Heitman

U.S. valuation outlook: ODCE index poised for next chapter

Executive Summary

Core real estate values stabilized in 2025 following a multiyear correction. The valuation adjustment now appears largely behind the market, and financial conditions improved as the year progressed. In tandem, underlying property performance strengthened and capital-market activity picked up. Collectively, these factors – along with a favorable supply and demand outlook for most sectors – suggest the market has reached a cyclical trough and a recovery in U.S. private commercial real estate is underway. In our opinion, this recovery is supported by several key observations:

1. Cap rates remained flat in 2025, indicating cyclical devaluation may be over.
2. ODCE discount rates exceed public REIT expected returns, suggesting ODCE is fairly valued relative to public market pricing.
3. Spreads between ODCE cap rates and S&P 500's EBITDA yield are at 20-year lows, signaling a fair relative valuation for private real estate compared to public corporations.
4. The ODCE index has posted positive total returns for six consecutive quarters, indicating the downturn is likely over, with public-market signals, improving NPI trends, and a muted supply pipeline all pointing to additional upside ahead.

If these trends persist, we expect core real estate to deliver improved returns and lift portfolio performance in 2026.

Cap rates hold steady in 2025

Cap rates plateaued in 2025 after expanding for nearly two years. This expansion was driven primarily by rising interest rates during the Federal Reserve's hiking cycle. With that cycle now complete, the bulk of the valuation adjustment appears to have run its course.

In 2025, the Federal Reserve shifted toward easing with three interest rate cuts, which improved debt financing conditions. Long-term nominal and real interest rates also declined throughout 2025, further easing upward pressure on cap rates. Any further interest rate cuts in 2026 will likely provide additional tailwinds for pricing, given the inverse relationship between interest rate movements and pricing.[1]

Public markets suggest ODCE may be fairly valued, or even undervalued

REIT expected returns have declined below ODCE's discount rate, suggesting that ODCE may be fairly valued or potentially undervalued relative to the public market (as shown in the chart below). Following strong performance and capital appreciation since Q3 2023, REIT prices have risen, which in turn has pushed their forward-looking expected returns lower. This sequence suggests that the public market has already repriced to a lower opportunity cost of capital.

In contrast, as highlighted in the chart below, ODCE discount rates appear to lag behind this public market shift. Private-market valuations typically adjust more slowly, and current ODCE assumptions may not yet incorporate today's lower return environment as reflected in REIT pricing. In our view, this mismatch between public-market repricing and private-market discount rates suggests that the ODCE index may be fairly valued or undervalued relative to the public REIT market. Additionally, based on historical yield differentials, we believe that public REITs are fairly valued or potentially undervalued relative to the S&P 500.[2]

ODCE discount rate vs. expected public-market return: U.S. Q4 2022 – Q4 2025

"Expected Public-Market IRRs" are unlevered figures based on Green Street calculations and represent a simple average of the office, industrial, apartment, retail, and self-storage sectors. Sources: ODCE Discount Rates from "3Q25 Expanded NCREIF ODCE Valuation Trends"; Green Street, accessed Q1 2026.

ODCE valuations attractive relative to corporations

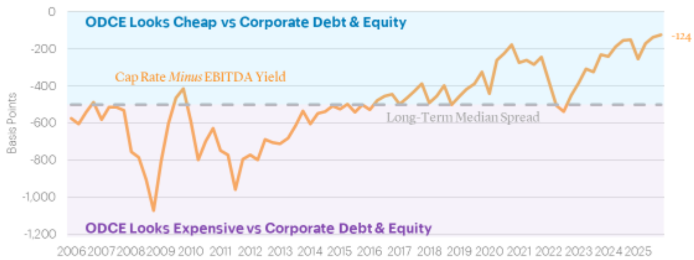
The spread between ODCE cap rates and S&P 500's EBITDA yield has narrowed below its 2006-2025 historical median, suggesting that private real estate may be fairly valued or potentially undervalued compared to corporations. Over this 20-year lookback period, the S&P 500's EBITDA yield – defined as EBITDA divided by enterprise value – has exceeded the ODCE cap rate by a median of roughly 500 bps, reflecting the higher risk premiums associated with public companies.

Today, the spread has compressed to just 124 bps, its tightest level in 20 years, suggesting that core private real estate income is fairly valued or even positioned at a discount relative to corporate operating performance. The risk premium available from equities appears to have compressed materially, the most favorable positioning since 2006, and at a time when concerns over elevated technology sector valuations have become more pronounced. Taken together, these dynamics suggest that ODCE may be positioned for relative strength in the years ahead.

ODCE total returns improving in tandem with NPI

Strengthening property-level returns suggest a recovery in fundamentals is underway. Capital valuations stabilized in 2025 after ten consecutive quarters of decline, signaling that the market correction is likely over. As fundamentals and income both strengthen, they may help set the stage for a recovery in capital values.

