

U.S. Commercial Real Estate Outlook: Autumn 2025

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Introduction: Seeing Trends Through a Performance Lens

Historically, income has driven over 80% of long-term returns in U.S. core and core-plus real estate.¹ That contribution tended to decline during periods of strong growth and low interest rates, and rise when growth slowed and rates increased. Today, sweeping changes in U.S. federal policies suggest a shift toward slower economic growth and a steeper yield curve.² In this environment, we believe properties with high income yields above financing costs and income streams less tied to the business cycle are best positioned to outperform.

Trends Impacting NOI Growth

We see four themes driving U.S. tenant demand and net operating income (NOI) growth³ potential over the next few years.

1. Tariffs: Less uncertainty, but higher costs

Resolving tariff negotiations could reduce uncertainty and lead to improved warehouse and retail leasing. However, higher import costs may curb consumer spending, limiting a full recovery of leasing. In Southern California, ongoing uncertainty around China tariffs may keep leasing and port activity subdued until policy is more clearly defined.

2. Housing unaffordability drives rental demand

Rising homeownership costs are driving more people to rent. Median U.S. home prices have increased 44% since the pandemic from 1Q 2020 to 1Q 2025, and 134% since the post-Global Financial Crisis low in 4Q 2011.⁴ During those same periods, the price-to-rent ratio for single-family homes versus apartments increased by 18% and 49%, respectively.⁵ Limited new supply will tighten vacancies, with the strongest rent growth expected for higher-income renters in mid-tier product.⁶

3. Secular trends drive strongest growth potential

Slower near-term growth puts focus on long-term drivers. Exponential growth of digitized data from visual media and artificial intelligence (AI) is driving demand for data centers, and new fiscal legislation⁷ provides incentives for capital investment and Research & Development (R&D). Infrastructure constraints, however, may limit data center development. Warehouse and manufacturing demand may also benefit from new fiscal legislation after the initial impact of higher tariffs stabilizes. Aging demographics support growth in senior housing and medical outpatient buildings (MOBs).

4. Construction Slowdown Shifts Focus to Demand

U.S. Construction starts in 2Q 2025 for the traditional property types (apartment, industrial, office, and retail) are down on average by 68% from their respective peak levels.⁸ High interest rates, immigration-driven labor shortages, tariff-driven increases of construction materials costs, and reduced availability of construction debt should further curb new building activity. Expect further reductions in space under development across most sectors over the coming year.

Implications for relative NOI growth by sector

With new supply slowing across most property types, we believe tenant demand will be the key driver of sector and market performance over the next 1 to 2 years. Below is our view on relative NOI growth by sector.

- **Highest potential: Data centers and senior housing**
Driven by strong secular trends. Data center growth will likely occur more through build-to-suit development activity, whereas senior housing growth will largely come from occupancy improvement and rent growth in existing product.
- **Next highest: Rental housing**
Expect NOI growth in apartments, single-family rentals, and manufactured homes to be supported by limited short-term supply growth and challenging homeownership affordability. Expect the timing of apartment rental gains to be staggered across metros based on the size of the remaining supply pipeline and the pace of demand.
- **Moderate potential: MOBs and retail**
MOBs have historically delivered steady though moderate annual growth, with potential upside going forward driven by aging demographics – though tenants remain sensitive to rent increases. Retail faces some pressure from tariffs, but low vacancy and limited new supply continue to support performance potential, especially in dense, high-income areas where demand is strongest.
- **Mixed potential: Industrial, office, and self-storage**
Industrial demand is expected to grow moderately, but asset-level NOI performance will vary based on how much vacant space needs to be leased and whether in-place rents are at risk of resetting to lower levels upon lease expiration. Office fundamentals remain strongest in top-tier⁹ buildings within higher-growth locations. Self-storage demand is tied to housing activity, which is likely to remain constrained by high mortgage rates, limited inventory, and moderating consumer spending and job growth.

