Morgan Stanley
INVESTMENT MANAGEMENT

Real Estate Midyear Outlook

Constructive Amid Fluid Backdrop

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The current macroenvironment is proving to be resilient, yet volatile and divergent. Interest rate policy has shifted from dovish to hawkish as central bankers combat elevated inflation fueled by energy price spikes. Real estate continues to screen attractively against other alternatives given re-pricing of ~25%, durability of income flows in sectors aligned to structural trends and a meaningfully lower supply environment, exacerbated by even higher construction costs. While MSREI remains constructive on the overall environment, the ability to build a diversified portfolio, dynamically shift capital between regions and/or asset classes and "stock pick" assets with specifications and locational attributes that fit new occupier demand preferences, remains critical.

Macroeconomic Environment

Contending with higher tariffs last year and ongoing Middle East conflict this year, global economies have remained surprisingly resilient. Pockets of outsized nominal growth exist in the U.S. (+6%), Japan (+4%) and Korea (+4%) which is driving strong real estate fundamentals, particularly in the absence of new supply.[1] While the U.S. economy is benefitting from the adoption of AI across all sectors of the economy and a pick-up in manufacturing, Japan and Korea are benefiting from exporting the chips and tech components that feed the U.S. adoption of AI. While Europe's growth has moderated below trend due to the impact of higher inflation on real consumer incomes and spending, government stimulus and private markets investment in defense and infrastructure should support a recovery in fundamentals once inflation subsides.

[1] Real Capital Analytics, July 2026

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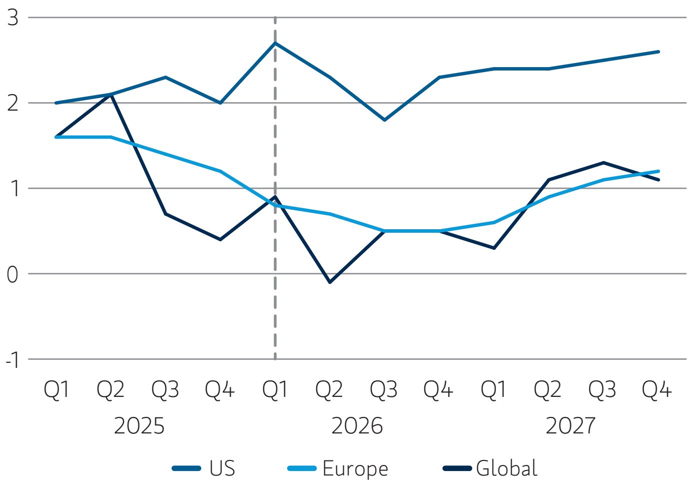
DISPLAY 1

U.S. Growth Structurally Higher

Real GDP Growth % (Quarterly)

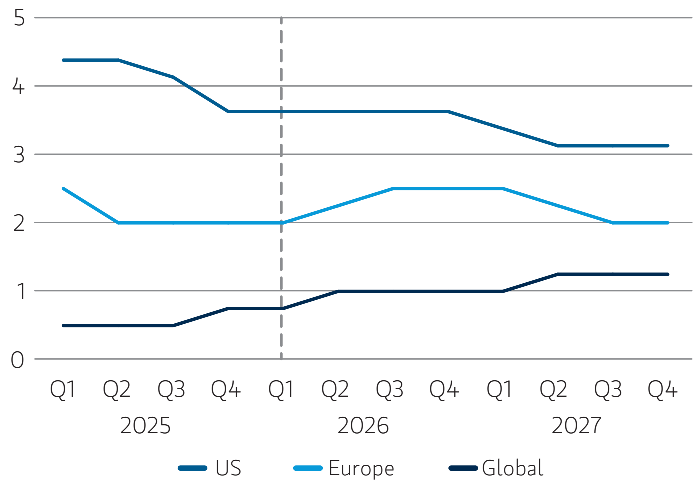


Source: MS Research, data as of May 2026

DISPLAY 2

Interest Rates Higher in the Near Term

Policy Rates (%)



Source: MS Research, data as of May 2026

While the uptick in inflation has been the major driver of an upward shift in interest rate curves around the world, the strength of the underlying economies and higher priced AI inputs has also contributed to a more hawkish central bank position. Australia and Japan were first out of the gates with interest rate hikes (75bp and 50bps respectively), followed by Europe (+25bps). The Fed has recently shifted its focus from employment to inflation, resulting in the removal of its easing bias and a hold through the medium term, with upside risk of higher rates if inflation remains sticky.

This structurally higher nominal growth, inflation and interest rate environment is likely to stay. The ability to acquire assets at an attractive basis below replacement cost, in sectors and locations where growth can exceed what the underlying economy can deliver, becomes critically important to deliver outperformance.

