

The Repricing of CRE Construction

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Key Points

- **Construction costs have shifted from a temporary pandemic-era shock to a more persistent investment variable.** Supply-chain normalization has reduced some of the volatility seen in 2021 and 2022, but tariffs, energy and freight costs, constrained production capacity, labor shortages, and elevated financing costs continue to pressure development economics.
- **Construction costs and property values have diverged significantly across CRE sectors.** Industrial values have generally kept pace with development costs, while multifamily, office, and retail values have lagged, narrowing development spreads and contributing to smaller construction pipelines in many markets.
- **Higher replacement costs are most supportive of modern, well-located properties with durable demand and limited competing supply**, while offering less benefit to outdated formats that would not be economically viable to build today.
- **Investors and lenders underwriting development opportunities or significant value-add renovations should carefully evaluate construction-related risks** by stress-testing budgets for changes in material and labor costs, as well as potential schedule delays.

Materials

The current construction-cost cycle began with COVID-era factory shutdowns, port congestion, and abrupt shifts in demand for goods, which created widespread supply-chain bottlenecks. When a sharp demand rebound, fueled by fiscal stimulus and accumulated household savings, hit those strained supply chains during a surge in industrial and multifamily construction, building-material prices spiked. The war in Ukraine then added an energy and commodity shock on the supply side.[1] Since early 2025, tariffs and shifts in trade policy have contributed to higher material costs. Although effective tariff rates have declined from their fall 2025 peak,[2] the recent trade dispute with Canada, along with 50% tariffs on a range of goods that includes building materials such as wood products and cement, shows that uncertainty remains.[3]

More recently, renewed conflict in the Middle East has increased both the risk premium embedded in

[1] Julian di Giovanni, Şebnem Kalemli-Özcan, Alvaro Silva and Muhammed A. Yıldırım. (2023, November; revised July 2024). *Pandemic-Era Inflation Drivers and Global Spillovers.* (Staff Report No. 1080). Federal Reserve Bank of New York.

[2] Penn Wharton Budget Model. (n.d.) *Tariffs.* University of Pennsylvania.

[3] Wyatte Grantham-Philips. (2026, August 22). *What to Know About Trump's 50% Tariffs on Canadian Goods That Just Went Into Effect.* PBS NewsHour.

construction bids and direct energy costs.[45] As a result, from February 2020 to August 2026, the Bureau of Labor Statistics (BLS) producer price indexes for net inputs to construction, which track the prices of goods and services that contractors purchase (excluding labor), rose 58.3% for new nonresidential construction and 53.7% for multifamily construction, compared with increases of 34.8% for headline PPI (final demand) and 30.3% for headline CPI.

Commercial construction is not exposed to a single commodity cycle. It combines globally traded metals, regionally constrained heavy materials, petroleum-linked products, and manufactured components. As Figure 1 shows, price increases have been far from uniform. Since February 2020, diesel fuel prices have nearly quadrupled, while copper wire and cable, aluminum mill shapes, and regular gasoline have roughly doubled. By contrast, ready-mix concrete (39%), particleboard and fiberboard (19%), and softwood lumber (5%) have risen more modestly, with the latter two trailing headline inflation.

