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The K-shaped real estate market: why quality and location are driving a widening performance gap

What does a K-shaped economy mean for commercial real estate?

Hans Nordby: It means that the highest quality real estate outperforms average quality real estate in a wider gap over time. This is already underway. Just as technological innovation makes the most productive people in society even more valuable, it does something similar for high-quality real estate. It's been going on for a long time really. 15 years ago, the consensus was that retail was cooked; Amazon was going to do it in. All that bad news was true for the bottom 20 percent of the retail market; the class B and C malls and low-quality retail centers are out of business. That happened. Yet the top 20 percent to 25 percent of the retail market has thrived. The NOIs were durable. Quality won the day, and everybody wants in now. K-shaped demand exposed the opportunities and the risks of functional obsolescence. The poster child for this is office. 5 years ago, people were saying it was the end of the office market, and yes, for the bottom third of that sector, prospects are grim. But quality office space is thriving. Rents are high and going higher. Occupancies are super high. They haven't suffered on the NOI side.

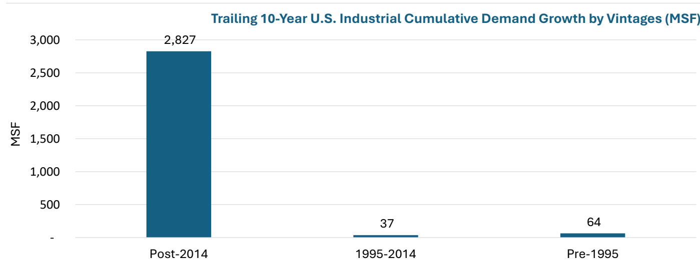
We believe it's logistics' turn. Industrial occupancies are under pressure nationally, but if you have the right building in the right location, there are opportunities for great NOI outcomes, especially now that construction deliveries have been declining for 2 years. This is starting to play out. Leases on older, less functional buildings that were executed when the market was super tight from 2020 to 2023 are rolling over now. The tenants are vacating that inferior space and moving to better-quality space much like retail and office tenants did before. And in every case it plays out on the NOI side, with growth for better buildings and losses for less desirable properties. We're focused on growing NOI in our business. For that, you need to be differentiated by the quality of the building and the quality of the submarket.

What differentiates truly top-tier industrial product today, and how are tenant expectations or supply chain needs influencing that definition across markets?

Hans Nordby: Increasingly the lead tenants driving the market are third-party logistics (3PLs), firms that specialize in distribution, who leverage technology and generally lease the best of the best buildings. At the same time, there is a shortage of labor in industrial settings, because 2.5 million workers left the country. The result is a high demand for top-quality real estate. The data shows that overwhelmingly the demand growth is in modern buildings that offer full functionality – typically those built in 2015 or later – whereas older buildings are losing traction.

Gary Jaye: Third-party logistics operators are leading occupancy gains because they utilize the latest technology, which requires modern buildings that can accommodate features such as expanded power, clear heights north of 36 feet, excess trailer and auto parking pre-wired for EVs, and the super-flat floors necessary to run robotics and automation equipment. Those are some of the attributes and vital calculations that determine how efficiently they can run a building. Occupiers are thinking not just in terms of square footage, but in terms of cubic feet, pallet storage capacity and the efficient movement of goods. Outdated buildings are not going to serve their needs, and they are going to be less sensitive to higher rent when they can save on labor, for example, and when they can move somewhere with all of these attributes needed to stay efficient and competitive in the long term. Occupiers are thinking ahead when they choose a building. Industrial lease terms are typically 5 to 10 years. Just think about the rate of change in AI. A year or two ago, it wasn't even that prevalent. To secure longer-term leases, properties will need to be pre-wired for new and accelerating technologies, with physical attributes that can deliver the required power. We're going to see rapid advances in many areas. It seems to happen slowly at first, until suddenly, it accelerates. The cycle of change is compressed, so in a sense, the buildings need to be future-proofed.

Figure 1. Automation in (AI) action: demand growth concentrated in modern properties



Source: Transwestern, CoStar, as of 2025 Q4

How are class A multifamily assets diverging from class B and C assets, and what is driving that divergence?