Commercial Real Estate Market

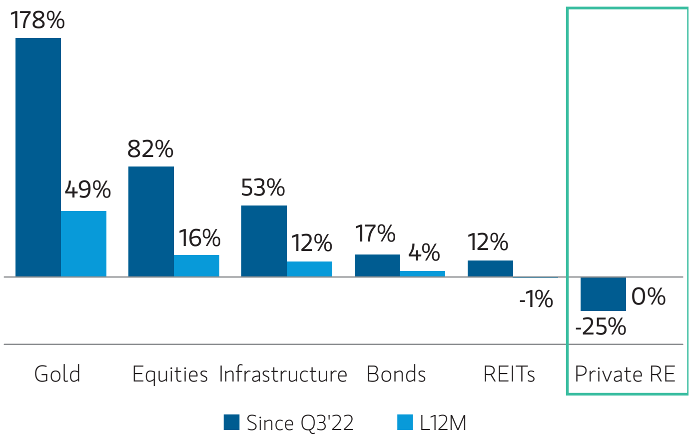
Despite events in the Middle East and the subsequent shift in interest rate policy, real estate capital flows have remained resilient as investors gravitate towards its relative value, inflation hedging attributes, and alignment with long term structural trends. Transaction activity is up 23% in the US, 25% in Asia and down 7% in Europe (YOY) through the first half of 2026.[2] With prices down 20-25% and yields at their highest level in ten years, real estate is viewed as "cheap" relative to other asset classes which continue to push record highs in values or tights in spreads.

[2] Real Capital Analytics, July 2026

DISPLAY 3

U.S. Private Real Estate vs Other Asset Classes Relative Valuation

Appreciation Index from Q3'22

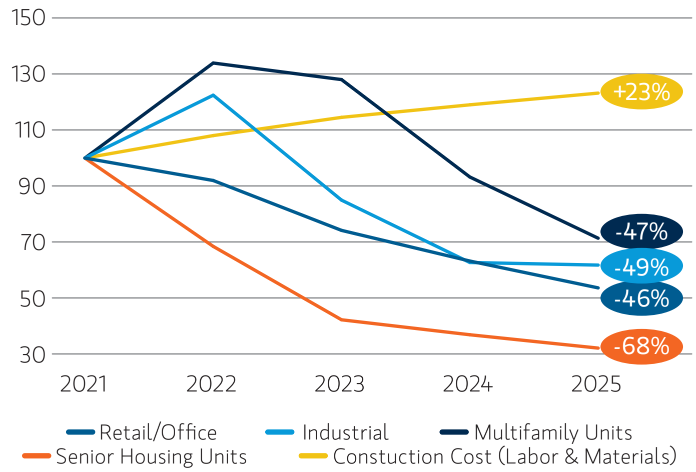


Source: Bloomberg, Greenstreet, MSREI Strategy, March 2026

DISPLAY 4

Reduced Supply Supports Fundamentals

U.S. Space Under Construction and Construction Cost Indexed to 2021



Source: Costar, NICMAP, March 2026

Additionally, given inflation forecasts are higher, real estate's proven ability to outperform during inflationary periods has become a much sought after attribute. Since the 1970s, real estate has generated total returns above inflation in five of the seven high inflation periods.[3] This outperformance is largely due to strong income growth derived from lower supply. Today's environment mirrors several of these moderate demand-pull/cost-push environments, where elevated construction and financing costs should continue to slow new development, tighten future supply and ultimately support rent growth and value appreciation in existing assets.

Lastly, clear pockets of outperformance in fundamentals and pricing are emerging for assets/locations/sectors levered to growing parts of the economy or long-term structural trends, including AI, defense, aging and de-globalization. By way of example, senior housing in the U.S. (aligned with aging demographics) continues to deliver rent growth of 7-10% and cap rate compression of 100-150bps over the past 12 months. Office assets in Japan (supported by the reflating economy) have delivered rent growth of 14% (YOY through 1Q26) while cap rates have held steady (despite higher interest rates).[4] Lastly in Europe, there are opportunities to acquire assets aligned to these themes at a discounted entry basis due to capital markets dislocation. This bifurcation in performance requires a very granular approach to selecting assets, sub sectors and locations tied to durable long-term trends.

Real Estate Investing Strategies

As discussed above, the ability to acquire tangible real estate aligned with long-term structural trends is a critical driver of outperformance, particularly in an environment where cyclical volatility, geopolitical risks and political fragmentation are becoming more frequent. Morgan Stanley Research highlights four key themes that have recently generated outsized returns: AI and technology diffusion (+108% LTM equity returns), deglobalization (+104%), societal shifts (+7%), and the future of energy (+56%).