Figure 1

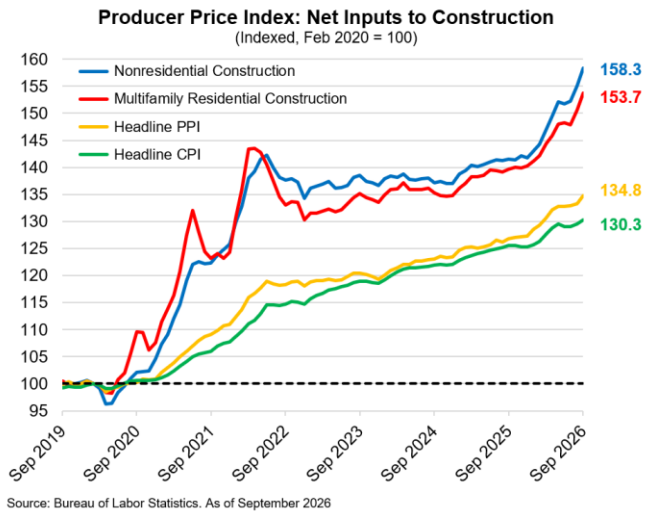
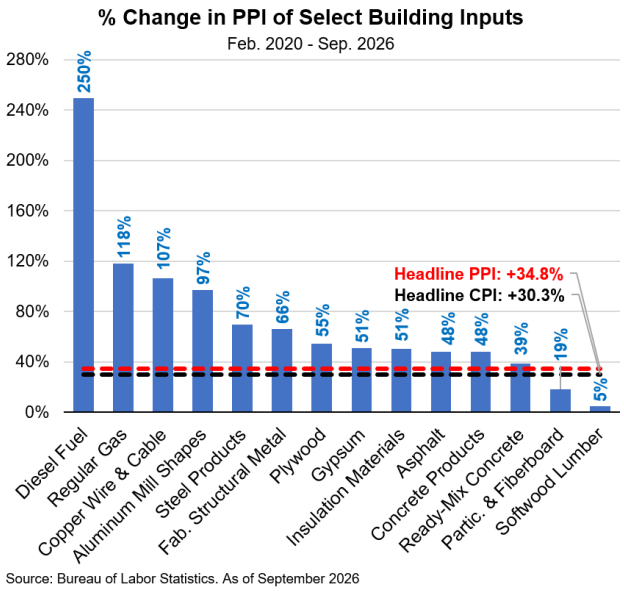


Figure 2



Labor

In addition to higher input costs, the construction labor market faces both long-term structural and shorter-term cyclical constraints with impacts that vary by market. Recently, stepped-up immigration enforcement has added to labor scarcity and project delays. In the 2026 workforce survey conducted by the Associated General Contractors of America (AGC) and the National Center for Construction Education and Research (NCCER), 29% of construction firms reported being affected by immigration enforcement over the prior six months, and 88% of firms with craft-worker openings said those positions were as hard or harder to fill than a year earlier. Workforce shortages were also the most frequently cited cause of project delays, reported by 42% of respondents.[6]

Beyond the recent dislocation, the construction industry has struggled to attract young workers over the long term, which has left it vulnerable to sharp swings in immigration policy. Associated Builders and Contractors (ABC) estimates the industry must attract 349,000 net new workers in 2026 and 456,000 in 2027 just to keep labor supply in balance with demand, with retirements accounting for the majority of 2026 need.[7]

[4] James Bohnaker and Owais Ansari. (2026, April 8). *The Impact of Tariffs on U.S. CRE Construction Costs*. Cushman & Wakefield.
[5] Associated General Contractors of America. (2026, September 10). *Construction Input Costs Climb 8.9% Between August 2025 And August 2026; Association Survey Finds War And Tariff Impacts Are Disrupting Projects.* Associated General Contractors of America.
[6] Associated General Contractors of America. (2026, September 3). *Construction Workforce Shortages Remain Acute Despite 'Soft' Market Conditions As Data Centers Strain Labor Supply, Survey Finds.* Associated General Contractors of America.
[7] Associated Builders and Contractors. (2026, January 15). *ABC: Construction Industry Must Attract 349,000 Workers in 2026 Despite Macroeconomic Headwinds.* Associated Builders and Contractors.

The scale of the industry's aging workforce is further illustrated by NCCER research showing that, as of April 2025, 41% of all construction workers at the time were projected to retire by 2031.[8] Over recent decades, more people have pursued four-year college degrees, weakening the entry pipeline into the trades and leaving fewer younger workers to learn from experienced construction veterans.

There is early evidence that college enrollment trends are softening as young people reevaluate the benefits of a four-year degree, weighing the potential impact of Artificial Intelligence (AI) on white-collar jobs against opportunities in the trades created by the reshoring of manufacturing and AI buildout.[9] However, a new generation of tradespeople will take years to train and does not address the current labor imbalance facing the industry. Investors and lenders pursuing development opportunities should stress-test schedule delays and confirm that contractors have adequate labor availability.

Financing

Commercial construction loans are generally floating-rate and benchmarked to the Secured Overnight Financing Rate (SOFR), leaving development budgets exposed to changes in short-term rates through interest carry. On September 16, 2026, the Federal Reserve raised the federal funds target range by 25 basis points to 3.75%–4.00%, its first increase since July 2023, citing elevated inflation and solid economic growth.[10] Long-term rates are also critical to development feasibility because they influence permanent takeout financing costs and exit cap rates. As of late September, the 5- and 10-year Treasury yields were approximately 5.0% and 5.3%, respectively, near levels last seen before the Global Financial Crisis.[11] Every month of schedule delay adds interest carry on top of already elevated hard costs.