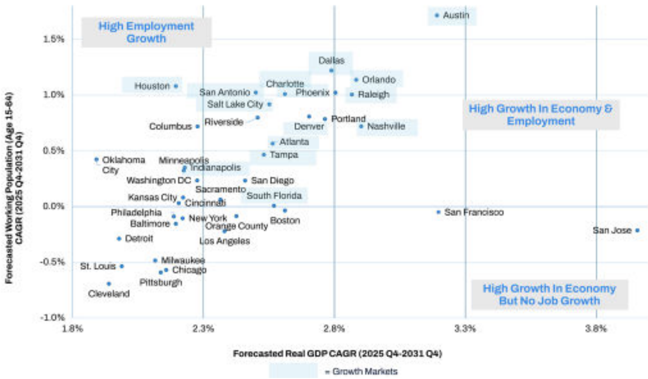
Hans Nordby: For the past couple of years class A directly felt the increase in vacancy because that's where the supply was, and there was a lot of supply. We're starting to see that change now. Year-over-year demand growth is positive in class A properties, and negative in class B and C. Certainly we've seen a shutdown in supply, so I think there will be a lot of success in submarkets where people really want to be. Here's what's different: for the past 20 years the millennials were entering their peak renting years. They're washing out of their renting years now. So, while the renter pool should continue growing, it won't grow at anywhere near the same rate, especially with lower immigration. Investors need to consider the demand growth at the metro, submarket and street-corner levels in a way they didn't when demand was everywhere. When we consider things through the lens of the K-shaped economy, we look at the intersection of factors like, "Where is the growth in higher-paying jobs?" and "Where are populations growing?" Some of the coastal cities that are so popular now are not going to look quite as favorable in the long run as markets that are oversupplied today, because coastal markets won't have growth in their renter pools and, in some cases, aren't producing high-paying jobs.

Gary Jaye: Renters are renting for a longer period of time and it's a lifestyle choice in many cases. Robust amenity packages, which include walkability to grocery stores, restaurants, and upscale fitness can be a key performance differentiator. Many renters by choice prefer to be in that kind of an ecosystem amongst their peers. Location within that ecosystem is a key driver.

How is the ongoing shortage of retail supply shaping performance across the sector? And then how are investors capitalizing on that imbalance?

Gary Jaye: Investor demand for retail is currently very high, largely due to a historic underallocation to the sector. There's an influx of capital right now that is exposing this lack of supply. Investors

Figure 2. Targeting geographies with strong drivers



Source: Transwestern, Oxford Economics

are starting to reimagine the types of retail they want to buy or develop, emphasizing environments like mixed-use that are outside of what existed in the past. B and C class centers have become obsolete, leaving far too many occupiers vying for not enough quality space, and without a viable path to quickly create more space. There's a hyperfocus on strategies to capitalize on that supply-demand imbalance: are you going to allocate capital to development? Are you going to reposition or redevelop an old center? The answer should be both. There's significant capital market activity, lots of new tenant concepts and expansions going on. I think the demand side is going to be a lot stronger than supply for the foreseeable future.

Hans Nordby: We've had 15 years of very low retail supply growth. Aside from data centers, there's more near-term demand for new retail construction than for any of the other major property types. In locations where you can't build, it's a great environment for redevelopment as well. While overall working-age population growth in this country is the moral equivalent of zero, plenty of cities are seeing an increase. Remember millennials aren't 25 years old anymore; they're tragically entering that adult zone where money flies out the door for the kids, for the house, for the furnishings and all those things. That disproportionately benefits places where there is population growth, which is mostly about domestic migration, and cities with growth in high-quality, often office-using jobs – cities like Dallas, Phoenix, Raleigh and Austin.

In the office sector, how is the divide between class A and lower-tier assets evolving, and what specific building characteristics or locations are proving most resilient in attracting tenants?

Hans Nordby: It's mixed-use environments and live-work-walk environments that attract tenants, places where there's a healthy cross-section of property types, and office might even account for a minority of square footage in the area. Compare that to mono-use high-rises like Bunker Hill in LA that are 30 to 40 years old and 40 stories tall, with only one use in the district.

Gary Jaye: Let's take Dallas for example. Preston Center, where we have an office, and the Uptown submarkets are leading in occupancy and rental rates. Contrast that to the Dallas Central Business District where the buildings are older and outdated. In Uptown you have great diversification. There's walkable retail and lots of growing businesses that are hiring workers who want to be there. It's a vibrant ecosystem. You're going to see triple-net leases with rents upwards of $50 to $75+ per square foot. Just a short distance from Uptown, in the CBD, the rents could be a fraction of that. You might think the sizable rent discount would be a demand driver, but that cost savings simply does not translate. The occupiers want to be where their workers want to be. That's a big differentiator. We are focused on projects that cater to where the customer wants to be, where the occupier wants to be, and where we can attract the best of both. For example, we have a very large mixed-use development underway in River Oaks in Houston called the RO, one of the most unique projects of its kind in the U.S. It's going to be office, residential, hotel, streetscape retail, and food and beverage, with subterranean parking. We don't want to see cars and pedestrians mix. We want to have that Old Town Houston feel. Those are the qualities that satisfy that particular market and will drive outperformance.

Looking ahead, what are your expectations for the real estate market more broadly?

Gary Jaye: We're coming out of a period when real estate was accused of being boring compared to other higher-yield investment opportunities. Capital is flowing back into real estate again because investors are looking for a safer place to invest. As that happens, the tide may rise across the board, but outperformance will be conditioned by technological changes and all the other supply and demand factors we've been discussing. When it comes to specific rent performance and alpha, location and quality matter more than they ever have. Your alpha is going to be based on the K-shaped economy.

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