



UNITED STATES

2025 Real Estate Outlook

Investment Research

EXECUTIVE SUMMARY

UNITED STATES

Now that real estate is fairly valued, we expect a sustained increase in investor demand, with returns back to historic norms.

Income growth will be supported by high early-cycle occupancy levels, an imminent supply dropoff and favorable structural tenant demand drivers.

Our high-conviction investment themes fall into four categories:

- Living Sector
- Logistics
- Data Centers
- Credit

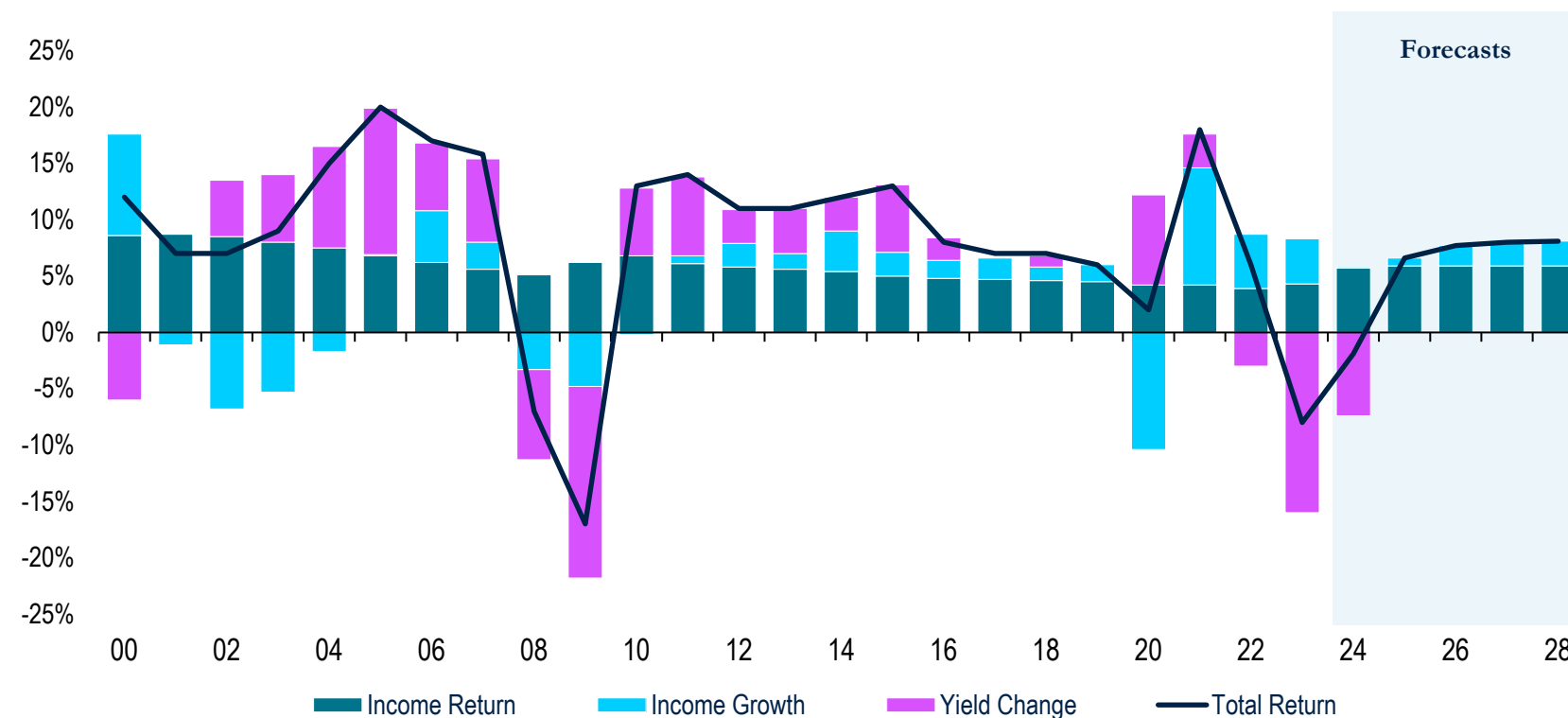
MARKET OUTLOOK

We have begun a new real estate cycle that will reward early movers. Lower debt costs alongside growing income create a favorable environment for investment across the capital stack and risk spectrum.



A Return to Growth for U.S. Real Estate

Private Real Estate Total Returns, Unlevered



Core returns mostly have been boosted by yield compression since 2000, driven by declining interest rates.

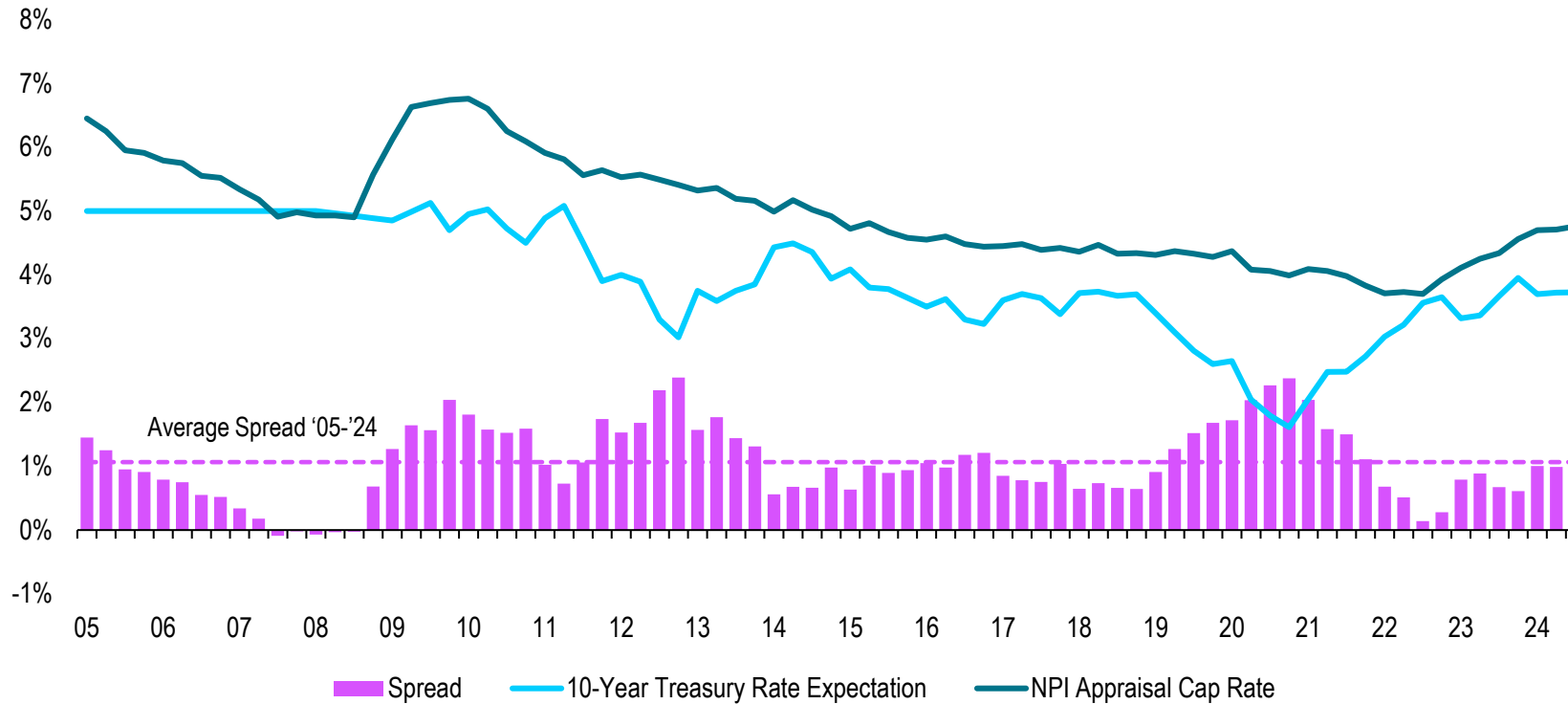
In this cycle, we expect positive returns without help from yields.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

Sources: NCREIF, CoStar, Green Street Advisors, PGIM Real Estate. As of November 2024.

Now Real Estate Is Fairly Valued . . .

NPI Appraisal Cap Rates vs. Three-Year Ahead 10-Year Treasury Yield Expectation*



Appraisal cap rates are close to their average spread over expected interest rates.

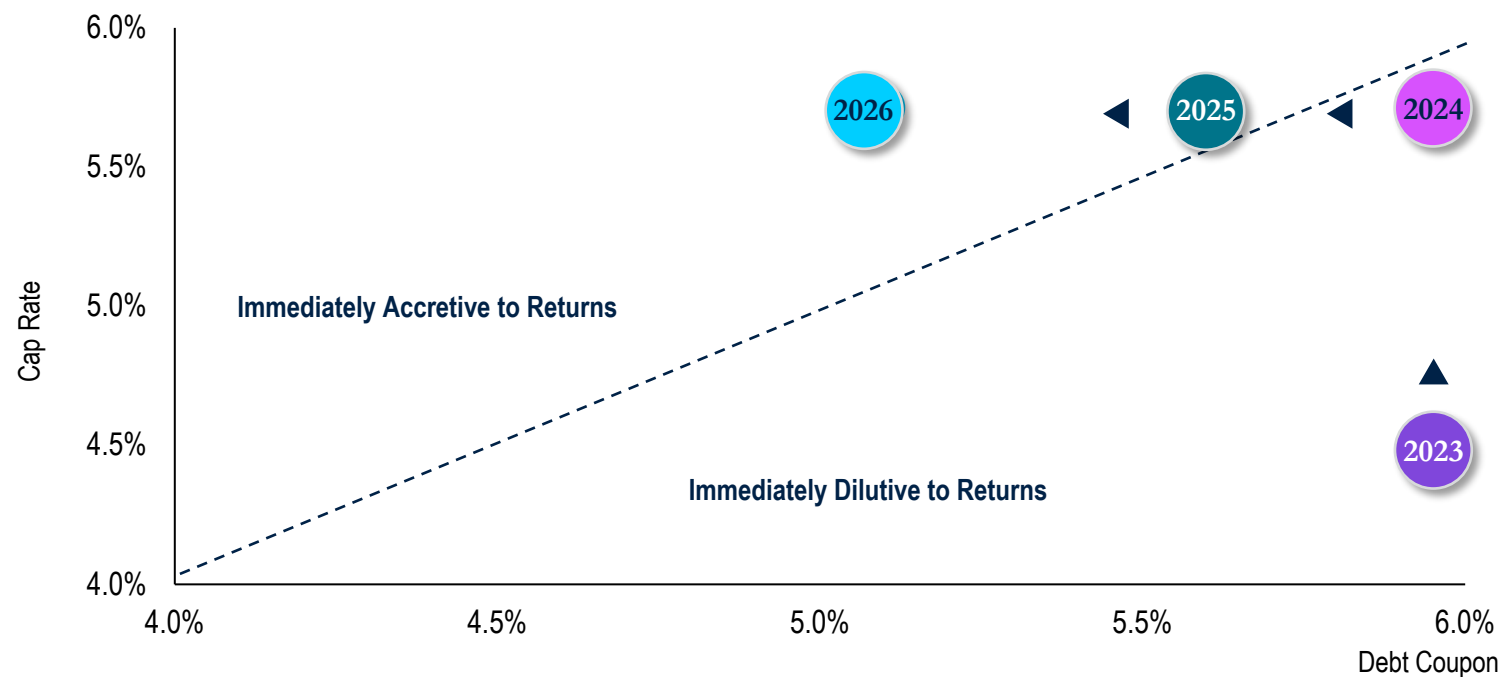
This is a sign that the gap between buyers' and sellers' expectations has closed.