Higher long-term rates also shape acquisition decisions. As Treasury yields rise, CRE investors generally require higher returns to maintain an adequate premium over those benchmarks, placing upward pressure on cap rates, all else equal. In the transaction market, the most immediate adjustment mechanism is purchase price: holding NOI constant, a higher cap rate implies a lower property value.

Impact on Existing CRE

Elevated construction costs can lift values for existing assets, but how much depends on two factors: what a competing new building would cost to deliver, and how much tenants value that new building over existing alternatives. As a result, the replacement-cost argument applies only to properties that would realistically get built in today's market. Overall, higher construction costs can benefit existing product, though the magnitude varies by property type and region. Higher barriers to new construction should benefit modern, functional properties with amenities suited to today's tenants, such as state-of-the-art multifamily, high-clear-height industrial with sophisticated logistics features, and trophy office, particularly in markets where fundamentals have been weighed down by competing supply. For these assets, the higher barriers should limit new competition and support stronger fundamentals and values. For owners of outdated product, however, the replacement-cost argument often carries less weight, while higher construction costs may make the infrastructure overhauls and capital expenditures needed to reposition an asset prohibitively expensive.

Shifting Development Economics

Construction-cost growth and property-value growth do not necessarily move together. Construction costs reflect the labor, materials, equipment, contractor services, and productivity required to deliver a building, while property values reflect the cash flow the completed asset is expected to generate, and the return investors require. When development costs rise faster than achievable net operating income, the stabilized yield on cost, calculated as stabilized NOI divided by total development cost, declines. If market cap rates also rise or remain elevated, the spread between the yield on cost and the market cap rate narrows further. As a result, the market value of a completed asset can decline even as its replacement cost increases.

The following sections examine this relationship by property type. The figures compare Bureau of Economic Analysis construction price indexes with three complementary measures of CRE values through year-end 2025.

[8] NCCER. (2025, April 30). *How Apprenticeships Empower Adult Learners and Bridge the Construction Workforce Gap*. NCCER.
[9] Stewart Rubin, Matt Wnek and Marshall Swett. (2026, April). *Office Job Disruptions: AI's Potential Effects on Entry-Level Office Hiring.* New York Life Real Estate Investors Strategy & Research Group publication in IRE Americas.
[10] Board of Governors of the Federal Reserve System. (2026, September 16). *Federal Reserve issues FOMC statement.* Board of Governors of the Federal Reserve System.
[11] CRE Finance Council. (2026, September 29). *Policy and Capital Markets Briefing September 29, 2026.* CRE Finance Council. (10-year Treasury close as of September 25, 2026.)

The BEA indexes measure changes in the price of producing different types of structures, using a combination of construction input-cost and output-price measures. Because their scope and methodology differ from those of the BLS input-price series cited above, the two sets of construction-cost measures will not necessarily record the same rate of growth.

- The **MSCI RCA Commercial Property Price Index**, or RCA CPPI, is a transaction-based repeat-sales index. It estimates changes in realized property prices by comparing the sale prices of the same assets across successive transactions. It therefore reflects pricing in the investment-sales market rather than changes in appraised values or investment returns.
- The **NCREIF Market Value Index,** or NCREIF MVI, reflects quarterly changes in the reported market values of institutionally owned income-producing properties. These values are established primarily through appraisal-based market-value accounting, with actual sale prices incorporated when properties transact. It therefore represents the valuation experience of properties held in institutional portfolios rather than a broad index of completed market transactions.
- The **Green Street Commercial Property Price Index**, or Green Street CPPI, is a monthly, value-weighted estimate of unlevered values for institutional-quality properties. It is derived from Green Street's valuation models for REIT-owned property portfolios and is driven primarily by changes in expected NOI and market capitalization rates. Although the underlying properties are owned by public REITs, the index measures estimated property values, not REIT share-price performance.

Because these indexes capture different stages of the price-discovery process, they can turn at different times and exhibit different levels of volatility. The RCA CPPI reflects completed transactions, the NCREIF series reflects periodic valuation marks on held properties, and the Green Street CPPI reflects modeled estimates of values based on public markets. The figures should therefore be interpreted as complementary, directional indicators rather than interchangeable measures of property values.