[3] High inflationary period defined as rolling four quarter annual inflation above 3%

[4] PMA, Greenstreet, July 2026

Despite this strong performance at the equity level, valuations for real estate linked to these same themes have largely remained flat—creating a notable disconnect—aside from data centers, which have appreciated approximately 22%.[5] This divergence presents a compelling opportunity to deploy capital into real assets, with the potential for both income growth and capital appreciation as these structural tailwinds increasingly translate into physical space demand.

MULTIPOLAR WORLD

While tariffs, deglobalization, and reshoring trends continue to underpin demand for industrial space, an increasing focus on defense spending, particularly in the U.S. and Germany, is providing an additional and accelerating tailwind. In the U.S., manufacturing and industrial production activity has strengthened, with manufacturing users now accounting for approximately 25% of total industrial leasing demand, reflecting a structural shift toward onshoring and supply chain resilience.[6] In Europe, the case for increased defense spending is even more pronounced, with the Middle East conflict reinforcing the urgency for R&D in advanced weaponry and technologies. This is translating into tangible real estate demand, particularly within established innovation clusters such as Paris and Munich, where defense-related industrial and R&D space is expected to grow meaningfully—potentially comprising 15–20% of total industrial stock within the next decade.

AI/TECH DIFFUSION

AI spending in the U.S. and globally continues to grow at an exponential pace, with nearly $3 trillion in AI-related infrastructure investment expected to flow through the global economy by 2028—over 80% of which is still ahead. This surge is already having a measurable macroeconomic impact, with AI projected to drive approximately 25% of U.S. GDP growth this year.[7] This dynamic creates a compelling

DISPLAY 5

MS Research Structural Themes, Equity Returns and Real Estate Strategies

Multipolar World	▪ Global defense ▪ Manufacturing reshoring ▪ Critical minerals ▪ Tech localization	104%	+ Industrial R&D + Manufacturing + Logistics benefiting from supply chain shifts
AI/Tech Diffusion	▪ AI enablers ▪ AI adopters ▪ AI infrastructure ▪ Humanoids/Robotics	108%	+ Data centers and derivative industrial + R&D innovation clusters/infill industrial + Prime office and resi
Societal Shifts	▪ Aging population ▪ AI-driven employment disruption ▪ K-shaped economy ▪ Shifts in demographics/consumer preferences	7%	+ Senior living + Class A Residential + High-end retail/hotels
Future of Energy	▪ Powering AI ▪ Nuclear renaissance ▪ Energy security and independence ▪ Clean energy	56%	+ Heavy powered solutions (industrial) + Micro grid value-add (batteries, NG conv.) + Value-add to improve energy efficiency

Source: Bloomberg Morgan Stanley custom ETFs, June 4, 2025, to June 4, 2026

[5] Greenstreet CPPI index, July 2026

[6] Morgan Stanley Research, June 20264 PMA, Greenstreet, July 2026

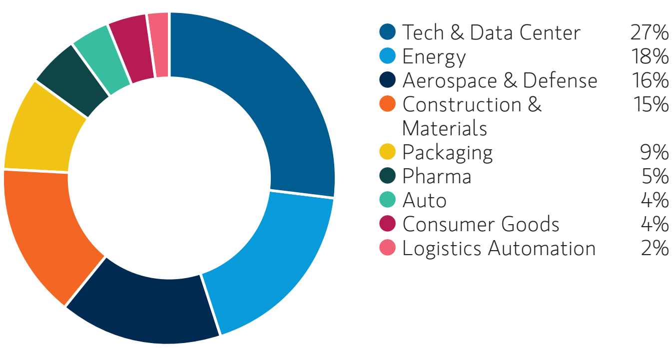
[7] Morgan Stanley Research, July 2026

opportunity to invest in real estate and markets that disproportionately benefit from AI enablement and physical deployment. Strategically, this favors overweight exposure to regions experiencing AI-driven GDP acceleration—particularly the U.S., Korea, and Japan—and to sectors that benefit both directly and indirectly, including industrial (such as advanced manufacturing, distribution and small-bay facilities in data center clusters, office R&D, and multifamily in markets facing less AI disruption risk). AI related demand is also reshaping geographic and asset-level dynamics, concentrating activity in major global hubs such as the San Francisco Bay Area, Northern Virginia, Los Angeles, Boston, Tokyo, Seoul, Munich, Paris, and London, often clustering further within micro-locations (e.g., Fremont in SFBA, El Segundo in Los Angeles).

