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U.S. core real estate: A new cycle is emerging

- **Emerging new cycle in commercial real estate:** Core real estate has posted five consecutive quarters of positive returns, driven by consistent income returns and flat to modestly positive appreciation returns.
- **Solid fundamentals underpin NOI (net operating income) growth:** Occupier demand remains resilient in most asset types and new supply is falling materially. Together, this should lead to declining vacancies and positive rent growth, supporting NOI expansion.
- **Structurally driven property types are expected to outperform:** Sectors driven by demographic shifts and innovation, particularly housing, industrial and alternative sectors, are positioned for above-average performance; more differentiated performance by property type and geography should continue, signaling a more nuanced cycle going forward.
- **Public market pricing support:** The valuations of public REITs, which have often served as an early indicator for private commercial real estate trends, support a commencing cycle.
- **Resumption of Fed rate cuts expected to support liquidity and overall economy:** Easing by the Federal Reserve should lower borrowing rates and benefit investment returns, which we expect to increase transaction volume.
- **Structural benefits of core:** Core private real estate should serve as the foundation of investors' portfolios, given its lower risk profile and strong risk-adjusted returns.

A new, more nuanced cycle has started

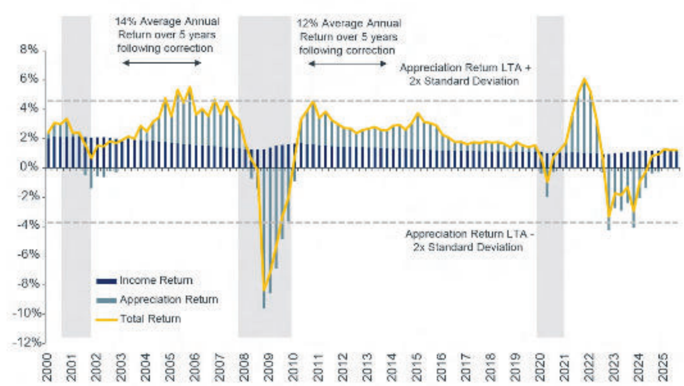
Clarion believes that the U.S. commercial real estate market is embarking on a new cycle. Following a phase of repricing and adaptation to elevated interest rates, private real estate, as represented by the national NCREIF Property Index (NPI), has posted multiple consecutive quarters of stable values and positive investment performance driven by income. The cycle is underpinned by, on one hand, a potentially more favorable outlook for capital markets, as the Federal Reserve has resumed interest rate reductions. On the other hand, stabilizing and strengthening demand fundamentals, along with diminishing supply-side constraints and improving liquidity, should further support the new cycle.

Unlike previous recoveries that were broadly synchronized across property types and markets, this cycle is likely to be one of more meaningful divergence. Most office and many retail types face persistent weak demand and potential obsolescence, while housing (broadly), logistics, necessity-oriented retail, and healthcare sectors are benefiting from secular tailwinds, such as demographic shifts, a persistent housing shortage with poor affordability, the pace of innovation, and an evolving, more geographically dispersed knowledge economy.

Commercial real estate values have started to recover

Following a cumulative value decline of 18.7 percent from peak to trough, property values in the Expanded NPI have stabilized, and total returns have been positive for five consecutive quarters through third quarter 2025. This has been driven primarily by income returns, with capital appreciation turning in flat to slightly positive returns (Figure 1).

Figure 1: NCREIF Property Index total return by quarter



Sources: Moody's Analytics, NCREIF, Clarion Partners Global Research, 3Q 2025. The Expanded NPI includes all NPI properties and all qualified alternative assets.

Cycle will be supported by strong fundamentals and NOI outlook

Notwithstanding a somewhat ambiguous economic backdrop and outlook, occupier demand remains resilient across most commercial real estate sectors, now further supported by a sharp pullback in new supply. Developers have sharply curtailed pipelines after the 2021–23 surge, while demand has remained resilient. The result is a backdrop in which occupancy levels are generally strong across most property types.

The interplay of resilient occupier demand with a notable pullback in new supply is creating a foundation for sustained positive NOI growth. And the NOI growth outlook looks particularly bright for sectors that are driven by structural demand shifts and are less vulnerable to cyclical ebbs and flows in the economy.

