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2025 US Real Estate Outlook

Forecasters expect positive US commercial real estate capital appreciation in 2025 after two years of negatives signifying a cyclical turning point. The improvement is supported by ongoing solid US economic growth, near-target inflation and lower interest rates. Property sector fundamentals are positive as well except for the ongoing challenges in the office sector.

Risk to this forecast is heightened, however, due to the possibility that the new Trump administration will implement policies that boost inflation and shrink growth prospects while boosting financial market volatility.

Reflecting these possibilities, property investors might prolong their due diligence as they assess opportunities for cyclically attractive purchases. Property sectors and metro markets with relatively more constrained supply and durable demand will be least affected by heightened uncertainty.

On a positive note, prolonged due diligence processes could prolong access to cyclically attractive property prices. Overall, long-horizon investors will have an advantage in the 2025 environment if they focus on the inherent strength in the US economy.

Forecasts and assumptions

Commercial real estate forecasters are taking stock of the foundational data underlying their forecasts for 2025. Those data points are generally positive and support the Pension Real Estate Association (PREA) Consensus forecast for 6.6% total return for 2025 with positive 1.7% capital appreciation. This follows negative capital performance in both 2023 and 2024. Good prospects for 2025 are based on assumptions for ongoing positive US macroeconomic and financial markets paths. For example, the Federal Reserve's December macroeconomic projections show real GDP growth at 2.1% in 2025 with inflation at 2.5% indicating a touch higher inflation versus 2024's 2.4%. Expectations for the year-end 2025 federal funds rate is 3.9% suggesting two quarter-point cuts in the federal funds rate.[1]

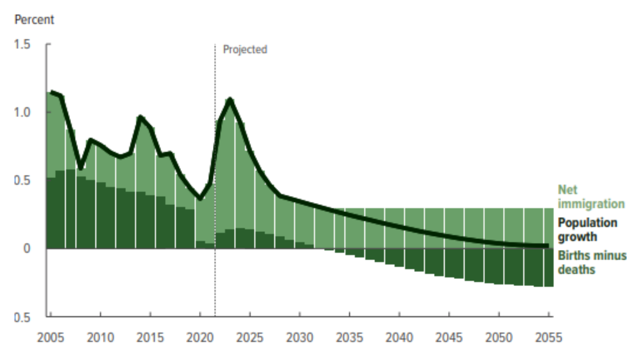
CRE expectations for 2025 represent a turning point in the real estate cycle which has historically been the most advantageous time to invest. Yet, the forecasts are plausible only if their underlying macroeconomic and financial markets assumptions are plausible. The Trump administration (Trump-2) supported by the solidly Republican Congress is adding uncertainty onto both macroeconomic and financial markets prospects for the period ahead. On balance, macroeconomic forecasters and CRE forecasters are taking a "wait and see" approach rather than opining on what might materialize. At the same time, the changes in Federal Reserve economic projections between their September and December reports might indicate some concern with upcoming policy.

Nonetheless, forecasters and investors do have more than an inkling of what may come. During the election campaign, two policy items were consistently identified as central to Trump-2: (1) curtailing immigration accompanied by a heavy stress on deportations; and (2) imposition of across-the-board import tariffs with special emphasis on China. Both policies will impact the macroeconomy and financial markets if enacted as promised. Impact will depend on both the dimensions of the policies put in place and the degree of market volatility generated by associated risk and uncertainty. Over the longer term, the Federal Reserve will need to address potential inflation emerging from these policies. Property sectors and metro markets will be affected to varying degrees depending on property sector fundamentals and the composition of local economies.

Immigration: Uncertain implementation

Immigration is a source of US labor force growth which drives economic growth. In recent years, the natural rate of population growth defined as births minus deaths has been shrinking and is expected to become negative by 2029 as shown in Figure 1. In the absence of immigrants, the labor force will shrink as well and impair economic growth prospects. Along with the historical pattern through 2020, the chart shows the Congressional Budget Office's (CBOs) projections for immigration through 2055 in the absence of immigration policy changes. Those projections incorporate a drop following the 3.3 million post-COVID peak in 2023 to a 1.1 million average beginning in 2027. The projections support CBO's macroeconomic forecasts showing a roughly 2.0% annual growth in real GDP over the near term.[2]

Figure 1: Population growth and contributing factors



Source: CBO, The Demographic Outlook. Data as of January 2025.

