estate.

We remain focused on monitoring key factors impacting the commercial real estate industry, particularly housing affordability, domestic migration patterns, and shifts in healthcare spending – all of which provide valuable insights into future demand. We continue to carefully watch these evolving trends in order to refine our investment thesis, identify resilient investment strategies, and position ourselves to capture long-term value in an ever-changing economic landscape.

[1] Fred GDPC1
[2] Congressional Budget Office – CBO's Economic Forecast: Understanding Productivity Growth – July 2024
[3] Bureau of Labor Statistics. Employment Projections - 2023-2033. Press Release. August 2024.
[4] https://fred.stlouisfed.org/series/CLF16OV
[5] https://fred.stlouisfed.org/series/CE16OV
[6] Fred CE16OV & BLS Employment Projections 2023-2033
[7] https://www.mercatus.org/research/policy-briefs/debt-and-growth-decade-studies#:~:text=Using%20the%20World%20Bank's%20World,than%20the%2030%20percent%20level
[8] U.S. Office of Management and Budget and Federal Reserve Bank of St. Louis, Federal Debt: Total Public Debt as Percent of Gross Domestic Product [GFDEGDQ188S], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/GFDEGDQ188S, June 12, 2025
[9] FRED – Net Domestic Investment (W171RC1Q027SBEA) / GDP (GDP) & Labor Productivity (PRS85006092)
[10] https://www.bea.gov/news/2025/gross-domestic-product-1st-quarter-2025-third-estimate-gdp-industry-and-corporate-profits
[11] https://www.cnbc.com/2025/04/30/gdp-q1-2025-.html#:~:text=Moreover%2C%20private%20domestic%20investment%20soared,steps%20for%20Trump's%20trade%20policy
[12] Fred: POPTOTJPA647NWDB, FPCPITOTLZGJPN & stat.go.jp
[13] Fred: SPPOPTOTLEUU, CP0000EZ19M086NEST, FPCPITOTLZGEUU, & worldometer.info
[14] FRED CPI: Shelter (CUSR0000SAH1) & RealPage Effective Rent Growth YoY
[15] U.S. Bureau of Economic Analysis, Gross Domestic Product [GDP], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/GDP, Board of Governors of the Federal Reserve System (US), Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity, Quoted on an Investment Basis [DGS10], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/DGS10
[16] FRED – Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity, Quoted on an Investment Basis (GS10) & Gross Domestic Product (GDP)
[17] NCREIF NFI-ODCE Index
[18] MSCI RCA Transaction Volume
[19] Monthly housing cost = monthly principal and interest based on 30-Year mortgage rate (FRED –MORTGAGE30US) and median sales price of homes sold U.S. (FRED – MSPUS) plus a 4% of total home valueadded as Operating costs of owning a home (Operating Costs of Owning a Home - National Association of Home Builders); Rent = Realpage Effective Rent
[20] Realpage Data Subscription
[21] https://jbrec.com/insights/top-housing-stories-first-quarter-2025/
[22] Yardi Matrix. Self Storage Market Outlook. June 2025
[23] Green Street Advisors Data Subscription
[24] RealPage Data Subscription
[25] RealPage Data Subscription
[26] Worldbank.org – Population Estimates and Projections – 2024
[27] JLL – 2025 Medical Outpatient Building Perspective
[28] Healthcare Realty – Investor Presentation
[29] https://www.cbre.com/insights/figures/q1-2025-us-medical-outpatient-buildings-figures
[30] Green Street – 2025 Senior Housing Outlook
[31] NIC MAP Data(R), powered by NIC MAP Vision
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