

RESEARCH BRIEF

CONSTRUCTION OUTLOOK

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Marcus & Millichap

Navigating Supply-Side Dynamics Key Part of Positioning Investment for the Future

The other half of the equation. Future construction plays a critical role in shaping long-term commercial real estate performance, including vacancy and rent growth, as well as investment decisions.

- Demand represents only one side of the market, with **long-term supply trends** equally important to commercial real estate.
- The supply outlook should therefore be a **central component** in CRE investment strategy.
- New construction typically lags market conditions, creating recurring cycles of **excess capacity and supply shortages**.
- As supply tightens, vacancies decline and rents rise, **eventually encouraging development**, which can reverse those trends.
- Property types and individual markets move through distinct **cycles**, which structural shifts can also disrupt.
- Offices face a **prolonged oversupply** following the pandemic-driven shift in demand, while retail may be approaching a **space shortage** as it continues to adapt to e-commerce.
- Apartments and industrial properties are absorbing excess supply nationally, but the construction outlook will affect even markets that are **not currently oversupplied**.

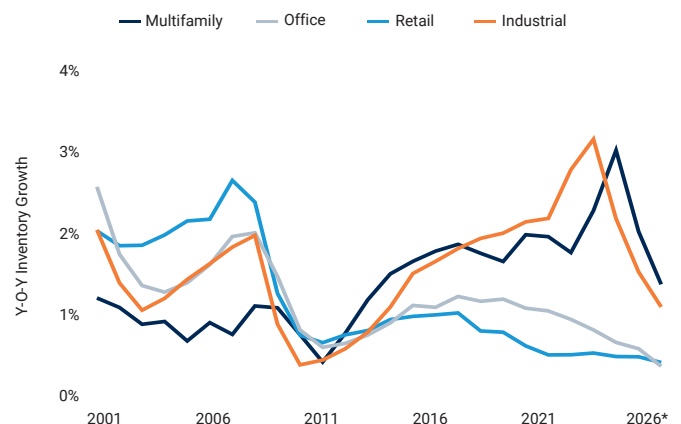
New projects face a higher threshold to break ground. Capital and resource constraints could limit inventory additions and extend favorable operating fundamentals.

- Three forces are aligning to restrain new construction and **potentially delay** the next development cycle by several years.
- Higher **interest rates** have significantly increased financing costs and reduced project feasibility.
- Trade policy, namely **tariffs**, and **elevated shipping expenses** are keeping building material prices high.
- Labor expenses are also under pressure from **immigration policy** and strong demand from **AI and data center development**.
- With overall costs elevated, new projects will likely remain limited until **rents rise enough** to support construction economics.
- Slower building activity could extend the falling-vacancy, rising-rent phase of the cycle, giving investors a **longer runway** for rent growth than the historical norm.

Identifying the next opportunity. Evaluating future growth alongside barriers to new supply can uncover opportunities before they become readily apparent.

- Apartment units under construction are down **50 percent** from their 2023 peak and continue to trend lower.
- Industrial space under construction has fallen **60 percent** from its 2022 peak, with the pipeline continuing to contract.
- Self-storage construction investment is down **32 percent** from its 2023 peak, while seniors housing and medical office are seeing **similar declines**.
- Retail and office construction **remain subdued**, with higher building costs likely delaying the next development cycle.
- Investment strategy may begin by identifying markets where **business expansion, job creation, and population growth** will support demand over a medium-term horizon.
- Those demand drivers should be cross-indexed against shrinking supply pipelines and **barriers to new construction**.
- Policy, land availability and land cost, and infrastructure constraints such as water and power can further limit future supply and **reveal opportunities** that may otherwise be overlooked.

INVENTORY EXPANSION IS SLOWING IN THE CURRENT CYCLE



* Forecast

Sources: Marcus & Millichap Research Services; Bureau of Economic Analysis; Bureau of Labor Statistics; CoStar Group, Inc.; Federal Reserve; NIC Map® Data and Analysis Service (www.nicmap.org); RealPage, Inc.; U.S. Census Bureau