



# Navigating the new CRE cycle: Insights from Davidson Kempner's Josh Morris on strategy and opportunity

by Andrea Zander

**A**s commercial real estate adjusts to a higher-rate environment and ongoing structural shifts, investors are re-evaluating strategies and seeking opportunities to generate returns in a more complex market. In an exclusive interview with IREI, Josh Morris, a partner and global head of real estate at Davidson Kempner Capital Management (DK), LP, discusses sector and regional dispersion and highlights how investors can identify attractive investment entry points, generate operational alpha, and navigate the evolving risk-return landscape. He also addresses the importance of nimble, data-driven decision-making in today's market.

In addition, the firm recently released a white paper providing an in-depth analysis of the structural shifts, and sector and regional dispersion. [Click here](#) to read the paper. Morris references pages in the below interview.

***How do you see this structural reset evolving over the next 12 to 24 months? Are certain sectors or regions more likely to outperform or lag?***

We believe we are in the early innings of a new real estate cycle, driven by the structural reset resulting from higher

interest rates. At this point, it's old news that higher interest rates have changed the valuation of commercial real estate. What DK's research indicates, however, is that higher rates are likely to lead to greater dispersion across the commercial real estate universe.

We see three key factors that we believe, in combination, have a multiplying impact on the performance of different sectors and regions:

**Rent growth.** We believe rent growth differentials will become more pronounced by sector because developing new product is more challenging in a higher-cost environment. The components of that higher cost include both interest rates and construction costs.

**Investor returns.** Investors tend to chase returns. If rents start growing faster in a particular sector, investor capital is likely to flow to that sector. We believe this will create more meaningful cap-rate dispersion between "winner" and "loser" sectors.

**Complexity premiums.** A higher-rate environment acts like an X-ray vision for market complexity. In normal markets, underlying complexity often stays hidden

below the surface because refinancings happen and capital flows smoothly where it's needed. In a higher-rate environment, we believe these complexities are more likely to rise to the surface, creating opportunities to acquire assets at more attractive valuations.

We believe that these three factors are going to play out over the next 12 to 24 months, likely increasing dispersion of returns.

In terms of sector performance, we see particularly attractive setups in a few areas:

- **Data centers:** The supply/demand differential is dramatic. We believe power will be a constraint for new supply for the next three years, while demand from tenants will remain strong. Despite media focus about how sustained incremental demand will be, DK's view — consistent since 2023 — is that the demand trajectory is solid. Higher rates also make it more challenging to deliver new supply.
- **Housing and housing-related assets:** The ongoing affordability crisis, driven by challenges in delivering new supply, is likely to support rent growth.
- **Industrial pockets:** Certain areas tied to reshoring, small-business growth in the United States, and specific geographies in Europe remain attractive.
- **Senior housing:** With the 80-plus population growing at roughly 5 percent annually, it will be challenging to deliver new supply given current costs versus rents, which may create favorable dynamics for returns.

From a geographic perspective, we are particularly excited about Europe, especially Southern Europe. We believe that Europe appears well-positioned because:

- Valuations have adjusted more significantly.
- Interest-rate changes were smaller.
- Inflation is lower, and tariffs have had limited impact.
- The market is less competitive, providing more idiosyncratic return opportunities.

This is not to say we are not investing in the United States, but achieving target returns may require more idiosyncratic or unique situations. In contrast, we believe Europe offers more broad-based, market-level opportunities, particularly in Southern Europe, over the next 24 months.

### **Can you share how you evaluated the U.S. market, any worries you might have had, and what factors gave you confidence to invest without leaning on your European experience?**

In our opinion, it comes down to valuation relative to interest rates. At the end of the day, if an asset's value

reflects prevailing rates, we feel comfortable exploring the investment opportunity. We find this particularly attractive when absolute rates are higher because it effectively prices in a more conservative scenario.

Starting in 2022, there was a period of adjustment as private markets took time to digest changes in capital markets and reflect them in underlying valuations. The reason transaction volume declined between 2022 and 2025 was that prices were misaligned — they didn't reflect the reality of higher interest rates.

As cash flows grew during that period and seller expectations adjusted downward, valuations began to better reflect the changes in interest rates. We became more comfortable with higher rates, and the values we observed started to incorporate them. This wasn't uniform across all asset classes or opportunities, but it was evident in certain pockets of the market.

### **How has transactional pace been affected by the current market environment, and what signals should investors watch for signs of recovery or further slowdown? What is your view of "alternatives" sectors?**

We believe that in this higher-rate environment, nimbleness is going to be important because the in-favor sectors change. We cover this throughout our recent white paper, specifically there's a chart on [page 3](#). We think that the trend of allocators moving toward individual sector allocations is likely to have some limitations and potentially reverse because you're going to see this greater dispersion, and you're going to need to stay on top of the reality of changes that might affect an individual sector. In each sector, investors should be focused on whether supply and demand are tight enough to allow cash flow growth that exceeds expense inflation.

To enlarge graph click [here](#).



In our view, two factors make alternative sectors attractive: higher cap rates (or higher yield on cost) and tighter supply/demand differentials. However, "alternative" also implies niche demand, as seen in

the life sciences sector where initial success eventually spurred overbuilding. It turns out you didn't have to build as much product as you thought to create oversupply in the market. A million square feet in a given life science market could be enough to create oversupply; by contrast, we build more than 400 million square feet of industrial in the United States every year.