*Note: 10-Year Treasury yield expectation is based on the median expected 10-Year Treasury yield three years ahead of the year in which the forecast was made. Data is unavailable prior to 2009. For years prior to 2009, we use the median expected 10-Year Treasury yield over the next 10 years and interpolate the data across quarters. Both data series come from the Survey of Professional Forecasters.

Sources: Federal Reserve Bank of Philadelphia, NCREIF, PGIM Real Estate. As of November 2024.

... And Debt Is Accretive Again ...

Floating Rate Debt Coupon vs. Cap Rate by Year (%)

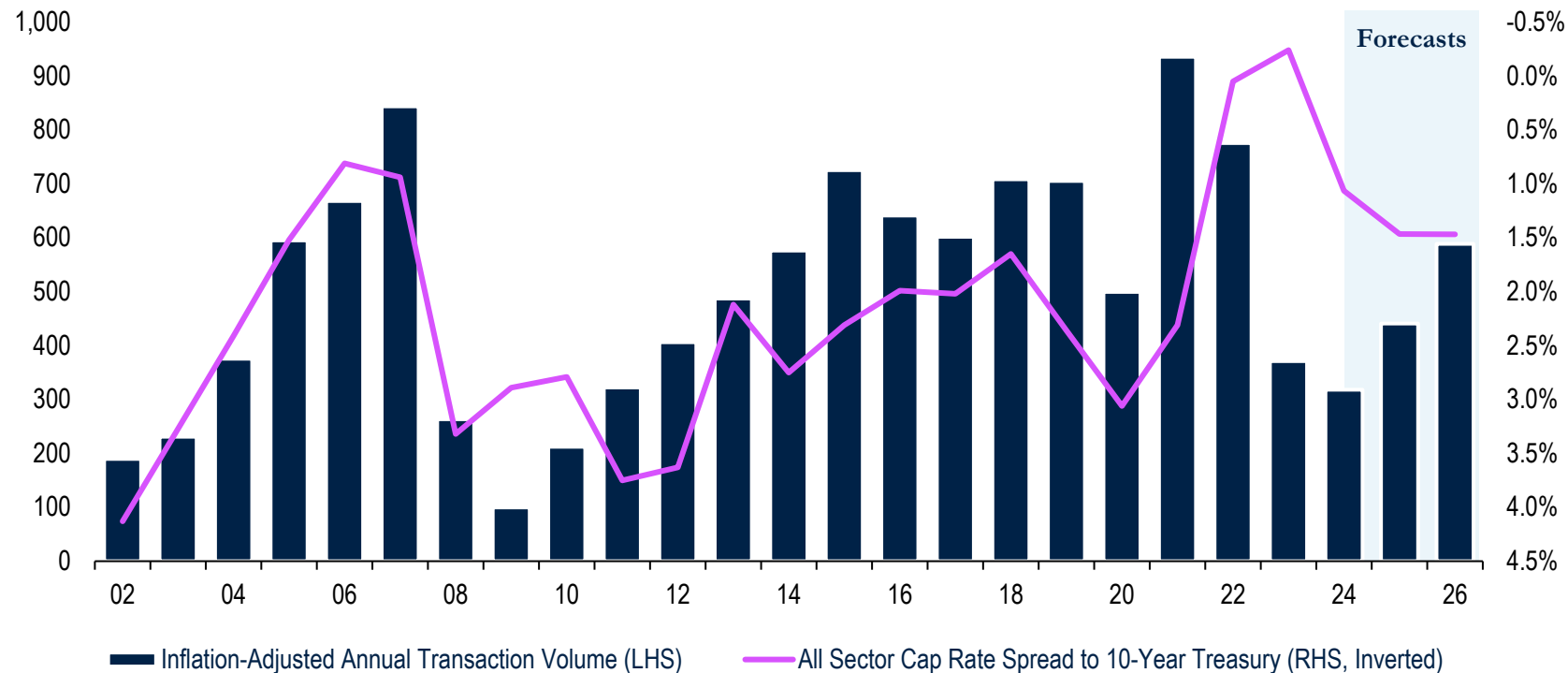


While initial yields remain slightly above debt costs now, leverage is already accretive to total returns.

Declines in debt costs over the next two years will further increase the positive effect of leverage.

... Which Will Spur More Transactions

Transaction Volume (US \$Billion) vs. Yield Spread to Treasury (Inverted, Basis Points)



After the last real estate recession, it took about two years for investors to come back into real estate.

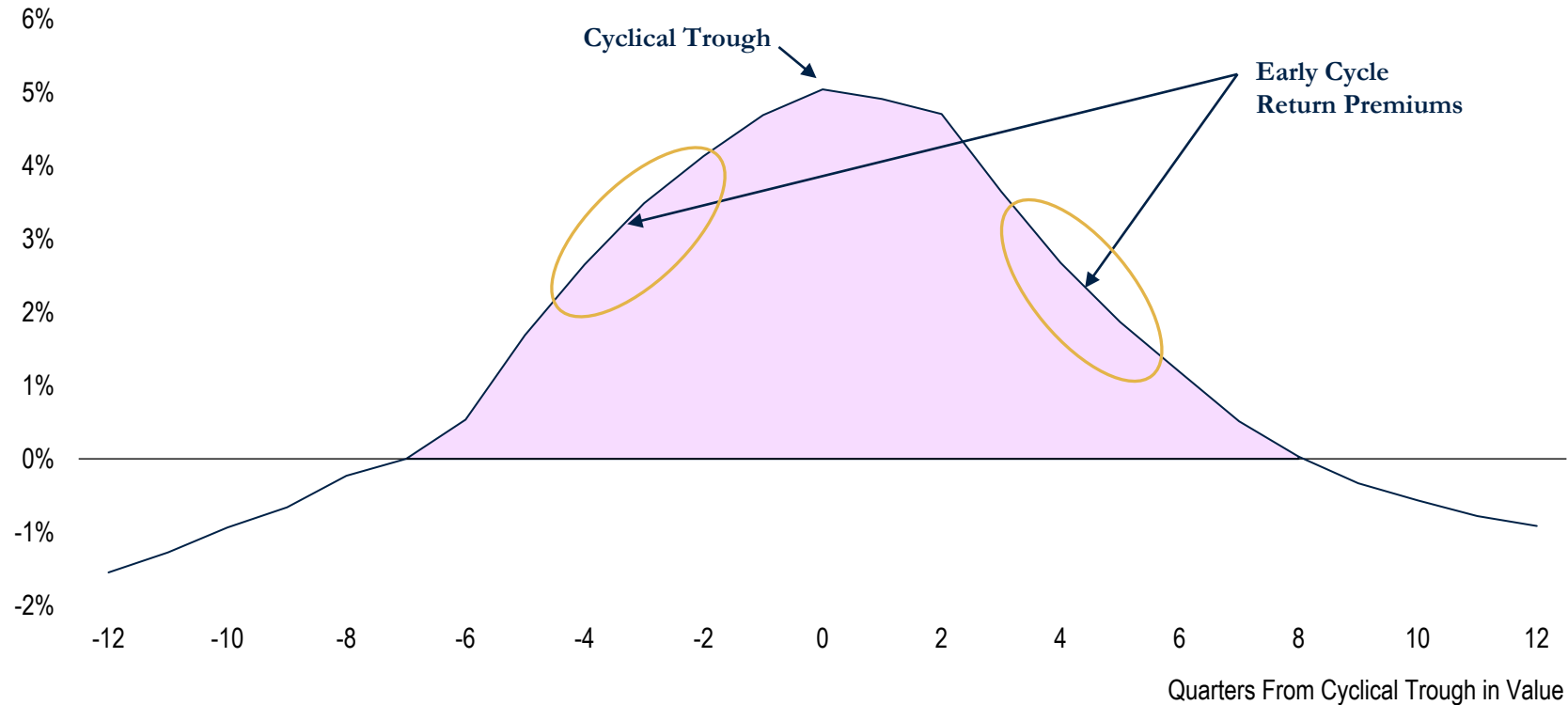
We are now two years past the last transaction volume peak.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

Sources: NCREIF, Real Capital Analytics, Mortgage Bankers Association, PGIM Real Estate. As of November 2024.

That Means Now Is an Attractive Early Cycle Entry Point

Annualized 5-Year Forward-Looking NPI Total Returns Minus Historic Average (Average of Past Cycles, % p.a.)