Implementing the immigration and deportation policies discussed during the campaign is viewed as unlikely by many policy analysts. Mass deportation would require manpower and infrastructure which has not been budgeted. Limiting new immigrants will be easier but will still require budget additions. Even without extensive change in immigration practices, the attractiveness of immigrating to the US could be affected especially among those with the most desirable qualifications. Foreign students might be similarly discouraged.

Analysis of the macroeconomic effects of even a modest 1.3 million deportations is estimated to cut 0.6% from baseline GDP and boost inflation by 1.5 percentage points by 2028.[3]

Curtailing immigration will swiftly affect agriculture, food processing, construction, hospitality and healthcare. Metro areas with disproportionate concentrations of employment in these sectors will feel the largest impact if immigration flows are cut. Geographically, the large coastal metros have the largest concentrations of immigrants and will feel the impact of any declines. Retail property will be affected first as consumer spending shrinks followed by apartment demand and warehouse space.

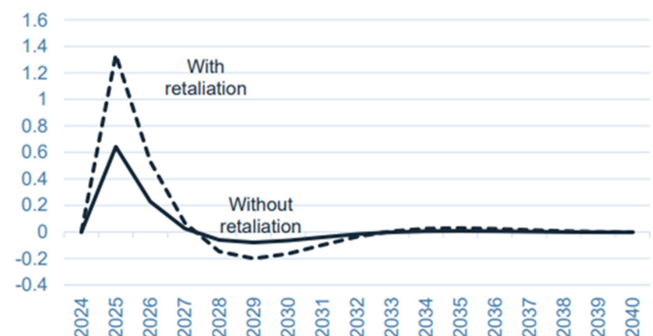
Tariffs: Easier implementation

The first few weeks of Trump-2 have brought an increase in tariffs on imports from China with China responding quickly with countermeasures. Steel and aluminum tariffs at 25% were reinstated to the levels imposed during Trump-1 which were removed during the Biden administration. At the same time, 25 percent tariffs on Canada and Mexico aimed at encouraging their efforts to stem immigrant flows into the US have been postponed pending negotiation. Higher tariffs are intended to raise federal revenues in the near term and to eventually redirect demand from imports to domestic goods. Success depends on the capacity of the domestic economy to satisfy redirected demand. Currently, the US economy is running at full employment suggesting that redirected demand cannot be satisfied without inflation. Moreover, not all imports have clear substitutes produced domestically. Finally, a substantial portion of imports are intermediate goods used by domestic producers so that tariffs will merely increase the cost of production which will be incorporated into final prices.

As shown in Figure 2, the impact of raising import tariffs by 10% will depend on the degree to which US trading partners retaliate. The biggest boost to inflation would occur over the near term with a 1.8 percentage point boost to prices by 2028. Inflation settles thereafter but prices do not decline. Economic growth would shrink 0.9 percentage points over the same period.

Figure 2: Percentage point deviation from baseline each year

Projected change in US inflation for an additional 10 percentage point increase in US tariffs on im,ports of goods and services from all trading partners, with and without retaliation from partners 2025-2040.



Source: W. McKibben

The impact of the proposed tariffs on US property will depend on the sensitivity of sectors and metro markets to the national economy. In general, sectors and metros that are now enjoying supply-demand balance with vacancy rates in line with historical averages can endure slower national economic growth and higher inflation with minor impact. But markets now digesting excess supply of new

space will require more time to achieve equilibrium as growth slows. To illustrate, Figure 3 shows the average vacancy rate by sector for US metros and for the ten metros among them with the highest vacancy rates. The data demonstrate the relatively more balanced conditions across the retail sector and the opportunity in the apartment and industrial sectors as over-supplied metros improve toward sector averages. Opportunity in the office sector is less obvious as high vacancy rates are pervasive across metros.

Figure 3: Sector vacancy rates for Q4 2024

	Apartment	Industrial	Office	Retail
Average metro vacancy rate	8.0	6.9	13.9	4.1
Average vacancy for 10 Hi metros	14.0	12.4	17.8	7.0

Source: CoStar. Data as of December 31, 2024.

Further policy proposals

Beyond immigration and tariff proposals, Trump-2 will push Congress to make the 2017 individual income tax changes permanent; they are due to expire at the end of 2025. Further tax changes are also under discussion, especially lowering the corporate tax rate.