Within each property type, outcomes will vary by market, submarket, and asset quality. Over time, narrower development spreads should reduce the construction pipeline, allow recent deliveries to be absorbed, and restore some scarcity. Where demand for modern, high-quality space remains durable, less competing supply should support occupancy, rent growth, and property values. As explored in the Strategy and Research Group's *A Paradigm for Sustainable Rent*, rents can eventually rise to the level required to make new construction economically feasible, when the capitalized value of a completed project exceeds its replacement cost, land value, and required developer profit.[12] At that point, developers have an incentive to add supply, which can limit further rent growth, although barriers to construction and other market-specific factors may delay the adjustment.

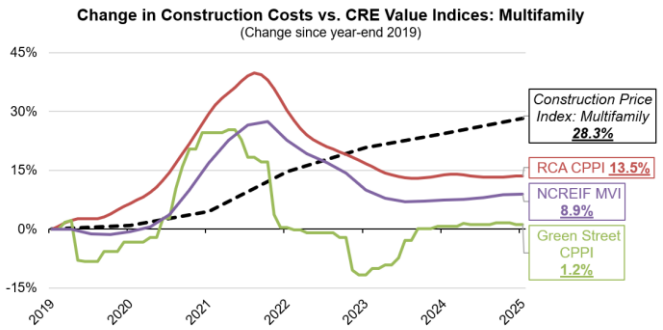
The central argument is that macroeconomic, geopolitical, and demographic supply-side disruptions have caused construction costs to rise faster than property values in several CRE sectors, compressing development yields and constraining new supply. This represents an interim phase of the cycle rather than a permanent condition: as rents and property values recover sufficiently to restore development feasibility, new construction should eventually resume. Until then, for owners of modern, well-positioned assets in property types and markets where recent weakness has been driven primarily by excess supply rather than a structural lack of demand, a slower construction pipeline should allow existing supply to be absorbed and support the fundamentals of those assets.

Multifamily

As seen in Figure 3, multifamily construction costs have risen more than values according to all three indexes: the BEA construction price index rose 28.3% from year-end 2019 to year-end 2025, versus gains of 13.5% for the RCA CPPI, 8.9% for the NCREIF MVI, and 1.2% for the Green Street CPPI.

[12] Stewart Rubin and Justin Yang. (2021, July). *A Paradigm for Sustainable Rent*. New York Life Real Estate Investors Strategy & Research Group.

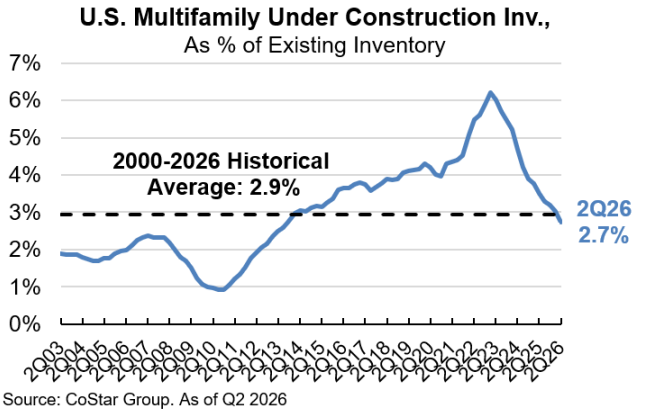
Figure 3



Source: Green Street, NCREIF, MSCI RCA, U.S. Bureau of Economic Analysis (BEA), *Price Indexes for Private Fixed Investment in Structures by Type*, via FRED. BEA construction price indexes track changes in the prices associated with constructing the specified structure type, including construction inputs and labor-related costs. As of year-end 2025.

In Sun Belt markets with strong demand growth and relatively low barriers to development, a surge in new supply has driven up vacancies and depressed rents and values. Along with increased construction costs, development yields have been strained, as evidenced by the construction pipeline, which has fallen from a peak of 6.2% of inventory in 1Q23 to 2.7% in 2Q26, below its long-term average of 2.9%.