ODCE cap rates minus S&P 500 EBITDA yield: U.S. Q1 2006 – Q4 2025

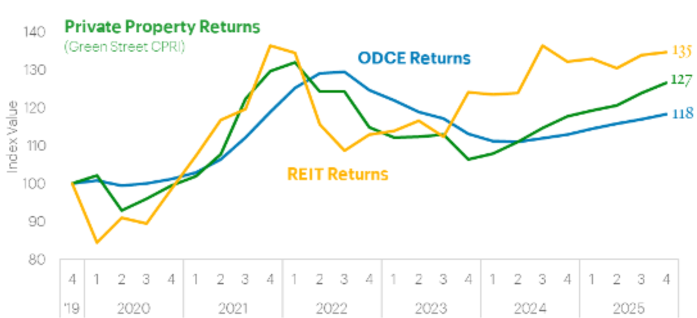


"ODCE Cap Rates" are a simple average of apartment, industrial, office, and retail cap rates. NOI is current quarter annualized. EBITDA Yield is defined as S&P's 500 EBITDA/Enterprise Value. Sources: NCREIF database, accessed Q1 2026; Bloomberg Database, accessed Q1 2026.

We expect this valuation recovery to continue, partially due to a favorable supply and demand environment. Sector-wide, median construction starts in 2025 were down 57 percent compared with their 2020–2024 peak, with all major sectors showing markedly reduced pipeline activity.[3]

ODCE total returns swung into positive territory in mid-2024. Strong performance in the Bloomberg REIT index and Green Street's Commercial Property Return Index over the past two years may point to a continued recovery for ODCE, which tends to lag behind the other two (see following chart). While income growth has driven most of ODCE's momentum so far, improving property fundamentals and capital markets indicates that capital appreciation may be poised to return and strengthen total returns.

Private property, public REIT, and ODCE return indices: U.S. Q4 2019 – Q4 2025, INDEX, 100 = Q4 2019



All indices are gross of fees and unlevered. "Private Property" refers to Green Street's Commercial Property Return Index (CPRI) for its "Top 50" U.S. markets. "REIT Returns" refers to a simple average for Bloomberg tickers B3MOR [Office], B3MIR [Industrial], B3APTRT [Apartment], and B3SCR [Retail]. The "ODCE Returns index" is a simple average for office, industrial, apartment, and retail. All indices accessed Q1 2026.

Conclusion

We believe that recent market signals indicate that valuations have reached a cyclical bottom and that core real estate appears to be entering the early stages of recovery. We find the current environment to be a compelling entry point for core real estate investors and believe that recoveries in both real estate capital markets and property fundamentals are now moving in tandem, creating a clearer pathway for price appreciation. Absent a major economic shock or unforeseen disruption, core real estate values appear poised for recovery, positioning the asset class for improved performance in the years ahead.

CONTRIBUTORS

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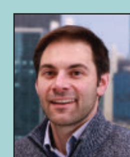
Jeff Bingham is the Chief Macro and Investment Strategist at Heitman and an equity owner of the firm. He focuses on macroeconomic house views, top-down investment strategies, and high-level frameworks designed to strengthen investment performance. In addition, Jeff serves on the Debt Investment Committee. Previously, he was Global Co-Head of Heitman's Investment Research Group and, before that, Director of Investment Strategy and Co-Head of Global Research Operations. Prior to joining Heitman in 2019, Jeff served as Vice President of Research at Equity International, where he was responsible for global macroeconomic, financial, and real estate research, with a primary focus on emerging markets. He began his career as a buy-side REIT analyst at DWS. Jeff holds a B.S. in Business Administration from Roosevelt University, an M.B.A. from the University of Chicago's Booth School of Business with concentrations in Economics, Finance, and Accounting, a Master of Divinity from Yale Divinity School, and a J.D. from Northwestern University's Pritzker School of Law. He has earned the CFA, CAIA, and FRM designations and is a member of the CFA Society New York, CAIA New York, and the Global Association of Risk Professionals.



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Jim Breen is a member of Heitman's Global Investment Research team, specializing in multifund strategy development. In this role, he analyzes global economic trends, capital markets dynamics, and cross-sector themes that inform the firm's strategic outlook and shape real estate performance across regions. His work supports the full lifecycle of investment decisions, from guiding top-down strategic views to contributing to underwriting and portfolio positioning. Jim received a B.A. in Economics with a minor in Finance from Miami University and is a CFA® charterholder.

COMPANY OVERVIEW

Heitman is a global real estate investment management firm with $47 billion in assets under management as of December 31, 2025. Founded in 1966 and globally headquartered in Chicago, with European headquarters in London, Heitman has 11 offices worldwide and is an active participant in the global real estate property and capital markets. Heitman makes real estate investments through private equity, debt, and publicly traded real estate securities.

Notes

1. Bloomberg, accessed Q1 2026
2. "U.S. Commercial Property Monthly," Green Street, published February 2, 2026
3. CoStar Data Export (BTR, Student, Apartment, Industrial, Office and Retail), NIC MAP (Senior Housing), Yardi Matrix (Storage), and Revista Top 100 Markets (MOB), accessed Q1 2026

This article presents the authors' opinions reflecting current market conditions. It has been written for informational and educational purposes only and should not be considered as investment advice or as a recommendation of any particular security, strategy or investment product.