The price of growth

Comparing our expectations for sector NOI growth to cap rates¹⁰ (after the deduction of capital expenditures¹¹) provides a sense of how much investors are paying for expected growth:

- **High cap rates, structural challenges**
 - **Includes:** Office
 - **Traits:** Elevated cap rates reflect sector-wide issues like hybrid work. While we expect NOI growth for the broad office sector to be limited, we believe top-tier assets have the potential for stronger performance and occupancy, albeit at lower cap rates.
- **Moderate to high cap rates, operational complexity**
 - **Includes:** Senior Housing, Data Centers
 - **Traits:** High cap rates stem from the need for specialized operational expertise. These sectors offer strong growth potential but require deep operational and investment knowledge, narrowing the investor base.
- **Moderate cap rates, low to moderate growth**
 - **Includes:** Retail, Self-Storage, MOB
 - **Traits:** Balanced pricing and growth. Retail varies – lower cap rates for necessity-based (grocery-anchored), higher for discretionary (power centers). MOB and self-storage are similarly priced; MOB may see upside from aging demographics, while self-storage growth is tied to housing trends.
- **Low cap rates, moderate to strong demand & financing support**
 - **Includes:** Industrial, Apartments, Single-Family Rental (SFR), Manufactured Housing
 - **Traits: Industrial:** Low cap rates reflect past NOI strength; expect future growth to be moderate in comparison. Outperformance within the sector will require higher cap rate assets and attention to tenant credit, product fit for local tenant needs, and submarket selection.
Residential: Low cap rates supported by agency lending and renter housing demand. Targeting higher cap rate metros may enhance returns potential for these lower cap rate property types.

In August, private market cap rates for industrial and residential assets (excluding senior housing) were much lower than those implied by public REIT valuations. This gap – 50 to 100 basis points¹² below the 10-year average¹³ – has led several U.S. public REITs across multiple sectors to pursue asset and platform sales to the private market. The disconnect between public and private market prices highlights the imperative of private markets to achieve higher NOI growth to justify current pricing.

Trends impacting prices

Short-term interest rates are expected to fall as job growth and consumer spending moderate, prompting the Federal Reserve (Fed) to cut policy rates. Long-term rates, however, are affected by the Fed's shrinking balance sheet and increased government borrowing from the new fiscal legislation. This could push up yields on instruments like the 10-year Treasury, even if short-term rates fall.

That's what happened when the Fed cut short-term rates almost a year ago – the federal funds rate¹⁴ was reduced by 100 basis points from September 19th to December 19th, and over the same period the 10-year Treasury rate increased by 84 basis points.¹⁵

While the reduction of short-term rates might bring some relief to real estate debt costs and help support transaction flows, significant cap rate compression is unlikely in sectors with already low cap rates, given the narrow spread over Treasuries.

Conclusion

As the U.S. economy slows and the yield curve steepens, we believe real estate returns will increasingly hinge on income durability more than appreciation.

- **Key Takeaways**

- **Tenant demand strength and higher relative cap rates** will be the primary drivers of performance as new supply declines across most sectors.
- **Sectors aligned with structural trends** – e.g., data centers, senior housing, and rental housing – are best positioned for NOI growth. MOB, historically a steady, lower growth property type, may also experience higher growth than normal.
- Sector performance can potentially be enhanced by **selecting higher cap rate segments** within the sector (e.g., power centers within retail; higher cap rate metros for residential).

- **Strategic implications**

- **Core and core-plus strategies** are likely to perform better when focused on assets with higher, sustainable income yields and resilient NOI growth capable of outpacing inflation. Properties with income yields above financing costs and with structural growth drivers less tied to the broader economic cycle are positioned to outperform the broader market over the next few years.
- **Higher risk/return strategies** may find opportunities in areas where pricing reflects dislocation (e.g., top-tier office), arbitrage (e.g., residential, retail, and MOB in secondary markets with growth comparable to primary markets).

We expect high-income assets with structural demand to outperform

Historically, income has accounted for over 80% of total returns on average. With limited scope for cap rate compression and forward economic growth expected to moderate, income's contribution could be even more pronounced in the near term. In this environment, paying a premium for expected NOI growth requires high conviction and clear evidence that the growth is both attainable and durable.

Postscript: We are observing increased federal engagement with traditionally non-partisan areas of the U.S. economy – such as the Federal Reserve, the Bureau of Labor Statistics, and private enterprise – in ways that may carry political implications. We are watching this trend and assessing its potential impact on the commercial real estate investment environment.