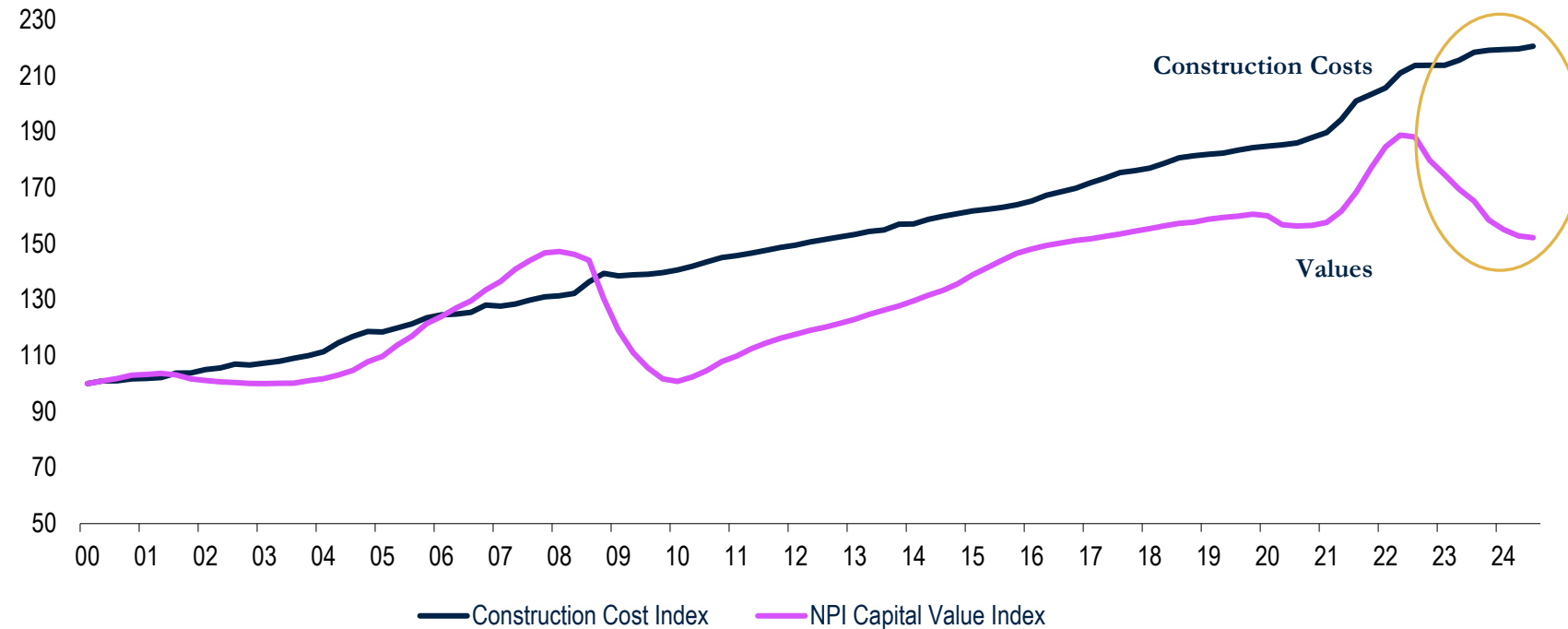


History indicates that investing near the cyclical trough in value maximizes returns.

Fortunately, investors' timing need not be perfect to achieve an early-cycle return premium.

Construction Cost Increases Have Outpaced Values . . .

Construction Cost Index vs. Capital Value Index (1Q 2000= 100)

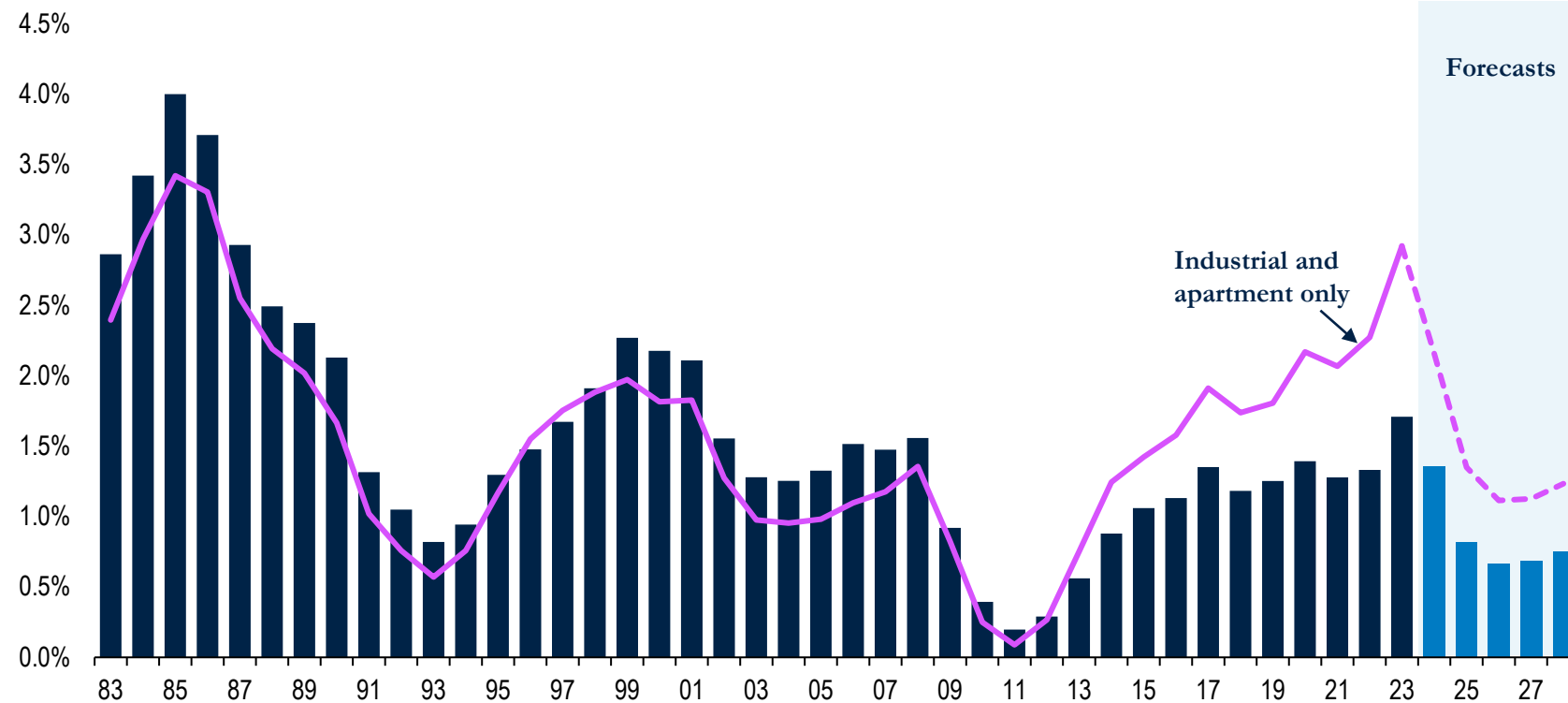


Construction costs remain elevated, but capital values have fallen ~19%, making development even harder to pencil than last cycle.

U.S. MARKET OUTLOOK

. . . Leading to a Low Supply Environment . . .

Net Additions to U.S. All Property Stock (% p.a.)



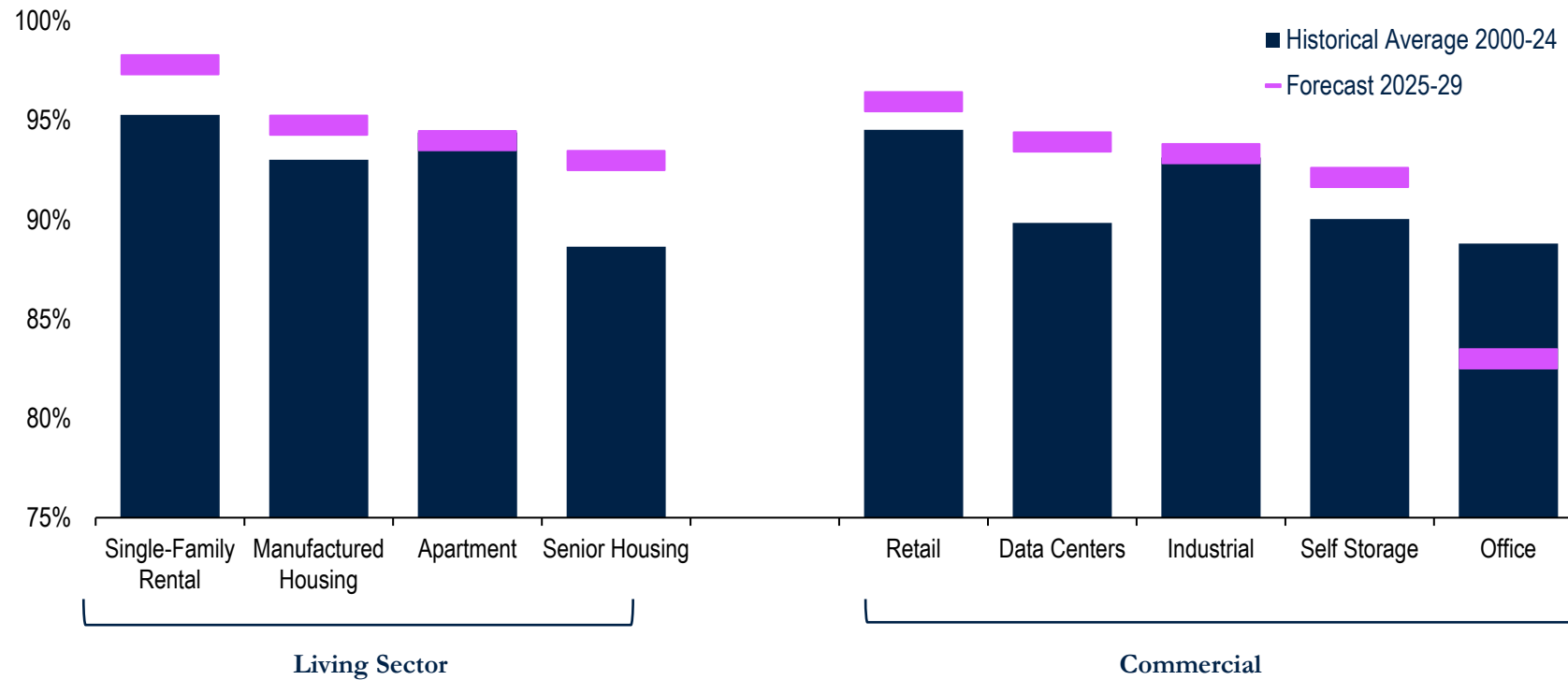
Supply growth was low through much of the last cycle and will fall back sharply.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

Sources: CoStar, PGIM Real Estate. As of November 2024.

... In a Period of High Occupancies ...

Occupancy Rate by Property Type (Forecast vs. Historical Average)



Occupancies are projected to be above or near historical averages across almost all property types.