You have to be careful to fully understand supply and demand dynamics. Having data to assess where you are in the supply/demand cycle for a given sector is essential to forming an informed viewpoint. Anecdotally, someone might argue that the difficulty of building a given product will limit future supply, but that perspective needs to be supported by data. While data is becoming more readily available over time, reaching a conclusion without it generally makes for a difficult investment case.

***Are there lessons from past commercial real estate cycles that help explain today's pricing gaps and market behavior? For example, how does current leverage, interest-rate policy, or capital flow compare with prior resets?***

It's important to set up a framework as to what makes this cycle the same and different from other cycles. What makes this cycle different from the global financial crisis (GFC) is that this cycle saw a change in value that was driven by interest rates, but the change in valuation occurred in the context of liquid capital markets. This is an orderly repricing and deleveraging of commercial real estate that's occurring.

What happened during the GFC was you had capital markets fall away, and fundamentals declined dramatically. Liquidity dried up. We observed a change in valuation in the context of less liquidity. That was a financial crisis, and obviously, transaction volume picked up at lower valuations.

What is occurring right now is much more orderly — transactions occurring at new valuations. What makes that interesting for us, and what makes us excited at DK, is that when we look at historical moments in time, we've seen that in higher cap rate periods there is better rent growth and better returns. There is a good chart on [page 3](#) of the white paper that articulates this point.

That is the lesson that we've taken away from the past: higher rates equal higher returns. And higher rates equal higher rent growth.

***How is investor sentiment shaping pricing today? Are we seeing over-optimism in certain sectors, or heightened caution that could create opportunities for strategic buyers?***

Broadly speaking, people are still cautious because the headline valuation — cap rate versus interest rates — doesn't scream broadly cheap. I still think we're operating in a market that is fairly cautious and where capital is less available — not on the debt side of the balance sheet but on the equity side. There have been

fewer equity dollars out there which naturally leads to greater caution..

We are approaching the environment with caution. With that said, we believe that opportunities exist in the dispersion. Just because the market as a whole may be fairly priced doesn't mean there aren't certain sectors, regions, or individual situations that can be very attractively priced.

Overall, we believe people are cautious, but I think there are certain situations that are very exciting.

***Given the valuation dispersion and structural shifts, how should investors and developers recalibrate their risk/return models, particularly in sectors like office, industrial and logistics?***

Taking the allocator's perspective for a second, the last few years have challenged assumptions about real estate's role in an institutional investor's portfolio. Part of the reason why investors had a real-assets component of their portfolios is that they believed it was meant to protect them against inflation. Real estate didn't provide that hedge against inflation that they were expecting. It has really been an underperformer relative to other asset classes during that time period.

That, combined with the lack of the DPI that allocators have seen, has caused them to think more broadly about the role of real estate within their portfolio. We have observed that allocators are concluding that core was a real underperformer. It did not provide core returns or core protection in that period. Additionally, allocators are looking at real estate relative to other illiquid components of their portfolio and suggesting that it needs to achieve returns commensurate with the other options available within their portfolio.

From our perspective, we think that means the return requirements investors are likely to have for real estate are going to be higher on a go-forward basis than they've been historically, and that you need absolute returns that are higher than what we saw over the prior 10 years in order to justify a place within investors' portfolios.

In terms of how you actually get there on a broad basis, the market is offering higher returns than it was offering before but not enough to get you to the rates of return needed to compete with other illiquid capital.

We see two additional components layered on top of that approach. The first is identifying opportunities with attractive entry points, where the concept of a "complexity premium" becomes relevant. The second is the ability to drive operating performance and rent growth, which is where what we call "operational alpha" comes into play. On [page 9](#) in our white paper, we underscore our viewpoint that discerning asset selection, entry price optimization, thoughtful structuring and rigorous management to ensure business success can lead to improved risk-adjusted returns amid the CRE reset.

From our view, that's really going to be a key theme driving allocators' perspectives going forward: they will expect higher rates of return to justify real estate's role within their portfolio. And we believe the way to get there is: one, being nimble about sector selection; two, finding unique entry points; and three, having operational alpha..

***Real estate historically has been viewed as a protective asset in portfolios. Do you see it regaining that reputation?***

We believe sectors that have strong supply/demand differentials are likely to serve that role within a portfolio going forward, especially because it's going to be that much harder to deliver new supply.

Take the example of data centers today. The centers that are built are close to, if not fully, occupied.

There's limited availability. They're pre-leased before they get built. As an example, the cost continues to go up to deliver that product. If you have existing product, it will continue to see its market rents appreciate. Granted, you probably have a long lease, but if you were to go and sign a new lease, it would be at a higher rent. I think that's a great example of the fact that you have strong inflation protection in a sector where supply and demand are tight.

On the other hand, the opposite is true. In a sector where you've seen operational disruption, you're not going to see inflation protection because rents are not going to adjust based on inflation. You need that tightness between supply and demand to be able to adjust your rents based on inflation. ❖

---

**Andrea Zander** is editor of *Institutional Real Estate Americas*

---