Figure 4



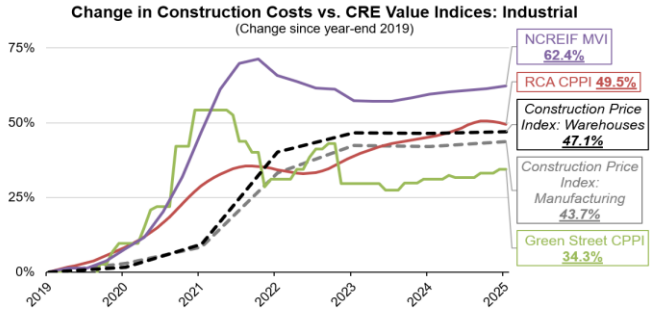
Source: CoStar Group. As of Q2 2026

In Sun Belt markets where long-term demand drivers, including household formation and job growth, remain intact and the construction pipeline is contracting, investors could see improving occupancy and rent growth as recent supply is absorbed.[13] In supply-constrained markets, where geographic and regulatory barriers have already created housing scarcity, elevated construction costs raise the bar for development even further. However, because these markets' fundamentals are driven more by persistent undersupply than by strong demand growth, higher construction costs are likely to provide a more modest incremental benefit. The effect should be most muted in markets with stagnant demand and little recent construction, where development economics were unattractive even before the current construction-cost cycle.

Industrial

As seen in Figure 5, industrial values have outpaced construction costs since 2019, according to the NCREIF MVI (62.4%) and MSCI RCA CPPI (49.5%). Over the same period, construction prices rose 47.1% for warehouse structures and 43.7% for manufacturing structures. The Green Street CPPI (34.3%) is the exception, trailing both cost measures. Notably, warehouse construction costs have risen slightly faster than manufacturing costs. This may reflect the growing sophistication of new industrial product: even logistics and distribution facilities increasingly feature higher power capacity, automation capabilities, higher clear heights, and more advanced racking and storage systems.[14]

Figure 5



Source: Green Street, NCREIF, MSCI RCA, U.S. Bureau of Economic Analysis (BEA), *Price Indexes for Private Fixed Investment in Structures by Type*, via FRED. BEA construction price indexes track changes in the prices associated with constructing the specified structure type, including construction inputs and labor-related costs. As of year-end 2025.

Industrial demand has undergone a structural transformation, and new supply has followed. Many new projects associated with the growth of e-commerce have taken the form of port-adjacent, regional distribution, and last-mile logistics facilities. Population growth, household formation, and e-commerce drove that demand, either within the local market for last-mile facilities or across the broader trade area for port-adjacent and regional distribution hubs. Shifting manufacturing supply chains have also been a key source of demand.[15] Nearshoring has shifted more production of both durable and nondurable goods to Mexico, boosting demand for cross-border logistics space. At the same time, reshoring has brought high-value, national-security-critical manufacturing back to the U.S.[16]

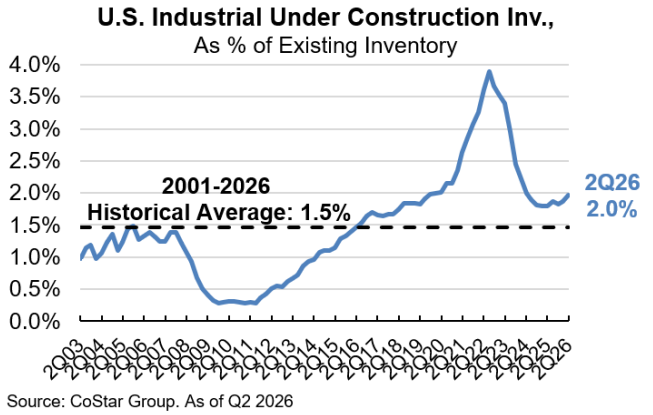
[13] For an example of a nascent Sun Belt multifamily recovery, see Stewart Rubin, Matt Wnek and Marshall Swett. (2026, September). *Phoenix: A Multifamily Market Poised to Rise.* New York Life Real Estate Investors Strategy & Research Group.

[14] Stewart Rubin, Matt Wnek and Marshall Swett. (2026, July). *The Power Premium: A New Differentiator in Industrial Investing.* New York Life Real Estate Investors Strategy & Research Group.

[15] Stewart Rubin, Matt Wnek and Marshall Swett. (2026, May). *Seaports and Land Ports in a Changing America: Implications for the Industrial Sector.* New York Life Real Estate Investors Strategy & Research Group.