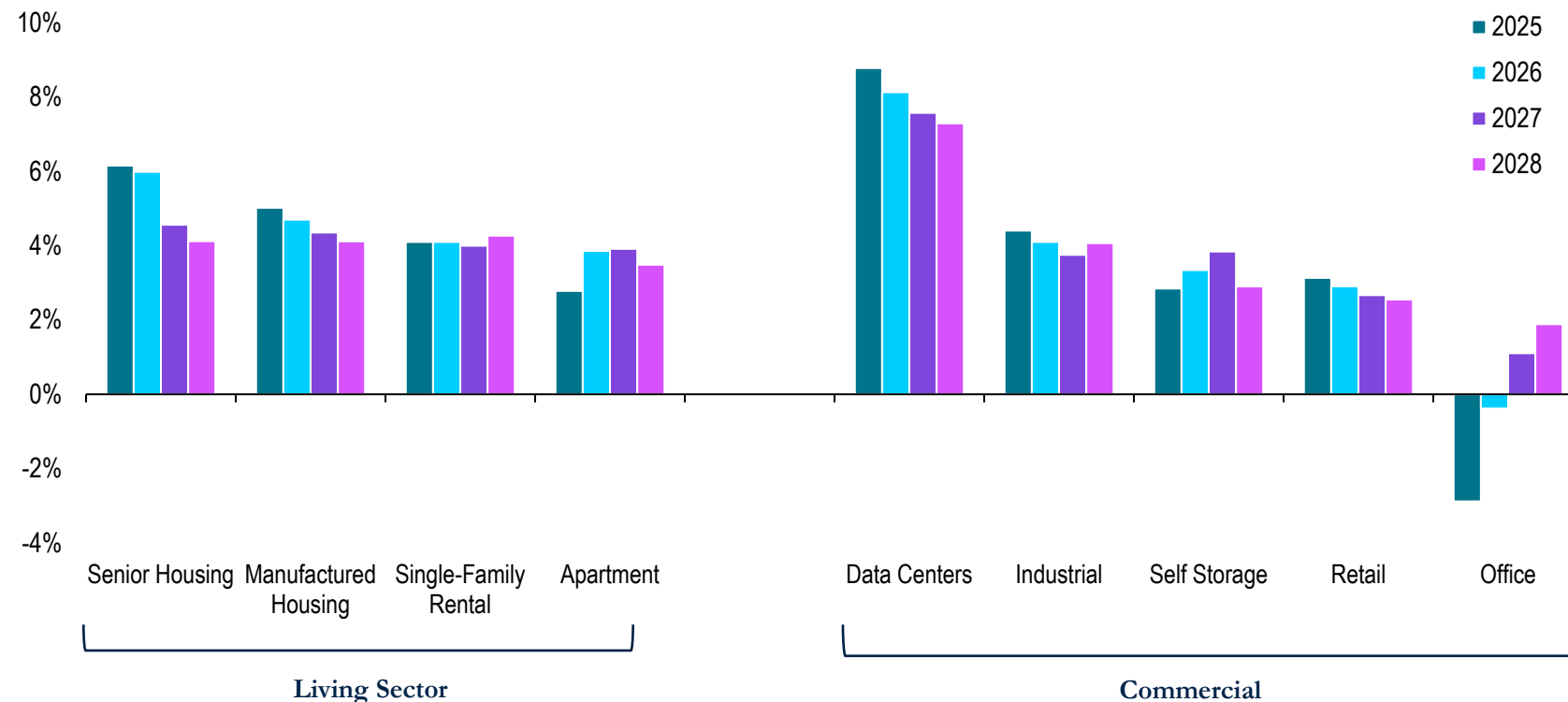
Forecasts are not guaranteed and may not be a reliable indicator of future results.

Note: Historical averages for some sectors are for different time periods due to data limitations: Data Centers ('13+), Senior Housing ('05+), SFR ('04+), Storage ('03+).

Sources: CoStar, Green Street, CBRE, PGIM Real Estate. As of November 2024.

... Supporting Resilient Income Growth

Forecasted Change in Property Market Revenue* (% p.a.)



Outside of near-term office headwinds, we expect positive growth across all property types.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

Note: Market revenue is a combined measure of rent and occupancy.

Sources: CoStar, Green Street Advisors, PGIM Real Estate. As of November 2024.

INVESTMENT THEMES

Investment Strategies

Current market conditions give rise to a wide range of risk and return opportunities.

Structural Themes

Investment conviction driven by basic needs and long-term structural trends that support ongoing demand creation.

Tactical Plays

Opportunities arising from near-term growth, the anticipated cyclical value rebound and market dislocation.



CORE/CORE+ STRATEGIES

Market selection will matter in the next cycle.

VALUE-ADD STRATEGIES

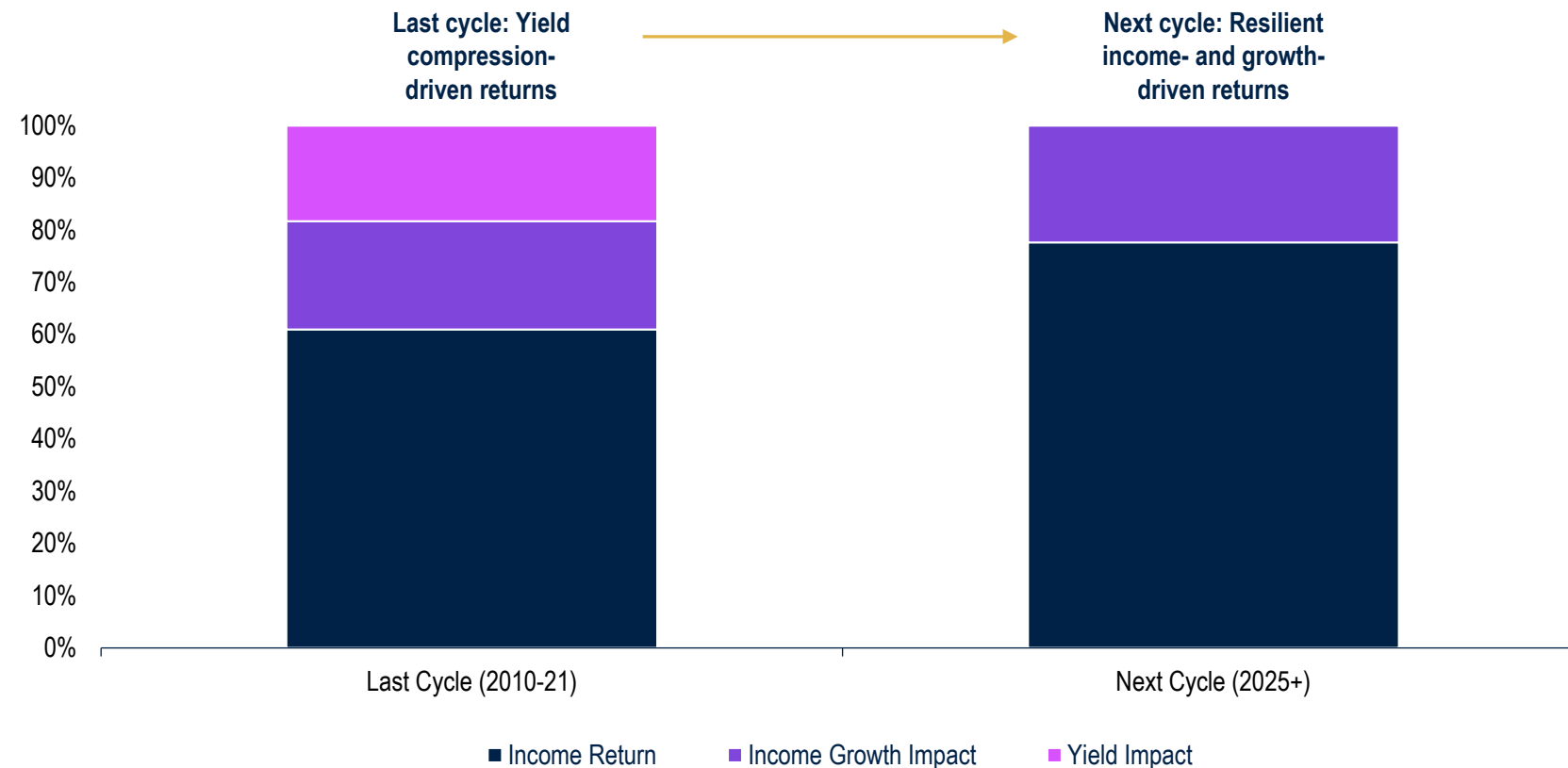
The need for capital injections into existing stock.

CREDIT STRATEGIES

Increased share of non-bank lending will continue in 2025.

Core/Core+ Strategies: Focus on Income Growth

Breakdown of NCREIF All Property Total Returns



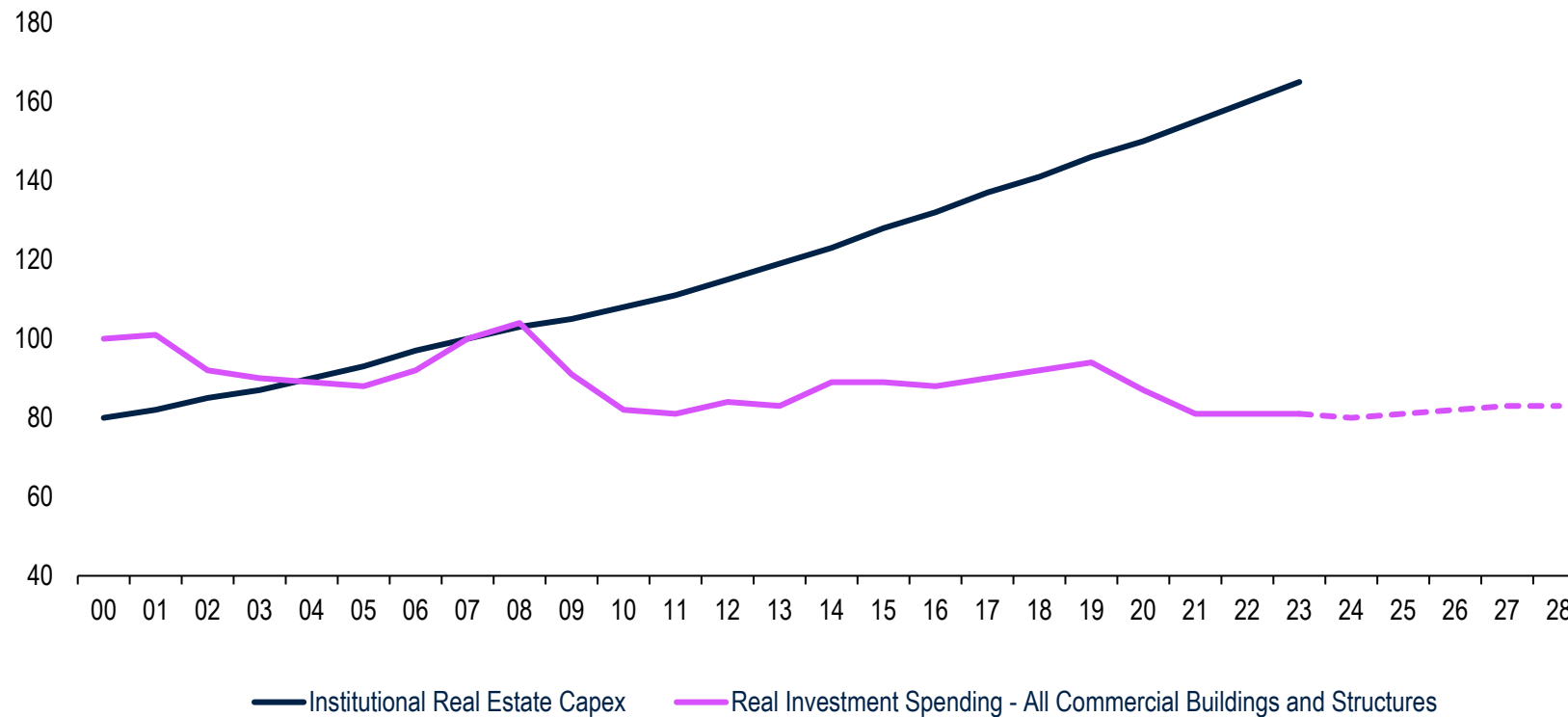
Unlike last cycle when yield compression and big sector plays dominated returns, returns will be driven by income and income growth.