Defined Terms and Notes:

1. Source: NCREIF as of August 2025. Calculation period covers the full life of the NCREIF Property Index (NPI) from the end of 4Q 1977 to the end of 2Q 2025. Over that time, income returns contributed 81% to total returns. The NPI is the broadest measure of private real estate index returns. The NPI is published by the National Council of Real Estate Investment Fiduciaries and is a quarterly, composite total return (based on appraisal values) for private commercial real estate properties held for investment purposes including fund expenses but excluding leverage and management and advisory fees. All properties in the NPI have been acquired, at least in part, on behalf of tax-exempt institutional investors and held in a fiduciary environment. NCREIF data reflects the returns of a blended portfolio of institutional quality real estate and does not reflect the use of leverage or the impact of management and advisory fees. Past performance does not guarantee future results. An investment cannot be made into an index.
2. The yield curve plots interest rates, at a set point in time, of bonds having equal credit quality but differing maturity dates.
3. Net Operating Income (NOI) measures the profitability of an asset or an investment after subtracting operating expenses from income.
4. Source: National Association of Realtors and Moody's Analytics as of August 2025.
5. Source: Moody's Analytics as of August 2025.
6. Mid-tier product refers to properties that fall between the high-end, luxury segment and the lower-end, affordable segment of the market.
7. Public Law No. 119-21 passed on July 4, 2025. Known informally as The One Big Beautiful Bill Act, the new law include immediate deduction of the full cost of qualified property (e.g., equipment, machinery) placed in service between January 20, 2025, and December 31, 2029. Also, real property used in qualified production activities is eligible for full first-year depreciation if construction begins after January 19, 2025, and the property is placed in service before January 1, 2033. Domestic R&D expenditures incurred between January 1, 2025, and December 31, 2029 can be fully expensed in the year incurred.
8. Sources: Invesco Real Estate, utilizing data from CoStar as of July 2025. Peak quarters for new construction starts per sector after the start of the pandemic were: 1Q 2022 for apartments; 3Q 2022 for industrial; 1Q 2021 for office; 1Q 2022 for retail.
9. Top-tier refers to buildings constructed in the last 10-15 years with modern amenities and state of the art building systems that support operation efficiency and sustainability. These buildings tend to be in areas with high concentrations of technology and high growth companies.
10. Capitalization rates (cap rates) is the quotient of a property's net operating income divided by the property's estimate value.
11. Green Street, a data source we referenced for cap rates, makes capital expenditure (a.k.a. "cap-ex) adjustments based on the following definition: "Cap-ex includes maintenance and leasing costs. Many of these expenditures are capitalized – not expensed – for accounting purposes. Nevertheless, they have a sizeable impact on property level cash flows."
12. Basis point (bps) is a unit that is equal to one one-hundredth of a percent.
13. Source: Green Street for conditions on August 8, 2025. The following lists by sector that day's implied public market cap rate, estimated private market cap rate, the difference for that day (private minus public), and the average difference from January 2, 2015 to August 8, 2025. Apartments: 6.09%, 5.15%, 93 basis points (bps), 40 bps. Single-family rentals: 6.30%, 4.86%, 144 bps, 36 bps. Manufactured housing: 5.41%, 4.83%, 58 bps, -36 bps. Industrial: 5.71, 5.08, 63 bps, -14 bps. An implied public market cap rate is a measure used to describe the property yield embedded in a REIT's current stock price. Represents the cap rate at which Green Street's NAV-per-share estimate equals the current share price.
14. The Federal funds (fed funds) rate is the rate at which depository institutions lend to each other. An investment cannot be made directly into an index.
15. Source: Moody's Analytics, reflecting conditions from September 19 to December 19, 2024.

Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. Property and land can be difficult to sell, so investors may not be able to sell such investments when they want to. The value of property is generally a matter of an independent valuer's opinion and may not be realised.

Generally, real estate assets are illiquid in nature. Although certain kinds of investments are expected to generate current income, the return of capital and the realization of gains, if any, from an investment will often occur upon the partial or complete disposition of such investment.

Investing in real estate typically involves a moderate to high degree of risk. The possibility of partial or total loss of capital will exist. Investing in commercial real estate assets involves certain risks, including but not limited to: tenants' inability to pay rent; increases in interest rates and lack of availability of financing; tenant turnover and vacancies; and changes in supply of or demand for similar property types in a given market.

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