DISPLAY 6

Manufacturing is Expanding Driving Leasing

Manufacturing Leasing by Occupier Type (%)



Source: Morgan Stanley Research, June 2026

SOCIETAL SHIFTS

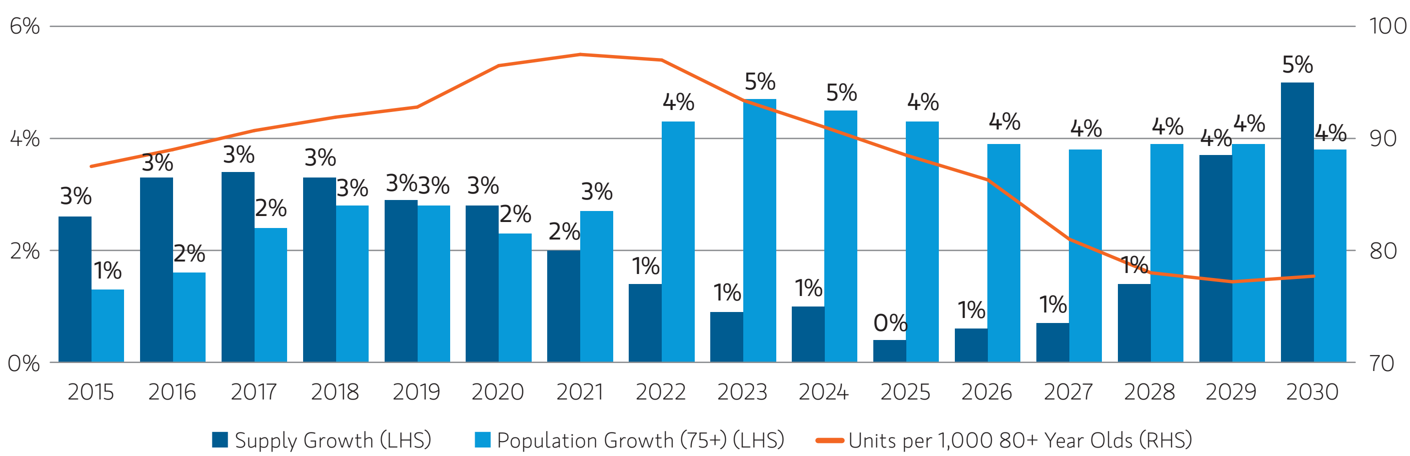
Aging demographics, shifting migration patterns, urbanization and the continued emergence of the K-shaped economy are key forces shaping residential investment strategies. In the U.S., the 80+ age cohort is expected to grow at 5% per annum through the end of the decade and continue outpacing new supply growth in senior housing. These dynamics are driving expectations for high single digit rent growth in the sector over the coming years. At the same time, evolving migration trends, including a rebalancing between gateway markets (impacted by reduced immigration) and Sunbelt regions (where domestic migration is moderating), combined with localized pockets of under- and oversupply, reinforce the need for a diversified and market-specific investment approach. Internationally, Japan continues to benefit from strong population inflows into the central wards of Tokyo, driven by urbanization and wage growth, resulting in outsized rent increases for the first time in many years. In Europe, where housing undersupply remains particularly acute (for example, only ~1,000 multifamily units commenced construction in London in 2025, down from an already low annual average of 5,000,

DISPLAY 7

U.S. Population Growth (75+) Should Drive Senior Housing Demand

Annual Growth in 75+ Age Cohort & Supply Growth

Units/1,000 80+ year olds



Source: John Burns, NIC MAP, MSREI Strategy, June 2026 for a population of 9 million),[8] the opportunity to acquire assets below replacement cost with embedded rental upside remains compelling, despite regulatory headwinds. More broadly, the K-shaped economy is favoring residential assets that cater to higher-income households, while also supporting hospitality demand in key European and Japanese markets that benefit from multiple demand drivers, including both tourism and business travel.

FUTURE OF ENERGY

The availability, cost and security of energy remain top of mind. Higher costs, initially driven by the rapid build out of data centers, have been further compounded by energy price spikes stemming from the Middle East conflict and closure of the Strait of Hormuz. At the same time, demand is accelerating sharply, fueled not only by data centers, but also by the physical adoption of AI (e.g., robotics), defense spending and broader industrial and manufacturing activity. In this environment, investment strategies focused on assets with surplus or secured power capacity are likely to continue commanding rent and valuation premiums. Similarly, markets characterized by abundant, reliable, and lower-cost power are positioned to capture a disproportionate share of incremental demand.

Conclusion

Overall, the investment landscape for real estate is increasingly defined by a combination of resilient macro fundamentals, structural supply constraints, and powerful secular tailwinds. While volatility in interest rates, geopolitics, and inflation is likely to persist, the ongoing repricing cycle has created a more compelling entry point, particularly for assets acquired below replacement cost and aligned with durable sources of demand. In this environment, outperformance will be driven by dynamic capital allocation, regional and sector diversification, and highly selective, asset-level underwriting.

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[8] Knight Frank, Multifamily Market Report, 2026

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