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Sources: NCREIF, PGIM Real Estate. As of November 2024.

Value-Add Strategies: The Need for Capital Injections

Index of U.S. Capex Spending (%)



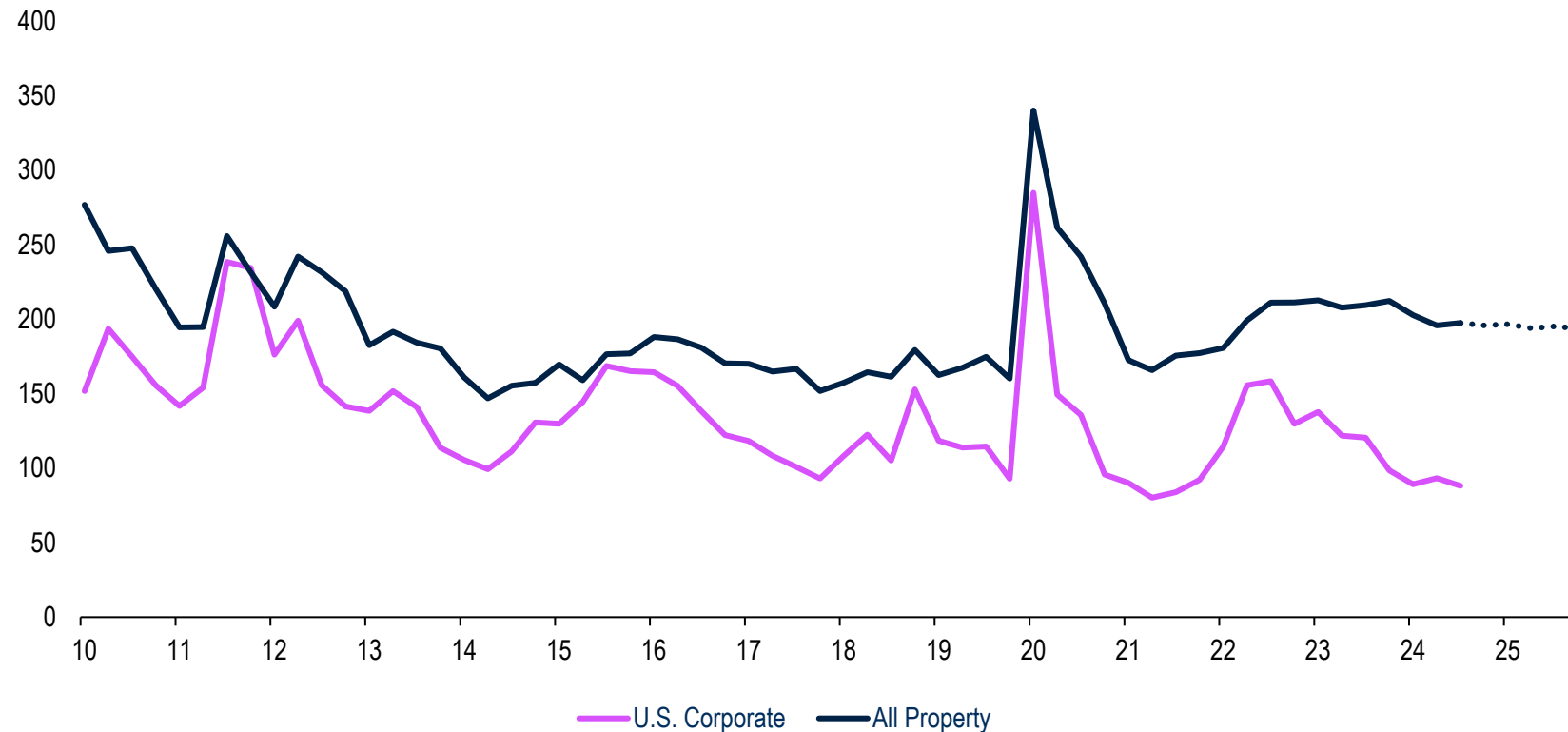
After a cycle characterized by low investment into the built environment, many buildings will need fresh capital injections.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

Sources: MSCI, OECD, Oxford Economics, PGIM Real Estate. As of November 2024.

Credit Strategies: Attractive CRE Debt Spreads

CRE Spreads* vs. IG Corporate OAS




CRE debt offers attractive relative value as the spread premium over comparable corporate bonds is significantly higher than historical averages.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

*Note: CRE spreads refer to 10-year fixed rate balance sheet spreads 60-65% LTV amortizing for banks, life insurance companies and investment managers, up to October 4, 2024.

Source: CREFC, PGIM Real Estate. As of November 2024.

Summary of U.S. Investment Opportunities

	NATURE OF OPPORTUNITY	REAL ESTATE APPROACH
 LIVING SECTOR	<p>Demographics Low homeownership affordability High construction costs</p>	<ul style="list-style-type: none"> • For-rent apartments • Single-family housing • Senior housing • Manufactured housing
 LOGISTICS	<p>E-commerce growth Urban infill supply constraints Investment in manufacturing Cross-border logistics needs</p>	<ul style="list-style-type: none"> • Infill logistics • Big box / supply chain • Southern U.S. border
 DATA CENTERS	<p>Data demand outstripping capacity Need for new development</p>	<ul style="list-style-type: none"> • Hyperscale • Colocation
 CREDIT	<p>Rising refinancing costs Bank retrenchment Workouts</p>	<ul style="list-style-type: none"> • Core originations • Transitional debt • Subordinated debt • Discounted loan purchases
 TACTICAL	<p>Consumer spending Low supply of high-quality product Need for redevelopment</p>	<ul style="list-style-type: none"> • Shopping centers • Higher-end office stock



1. LIVING SECTOR

Needs-based real estate that meets affordability objectives, targeting growing demographic segments in preferred locations.



2. LOGISTICS

Consumer, manufacturing and logistics-driven properties; selective on size and focused on shifting global trade patterns.



3. DATA CENTERS

Ongoing favorable demand-supply dynamics due to essential digital infrastructure needs.



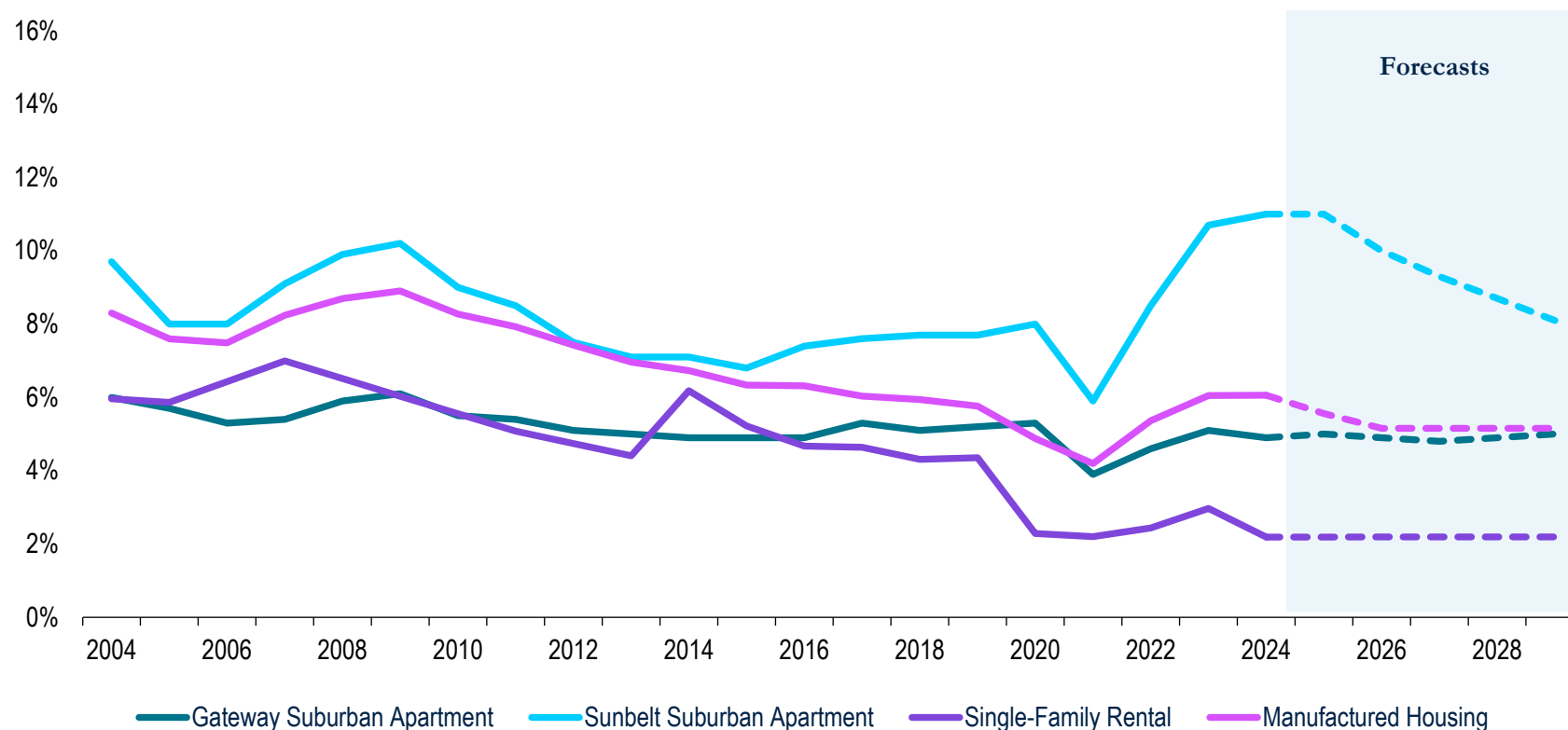
4. CREDIT

Capturing opportunities to lend as transaction volumes improve.



Suburban Living: Driven by Demographics and For-Sale Unaffordability

Vacancy Rate by Living Sector Segment



Vacancies will remain low across most segments, though the apartment sector in Sunbelt markets will need to work off near-term supply headwinds.