[16] Stewart Rubin, Matt Wnek and Marshall Swett. (2026, March). *Commercial Real Estate in a Neo-Mercantilist World.* New York Life Real Estate Investors Strategy & Research Group.

Figure 6



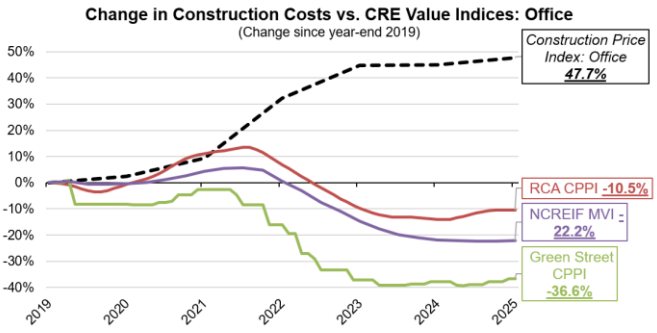
Source: CoStar Group. As of Q2 2026

The construction pipeline has fallen from its 3.9% peak in 3Q22 but has ticked up over the past few quarters to 2.0% of inventory, still above its 1.5% historical average. The recent uptick in the construction pipeline, together with values that have kept pace with or exceeded costs on two of the three measures, suggests development economics may still make sense in many cases. In areas where higher development costs incrementally discourage competing supply, any resulting upside in fundamentals and values should accrue to modern facilities in desirable locations. The effect will be less significant for functionally obsolete formats.

Office

Office has undergone a structural demand transformation since COVID, and in many cases new office development no longer makes economic sense. Since year-end 2019, the BEA office construction price index has risen 47.7%, while office values have fallen 10.5% according to the RCA CPPI, 22.2% according to the NCREIF MVI, and 36.6% according to the Green Street CPPI.

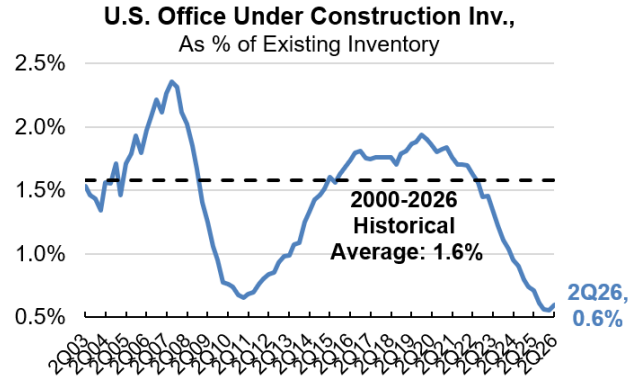
Figure 7



Source: Green Street, NCREIF, MSCI RCA, U.S. Bureau of Economic Analysis (BEA), *Price Indexes for Private Fixed Investment in Structures by Type*, via FRED. BEA construction price indexes track changes in the prices associated with constructing the specified structure type, including construction inputs and labor-related costs. As of year-end 2025.

Reflecting this gap, the office construction pipeline has shrunk to just 0.6% of inventory, well below its 1.6% historical average.

Figure 8



Source: CoStar Group. As of Q2 2026

Office also illustrates the limitations of replacement-cost analysis more clearly than other property types. Outside markets with extreme barriers to entry, functional obsolescence can occur so quickly that even buildings delivered 20 years ago may no longer compete effectively for best-in-class tenants. These tenants often prioritize new construction, modern layouts, advanced building systems, and sophisticated amenity packages over the lower occupancy costs available in older buildings. As a result, an existing property may trade well below replacement cost and still struggle to stabilize, because a low basis does not overcome deficiencies in functionality or tenant appeal.