Differentiated performance by property type

Since 2017, there has been significant variation in performance across property sectors, with industrial and multifamily apartments vastly outperforming office and retail. In addition, during the past three years, the alternative sectors have, generally, outperformed traditional sectors, reinforcing their increasing strategic importance in institutional portfolios and reflecting investor preference toward sectors that have benefited from structural tailwinds (demographics, innovation, and housing shortages) that are also likely to be at the forefront of the burgeoning cycle.

REIT markets offer more evidence of new cycle

The perspective that a new cycle is developing is further substantiated by recent performance trends among public REITs. Often serving as a leading indicator for valuations within private real estate, publicly traded REITs continue to post gains from post-pandemic lows. The positive momentum observed in public REITs suggests that private CRE markets are recovering and should narrow the gap in the coming quarters.

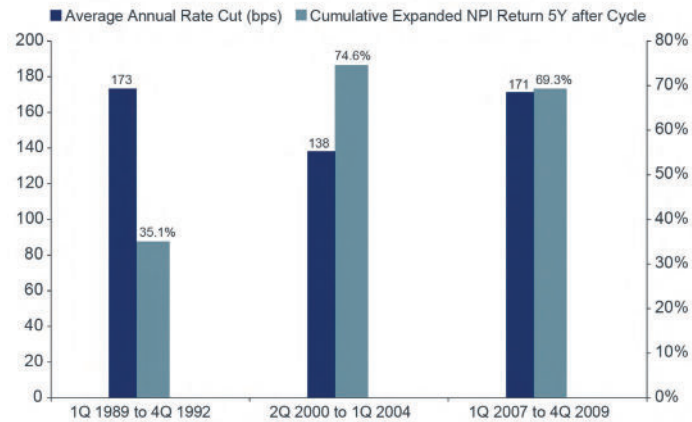
Fed easing should provide additional support for the cycle

After holding rates steady for several months, the Federal Reserve lowered benchmark interest rates in 2025 by 75 basis points. Recent comments by Chairman Powell have reduced the probability for a third consecutive rate cut following the December FOMC meeting. However, market expectations are for an additional 50 basis points cut later in 2026, implying that the federal funds rate stabilizes at around 3 percent to 3.5 percent in the longer run.

Major Fed rate-cutting cycles in the past 35 years offer perspective as to how CRE reacts once monetary policy turns accommodative. Generally speaking, in recent decades, core real estate has tended to respond positively after policy rate cuts (Figure 2).

Past rate-cutting cycles underscore two key themes: (1) lower interest rates ultimately unlock investment demand for real estate, but (2) the positive effects often lag the policy change and depend on economic conditions. On the latter, rate cuts could help alleviate some of the economic uncertainty that has resulted from weakening labor markets and growing consumer strain in light of higher inflation. Judicious rate reductions could help to smooth the business cycle impact from tariffs, limit second-round damage to employment and investment, and, in the current context, provide a very helpful bulwark against potentially slowing growth.

Figure 2: Expanded NPI total returns 5 years after Fed rate-cutting cycles



Sources: NCREIF, St. Louis FRED, Clarion Partners Global Research, 3Q 2025. Note: Rate cuts are based on Effective Federal Funds Rate; Total Returns 5Y after Fed Rate-Cutting Cycle begins in the last quarter of the rate cutting cycle.

Implications and the road ahead

Historically, factors such as stabilizing values, restricted supply and strengthening fundamentals have indicated the beginning of a new commercial real estate cycle – all factors that we believe are visible in the market today. Sectors within the housing, logistics and healthcare umbrellas, in particular (many of the alternative real estate sectors that are benefiting from secular tailwinds, such as demographic shifts, innovation and the rise of the knowledge economy), should garner the strongest investor response.

Investors who identify and respond to these structural changes should be well positioned to achieve outperformance.

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CORPORATE OVERVIEW

Clarion Partners has been a leading U.S. real estate investment manager for more than 40 years. Headquartered in New York City, the firm has offices in major markets throughout the United States and Europe. With more than $73 billion in total assets under management as of September 30, 2025, Clarion Partners offers a broad range of both debt and equity real estate strategies across the risk-return spectrum to its approximately 500 domestic and international institutional investors.

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