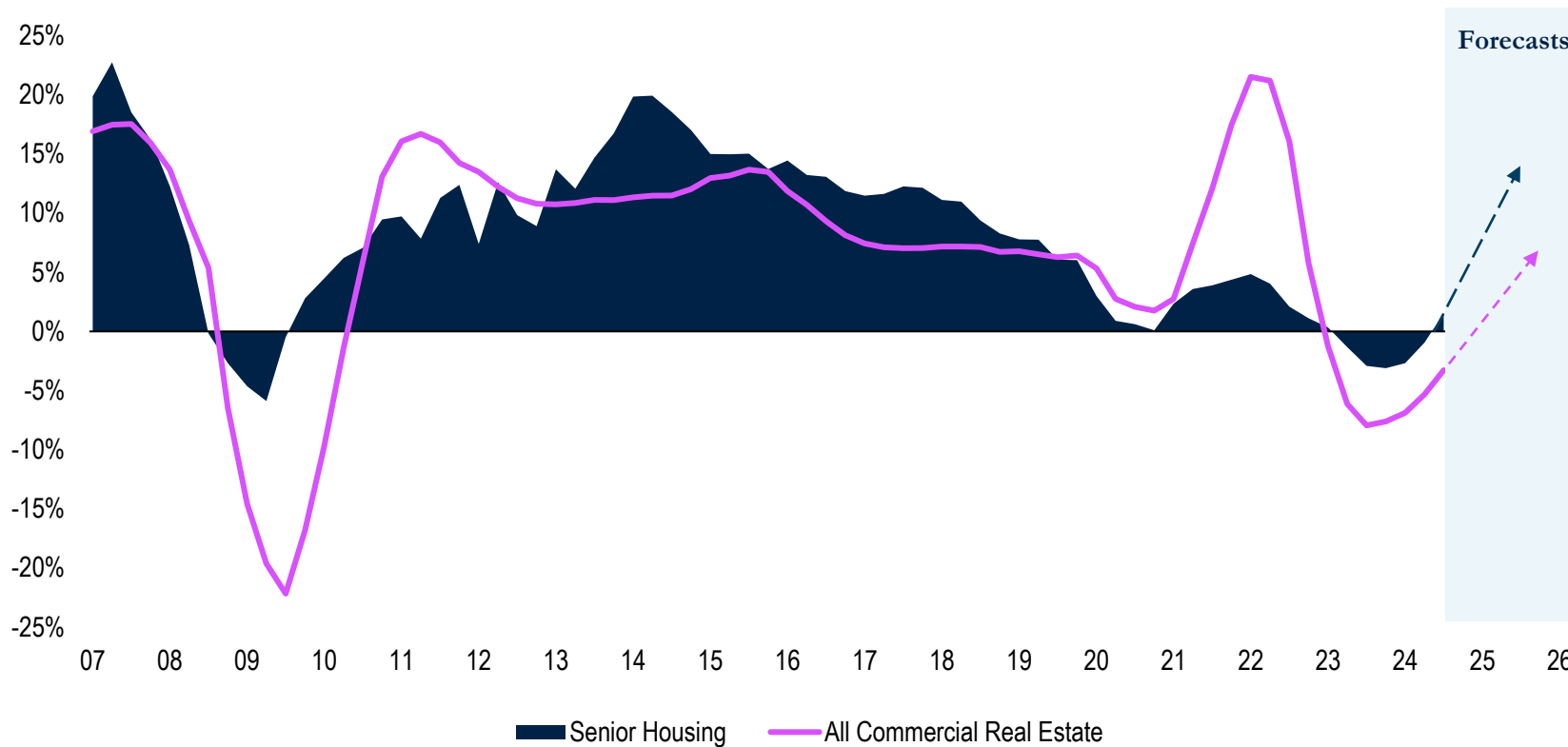
Forecasts are not guaranteed and may not be a reliable indicator of future results.

Sources: CoStar, Green Street, PGIM Real Estate. As of November 2024.



Senior Housing: Robust Demand Will Lead to Outsized Returns

Senior Housing and All Commercial Real Estate Returns (%)



Historically, senior housing has offered recession-resilient returns.

We expect outperformance from now driven by both cyclical and structural factors.

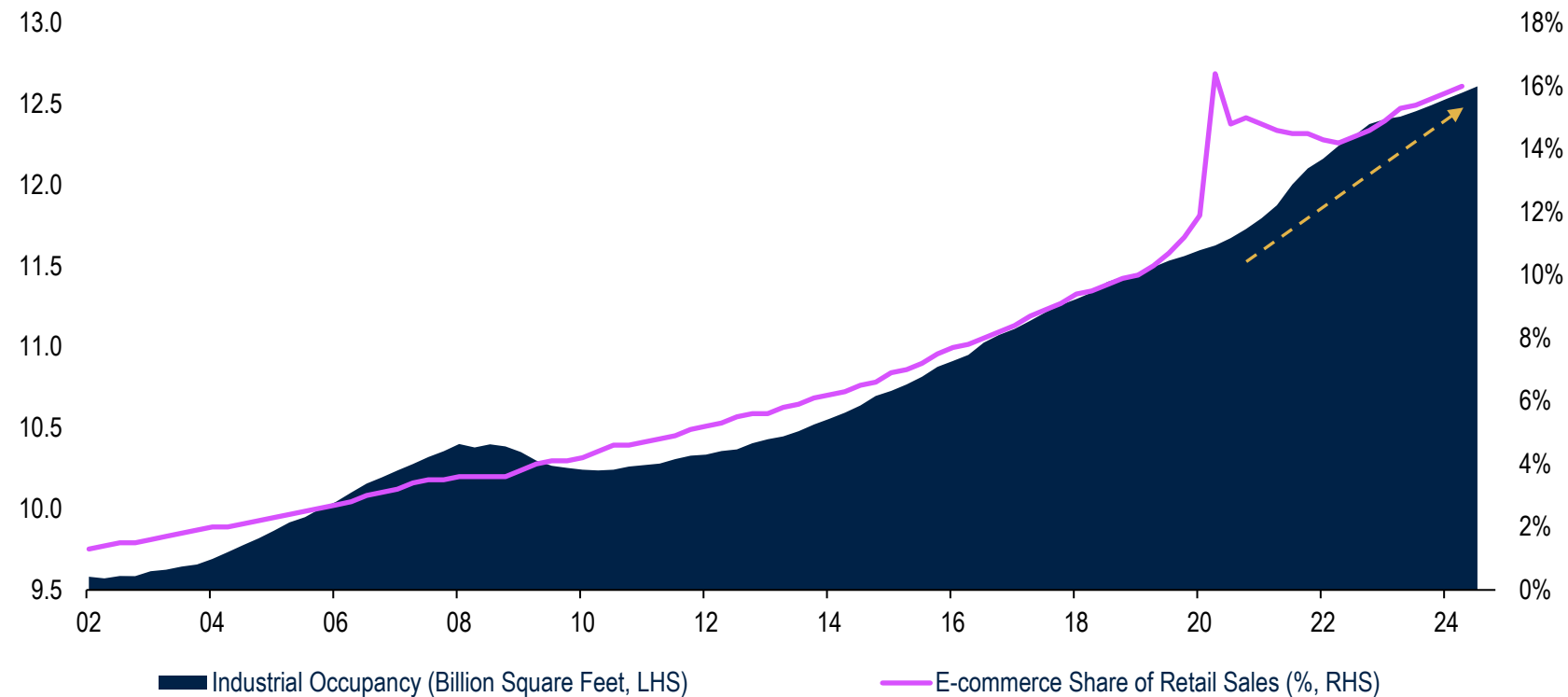
Forecasts are not guaranteed and may not be a reliable indicator of future results.

Sources: NCREIF, PGIM Real Estate. As of November 2024.



Logistics: Rising E-Commerce Continues to Push Demand Higher

Industrial Demand (Billion Square Feet) and U.S. E-Commerce Market Share (%)



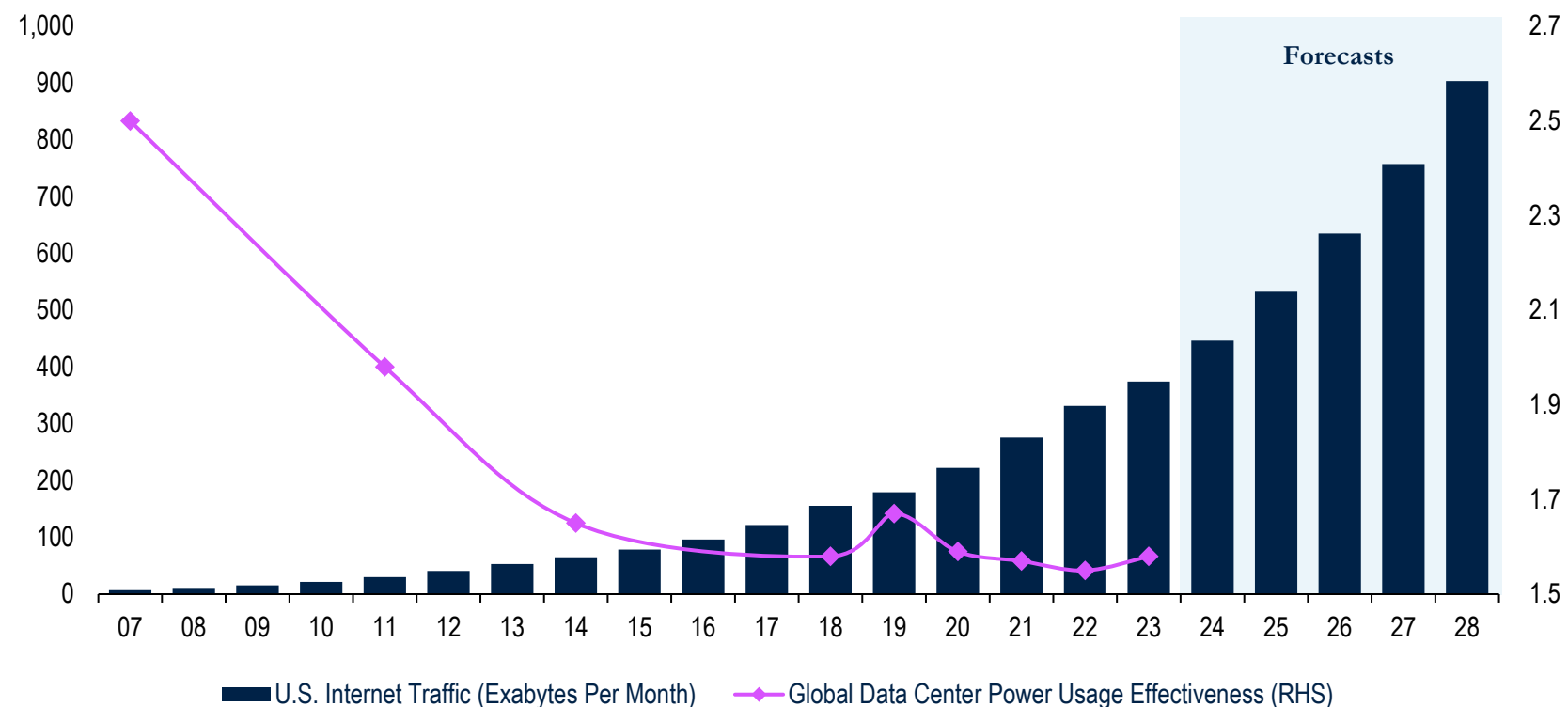
E-commerce penetration is approaching a new high after a brief pullback post-2020.