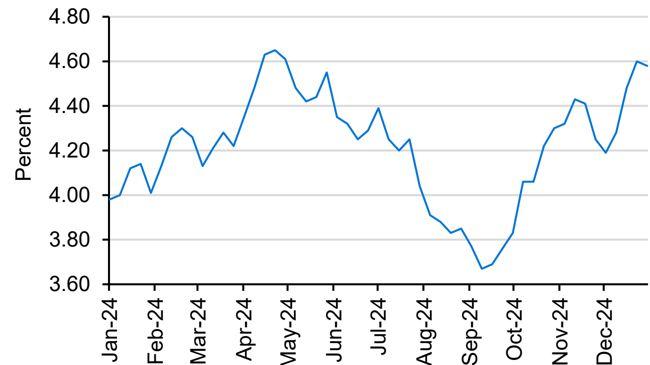
Combining possible further tax cuts with immigration and tariff proposals will exacerbate the inflation risks emerging during the years ahead. The response of the Federal Reserve will be all-important. As such, it might be wise for investors to expect heightened financial market volatility and a risk of higher longer-term Treasury yields. That risk might be evident in the run-up in the 10-year Treasury yield since September as shown in Figure 4.

US CRE performance prospects in a Trump-2 economy

Keeping all these points in mind, the year ahead offers US CRE investors opportunity to buy property at values near a cycle valuation trough. Historically, valuation troughs have represented the most auspicious timing for acquisitions. In addition, the cycle of property sector fundamentals is offering some attractions as well. The construction pipeline for 2025 deliveries promises smaller new supply inflows compared with recent years. Sparser new supply will benefit the apartment and industrial sectors, especially in metros that are digesting over-supply. National retail supply has grown little in recent years and is already enjoying tight availability and modest rent growth influenced by metro area demographics. Retail is largely in equilibrium. In contrast, the office sector is far from equilibrium but uncertainty regarding hybrid work is easing, and investors are beginning to discern relative value.

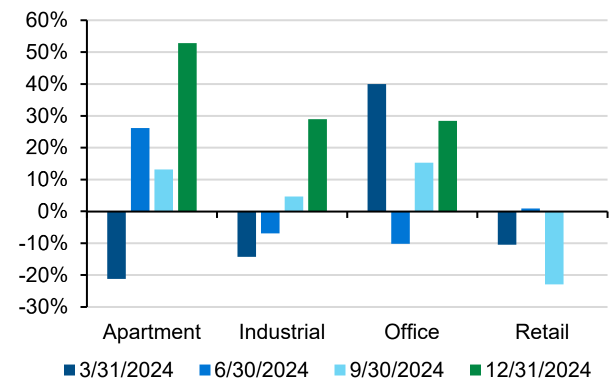
Figure 5 shows the uptick in apartment, industrial and office property transactions that closed in Q4 2024 versus Q4 2023. For those sectors, the volume of transactions in the fourth quarter was the strongest of the year. Transactions typically close with a lag so that fourth quarter closings were negotiated prior to the 2024 election. As such, they reflect investor expectations for the period focused on the cycle trough. For retail, there was no transactions bounce in any quarter of 2024 because the cycle for retail has been muted by limited construction.

Figure 4: Market yield on US Treasury securities at 10-year contstant maturity



Source: St Louis Federal Reserve, FRED. Data as of January 31, 2025.

Figure 5: Property transactions for 2024 year-over-year by quarter



Source: MSCI, Real Capital Analytics. Data as of December 31, 2024.

In the months ahead, the pace of transactions may slow as some investors take a more cautious view of Trump-2 policies. Even without any drastic policy changes, ongoing media attention to the possibilities will contribute to financial market volatility which can also slow investment decision-making. The likelihood of an increase in cautious behavior is affirmed by the 67% of respondents to a recent survey of global investors who expect 50% slower cross-border property investment as a result of Trump-2. Forty-two percent of the surveyed investors also expect global politics and trade issues to have the greatest impact on cross-border investment in the year ahead[4] At the same time, the

heightened caution of some investors could spell slower property value recovery and prolonged acquisition opportunity for more optimistic investors.

In this environment, long-horizon investors will have an advantage if they are confident in the inherent strength of the US economy. They will seek properties that can weather volatility with long term leases and high-quality tenants. They will use short term debt carefully reflecting interest rate uncertainty. They will acquire lease-up risk and value-add potential very selectively using careful market research. They will have patience in persevering through whatever turbulence awaits.

Authored by

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Martha Peyton is a Research Consultant to LGIM America'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, she 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 President of the Real Estate Research Institute.

1. Federal Reserve Economic Projections, December 18, 2024
2. CBO, The Demographic Outlook.
3. W.McKibben et al, "The Economic Implications of a Second Trump Presidency, Peterson Institute for International Economics, September 2024
4. AFIRE, International Investor Survey, Fall/Winter, 2024, survey of 180 investors holding roughly $3 trillion in US AUM.

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