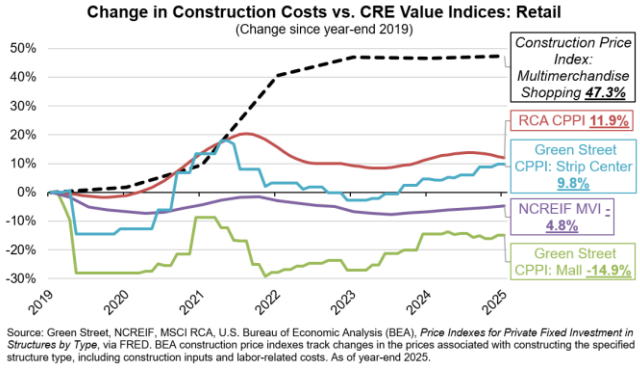
At the same time, select trophy developments may proceed even in markets with elevated vacancy and abundant lower-cost alternatives if top-tier tenants are willing to pay the rents required to support new construction. In some Sun Belt markets, population growth and high-profile corporate relocations have supported new projects designed specifically for today's tenants.[17] These examples suggest that the replacement-cost benefit in office accrues primarily to recently delivered, state-of-the-art buildings that can compete for the strongest demand. For commodity and functionally obsolete product, higher construction costs offer far less protection and may instead make the capital investment required to remain competitive increasingly difficult to justify.

[17] Stewart Rubin, Matt Wnek and Marshall Swett. (2026, September). *Nashville: Setting the Stage for Office Opportunity.* New York Life Real Estate Investors Strategy & Research Group.

Retail

The replacement cost argument does not hold up for most retail, particularly enclosed malls. Since year-end 2019, the BEA multimerchandise shopping construction price index has risen 47.3%, far outpacing value growth on every index, which ranges from 11.9% for the RCA CPPI to −14.9% for the Green Street mall CPPI.

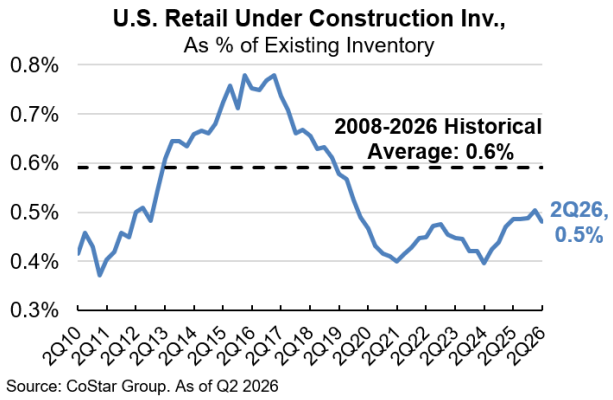
Figure 9



Source: Green Street, NCREIF, MSCI RCA, U.S. Bureau of Economic Analysis (BEA), *Price Indexes for Private Fixed Investment in Structures by Type*, via FRED. BEA construction price indexes track changes in the prices associated with constructing the specified structure type, including construction inputs and labor-related costs. As of year-end 2025.

Within retail, however, the Green Street strip center index (9.8%) has outperformed its mall counterpart by roughly 25 percentage points, reflecting steadier demand for well-located open-air centers. Retail construction stands at 0.5% of inventory, just below its 0.6% historical average.

Figure 10



Source: CoStar Group. As of Q2 2026

The limited new retail being built tends to be experiential lifestyle centers in fast-growing metros, while most other retail construction takes the form of redevelopment and adaptive reuse.

Conclusion

Rising construction costs are reshaping development economics and should support fundamentals of existing commercial real estate, although the magnitude of that support will vary across property types, markets, and asset vintages. By raising the income hurdle for new construction, higher costs can constrain future supply and strengthen the competitive position of modern, well-located assets where demand remains durable.

Strong investment opportunities should therefore pair a defensible acquisition basis relative to the replacement cost of comparable product with durable demand, manageable capital needs, and a declining pipeline of competing supply. In markets where recent weakness has been driven primarily by excess supply rather than a structural lack of demand, a slower construction pipeline should allow recent deliveries to be absorbed and support the fundamentals of modern, well-positioned assets. By contrast, discerning value-add and opportunistic investors and lenders seeking to reposition older properties should proceed cautiously and carefully assess the materials, labor, time, and overall capital required to complete a successful repositioning.

This advantage for existing owners is not permanent. If rents and property values recover sufficiently to restore development feasibility, new construction should eventually resume and place a natural limit on further rent growth. However, the macroeconomic, geopolitical, and demographic supply-side disruptions of recent years have caused construction costs to rise much faster than CRE values in most cases, creating a cost-to-value dislocation.

Ultimately, elevated construction costs do not affect all assets equally. They are most supportive of properties that tenants value and that would be difficult or expensive to replicate, while offering far less protection to properties with significant functional obsolescence.

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