Sources: CoStar, CBRE, U.S. Census Bureau, PGIM Real Estate. As of November 2024.



Data Centers: Rising Data Use Will Drive Demand . . .

U.S. Internet Traffic Volume and Global Data Center Power Usage Effectiveness



Data center energy efficiency has plateaued.

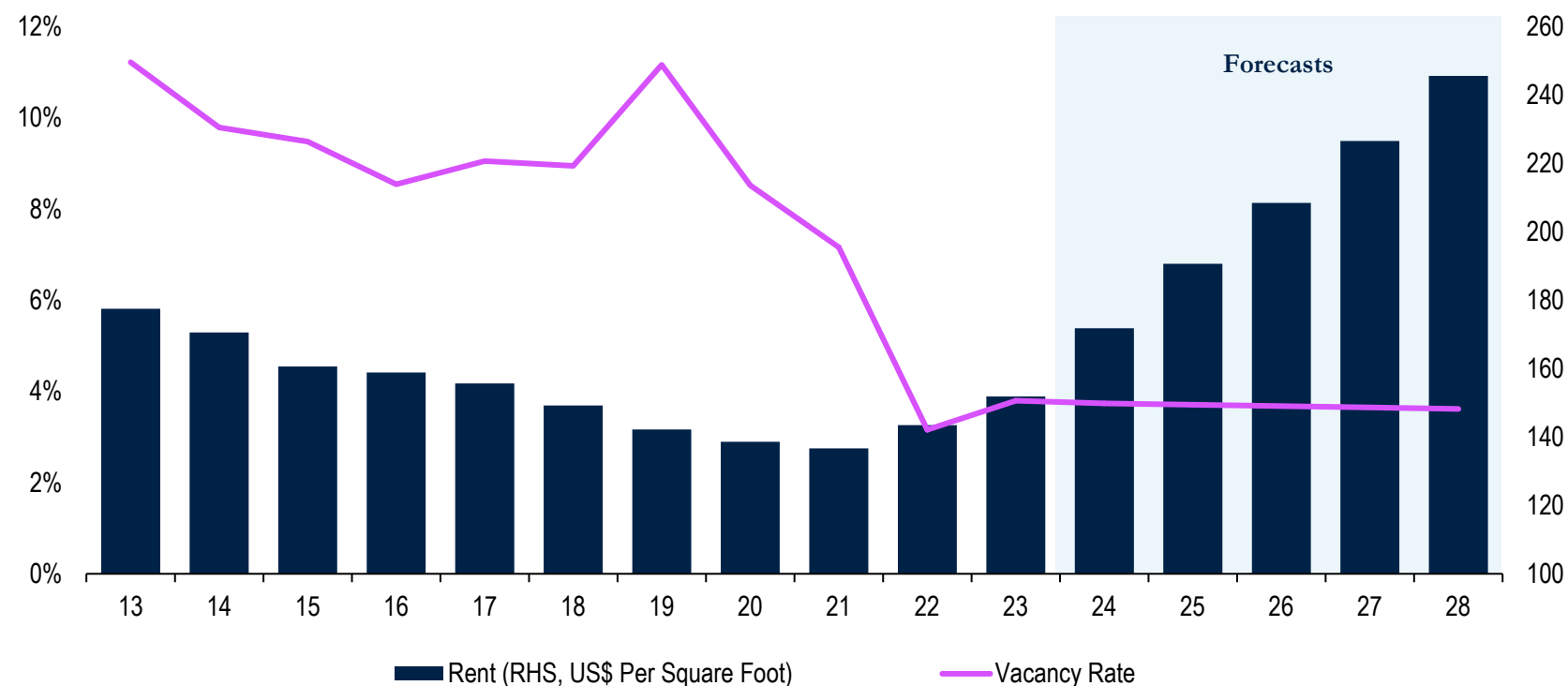
Ongoing technological transformations will underpin high future demand for more space.

Forecasts are not guaranteed and may not be a reliable indicator of future results.
Sources: IBISWorld, Uptime Institute, PGIM Real Estate. As of November 2024.



Data Centers: ... And Push Up Against Supply Limitations

Data Center Vacancy Rate vs. Rent (US\$ Per Square Foot)



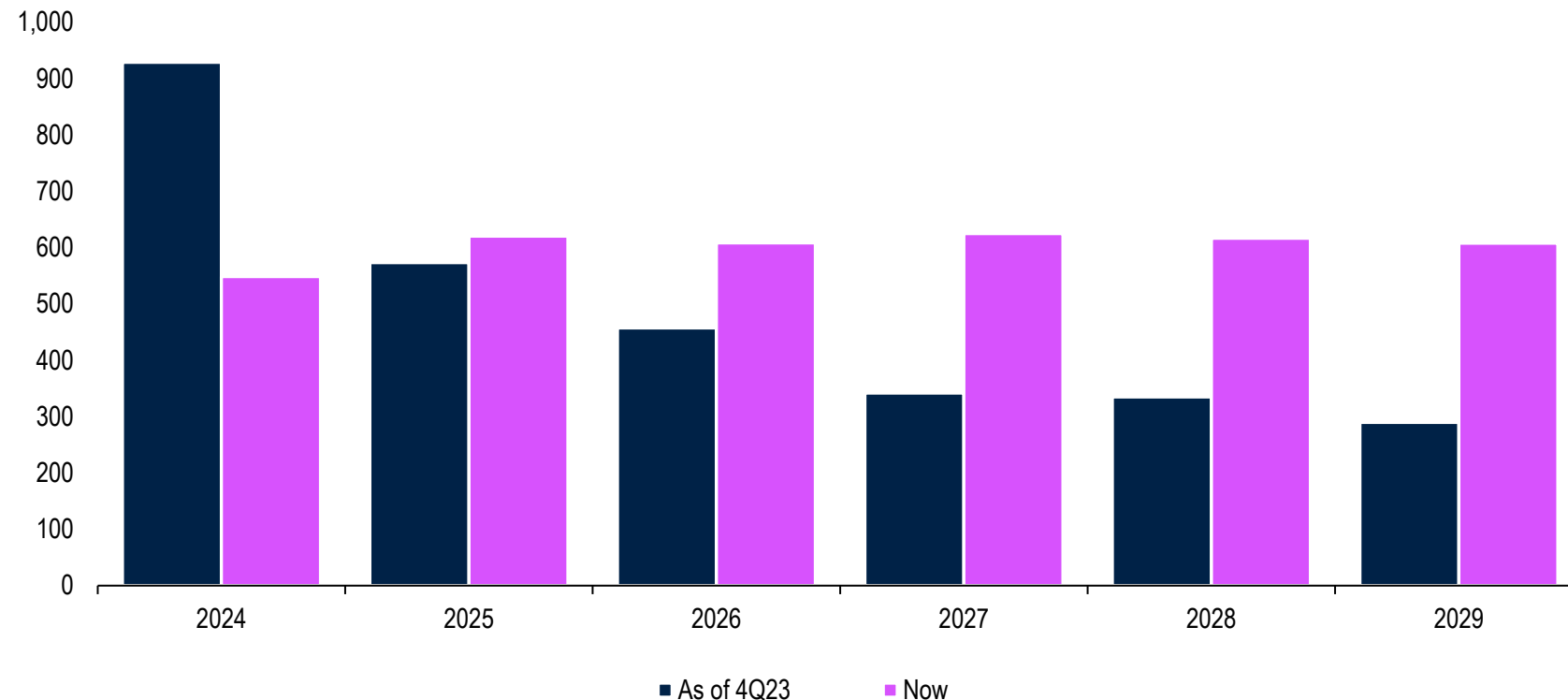
Excess data center capacity through much of the 2010s has reversed, which will drive rents up.

Forecasts are not guaranteed and may not be a reliable indicator of future results.
Sources: CBRE, Green Street Advisors, PGIM Real Estate. As of November 2024.



Credit: Prolonged Period to Capitalize on the Refinancing Gap...

Loan Maturities by Year (US\$ Billions)



The extension of high loan maturities into later years means that refinancing and recapitalization opportunities will extend through the rest of the decade.

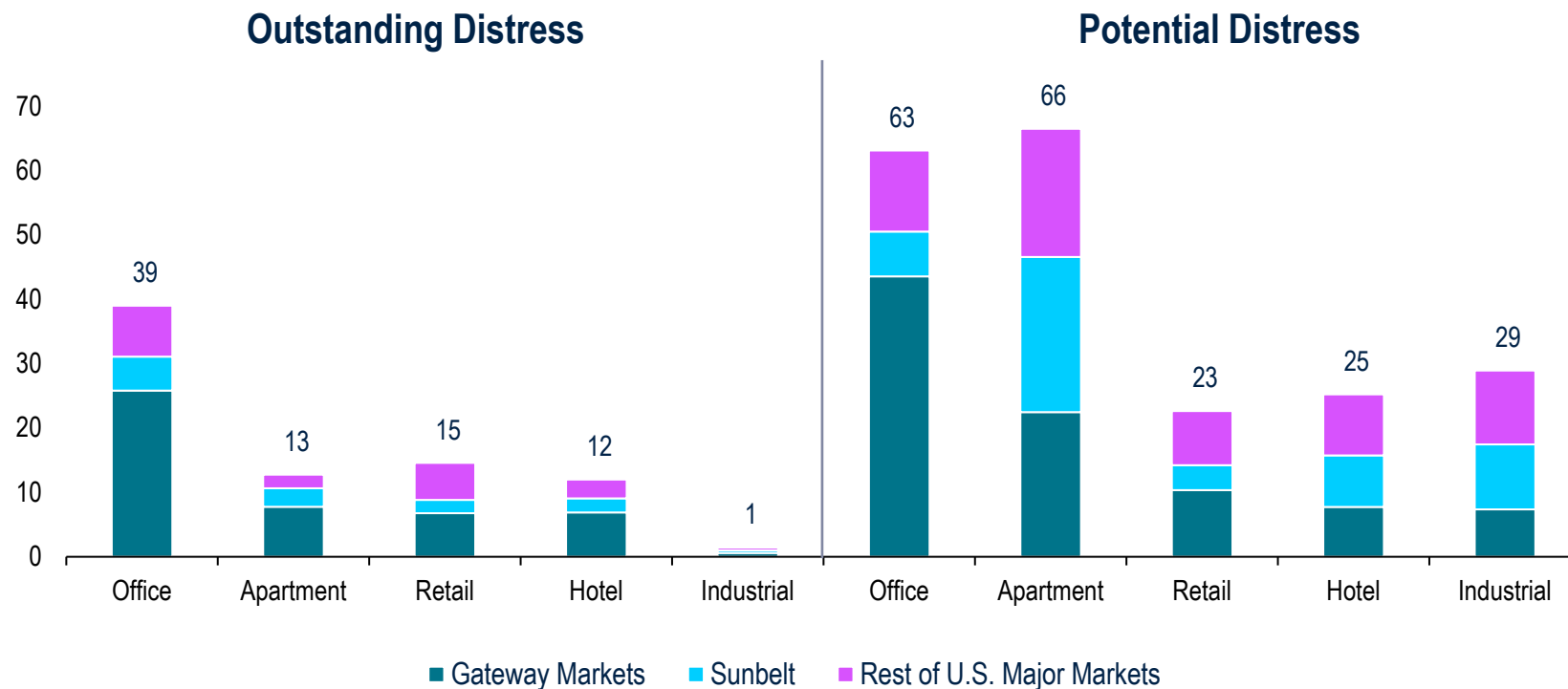
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Sources: CoStar, PGIM Real Estate. As of November 2024.



Credit: ...Including Multifamily in Gateway and Sunbelt Markets

Outstanding and Potential Distressed Debt (US\$ Billions)



Record new construction will create distressed apartment refinancing and recapitalization opportunities in the Sunbelt.

Forecasts are not guaranteed and may not be a reliable indicator of future results.
Sources: MSCI Real Capital Analytics, PGIM Real Estate. As of November 2024.



1. RETAIL

Shopping center formats offering necessity goods and services.



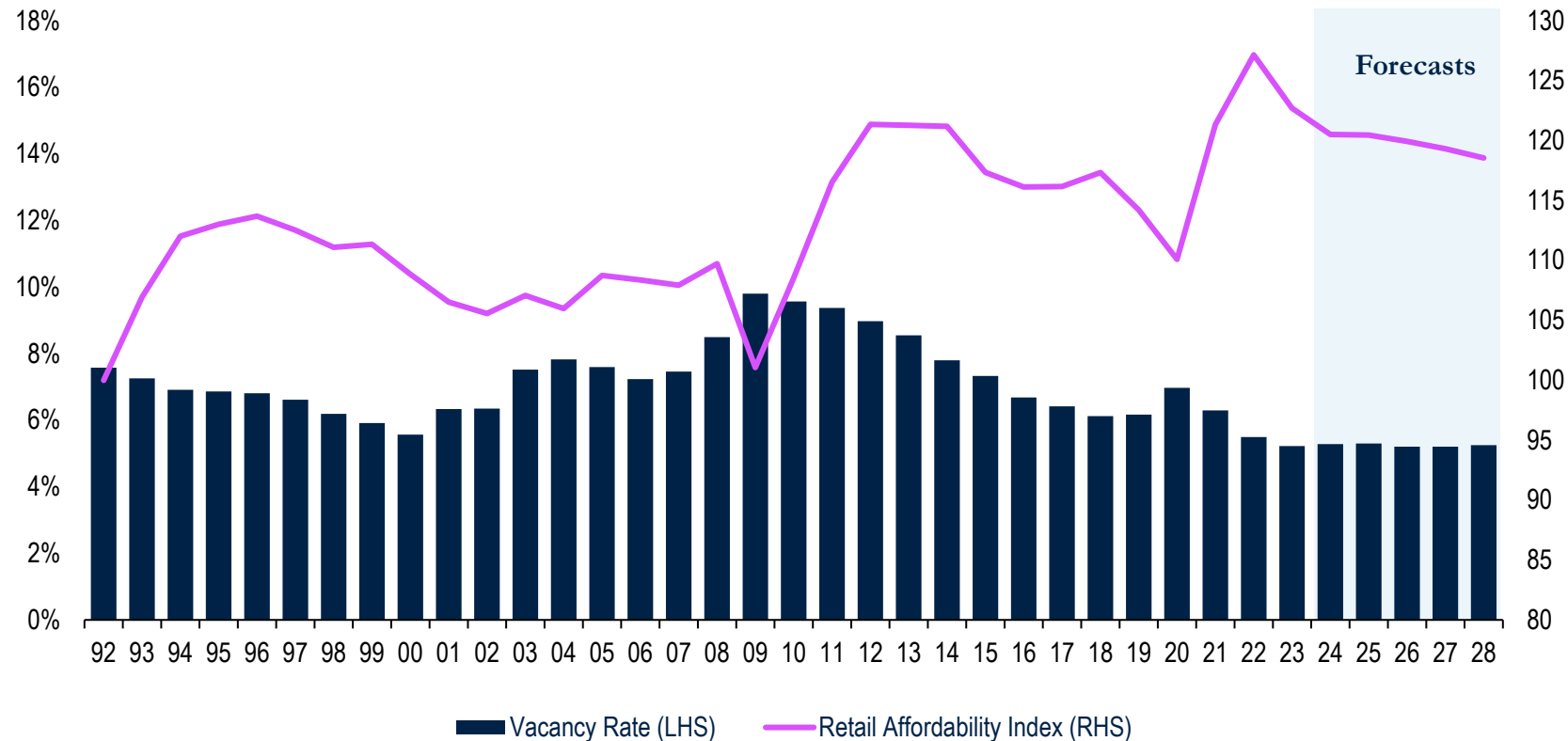
2. OFFICE

Office space improvements to meet modern tenant demand requirements.



Retail Income Growth: Room to Move Rents Higher

Retail Vacancy Rate vs. Rent Affordability Index (ratio of in-store sales to retail rents, 1992 = 100)



Since 2010, in-store retail sales have risen much faster than retail rents. This indicates that retailers can now afford higher rents.

With vacancies now historically low, retail center owners again have the leverage to raise rents.

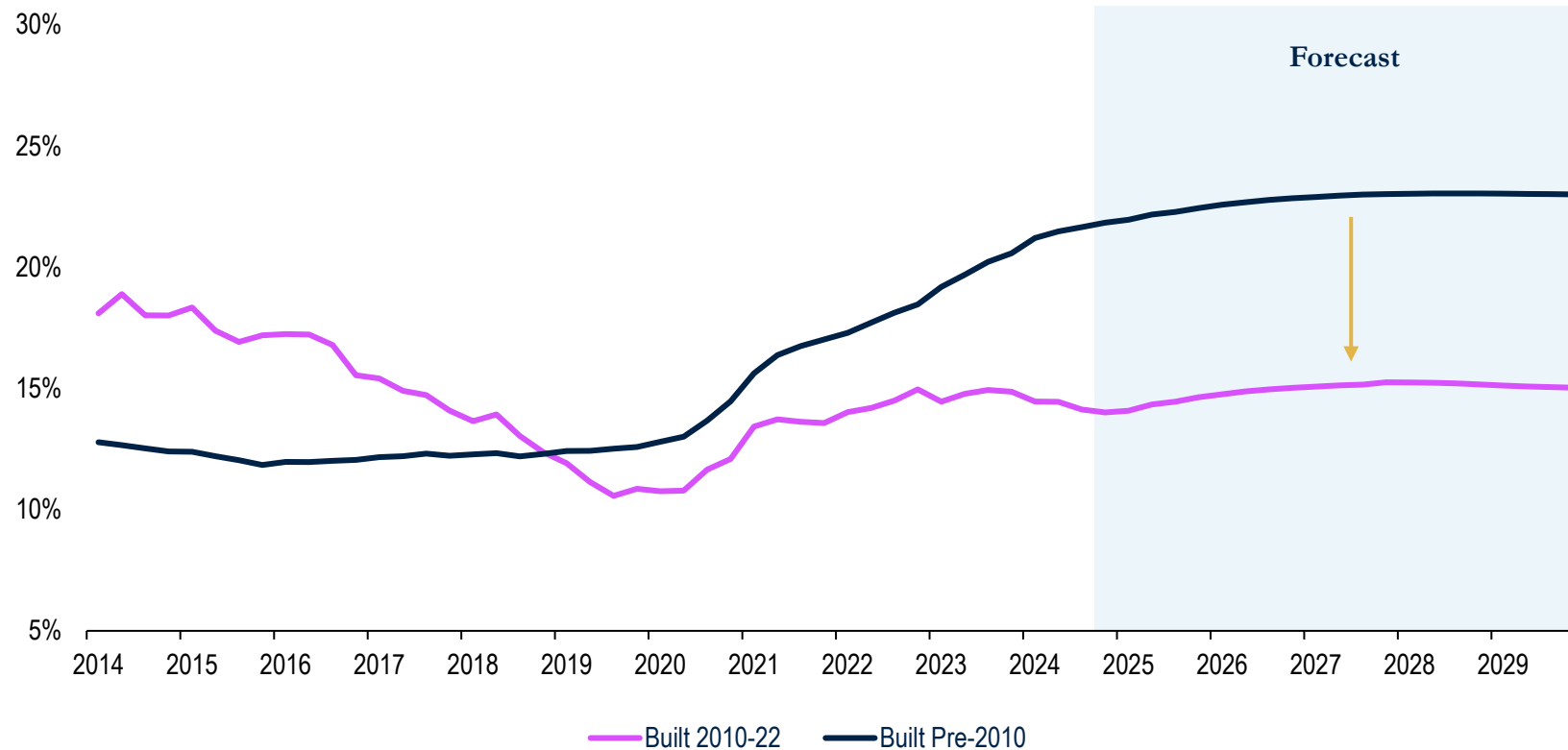
Forecasts are not guaranteed and may not be a reliable indicator of future results.

Sources: CoStar, Oxford Economics, PGIM Real Estate. As of November 2024.



Office Upgrades: Need for Improvements in a Period of Low Supply

Office Vacancy Rate by Vintage



Though overall office sector conditions remain challenged, tenant demand for newer vintage space has been resilient, keeping vacancies low.

With vacancies expected to stabilize, there is an opportunity to upgrade older buildings to compete with recently built ones and meet future tenant demand for modern space.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

Sources: CoStar, PGIM Real Estate. As of November 2024.

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