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RPM Episode 62 | Spring 2026 Real Estate House Views with Jeff Giller and Margaret McKnight

Cold Intro

[00:00] Maribel Yoo: The world feels anything but stable right now, yet real estate is telling a fairly steady story. Prices sit near a cycle, low income is holding up and a lot of capital still tied up and stretched balance sheets that need a resolution. That combination is what's creating openings for investors who know where to look. Today we get into what all of it means and how to think about real estate in 2026.

Welcome

[0:30] Maribel Yoo: Welcome to RPM, The Stepstone Group podcast, where we share practical insights on the trend shaping private markets. I'm Maribel you, and today I'm joined by Jeff Giller, partner and Head of Stepstone Real Estate, and Margaret McKnight, partner and Head of Portfolio Solutions for SRE. They're back to walk through our Spring 2026 real estate house views.

We'll cover where pricing sits in the cycle and why the entry point looks attractive, the loan maturities and balance sheet pressures still moving through our system, and the bigger macro forces in play from the Iran war to AI to the widening wealth gap. We'll also revisit why real estate earns its place in a portfolio and where the team is finding durable income and opportunity.
Jeff, Margaret, welcome back.

[1:15] Jeff Giller: Thanks, Maribel, and welcome to our listeners.There are so many major forces reshaping our world today, most recently the Iran war, AI and growing wealth inequality. These are on top of Trump tariffs, accelerating deglobalization, Russia, Ukraine and so on.

Before we dig into any of those and what they might specifically mean for real estate investors, Margaret, let's cut to the chase. What's the overall take away on how to approach today's real estate markets?

[1:40] Margaret McKnight: Hello, everyone. So despite all the turmoil in the world, our recommendations are very similar to what they were in the last edition of the House Views, proving that real estate really does March to the beat of its own drummer.

Pricing is around cycle bottom, relatively cheaper than other important asset classes. Fundamentals are mostly fine and there are still a lot of over leveraged balance sheets that need fixing, which creates investment opportunity. So capitalizing on all of that makes a lot of sense.

We can't ignore the turmoil. It's bringing inflation, higher interest rates, slower growth. So we suggest leaning into what real estate does best, providing current income that can grow. So this means core plus and value added strategies where there's a good bit of existing in place income to get us through this turmoil with real potential for upside over time, especially if you're capitalizing on the dislocation. Debt remains useful for those desiring current income and lower risk. Also, importantly, now more than ever, the classic benefits of having real estate in the portfolio matter. It can be a powerful diversifier because of its low correlation to financial assets, stocks and bonds.

As I said, because it has its own rhythm, it generates current income, which reduces risk even if you don't need it to cover funding obligations. And it's pretty handy if you do. Plus, real estate has proven very useful in protecting the overall portfolio in times of unanticipated inflation.

[3:15] Jeff Giller: Let's talk more about the balance sheet challenges. We're definitely seeing deal flow. Most obviously to us are the many recap opportunities arising from both balance sheet and fundraising challenges, which are related.

Some investors talk about waiting for dramatic cleanup moment, asking when is it going to break, then doubting there's even an issue because it hasn't broken. But with all that's going on at the macro level, it's pretty clear there isn't 1 catalyst will suddenly create a fire sale.

[3:44] Margaret McKnight: No, and yet the balance sheet challenges exist in size and they are being worked out, just not dramatically in one fell swoop. There's plenty of opportunity for those who know how to look. Non core fund capital calls or around normal levels. So those GPS are finding things to do, buying where stress is greater, and then the new generation of debt funds are deploying money where stress is lower.

We discussed in the last edition of the House Views how this cycle is so different from the GFC, which did have a bit more of a sudden cleanup moment. At that time, a severe recession created more operating stress and urgency, whereas this cycle income has been steady with some growth, which prolongs the workout. Also, the GFC was followed by a big drop in interest rates that continued for about 15 years, which made a lot of things possible by inflating asset values across the board and not just in real estate. And it in essence, trained the market to expect falling interest rates.

But that's not what's happening now, nor is it likely. You could argue that we're paying for it now. Actually, rates in the 4 to 4 1/2 range for the US 10 year are around long term averages, and that's a similar phenomenon globally. And with all the swarming black Swans that you listed a minute ago providing upward pressure, there are two good sources of data that indicate large balances of unresolved balance sheet problems since the interest rate jump in 22.

And just to recap why this is a problem, higher rates raise borrowing costs, which leaves funding gaps. New loans are smaller than expiring loans because loans are sized on the ratio of income to borrowing costs. Real estate prices with the marginal buyer being leveraged fell 20 to 25% and they have not recovered. Pre correction loans continue to be a problem especially for borrowers with higher leverage transitional assets and limited ability to fund them further especially in the existing vehicle.

Now these three items pretty accurately describe the non core fund universe, which of course is only part of the greater real estate market, but it's the segment for which we have data. Over a trillion dollars of value is in assets that those funds have held for over 5 years and a quarter of that amount is in funds that are past the end of their fund life.

This build up is a result of the slowdown in asset sales as managers hope for enough income and price growth to offset the effects of higher interest rates by the time they sell. So distributions from these funds are less than half the normal level and that's been true for three years. Holding is enabled by the fact that the carrying values are generally too high versus today's property trading prices.
The clear evidence of that is a loss ratio of 34% on fund sales this year, which is happening because realizations force recognition of losses not fully reflected in the current mark. So selling triggers recorded losses, but time is not your friend in IRR based funds.

So the GPS holding this trillion dollars in assets are under real and growing pressure to find liquidity solutions. Reinforcing this. They're learning the hard way that LP's need their capital back before they can make new commitments. The phrase DPI is the new IRR is getting tossed around a lot. Although we still like IRR and multiple, the second simpler stat is that according to US Mortgage Bankers Association, only 17% of loans that were set to mature in 25 were actually paid off. The remainder, which is 800 billion were deferred. Now there's a lot of different stories in that number, but it's a big number.

[7:37] Jeff Giller: Well, that raises the issue of fundraising. Market fundraising levels have been lower and funds are making investments so the levels of dry powder actually falling. Fundraising increased back to normal levels in 2025, but the lift is really just coming from the mega funds over $5 billion. We recently published an article in the PERE Journal that covers the benefits of being a multi asset class shop. Given the growing complexities of the modern investment landscape. That is one factor supporting the growth of these funds.

For GPS raising funds under $5 billion, fundraising has been stalled out for the last three years, basically a 2016 levels. Part of the reason is that it helped LP's have been disappointed with returns because they've fallen fall short of advertised levels. We are definitely hearing from LP's who are rethinking their real estate exposure. For a while real estate was delivering high returns and that can happen at different points in the cycle.

We think that now is one of those times, but that's not the natural state. Scaling real estate is limited by properties for walls and height limitation as opposed to a company which can grow infinitely and that's why PE has has higher return potential. Real estate has tried to compete with PE for returns for a long time and really should not. Real estate has different attributes it can deliver to an investment portfolio.

[8:51] Margaret McKnight: Yeah, that's real estate's limitation. But though that is also its strength, it's a physical asset and supply is constrained more so in some places than others, of course, and that's important, but it doesn't adjust quickly. And now with higher interest rates bringing higher carrying costs for development, plus significant inflation of both material and laborers costs, new development is tapering in many places and more likely to remain limited for a while.

So this facilitates more stable income and overall projections for modest income growth even in the face of weaker demand. It's a very diverse world out there of course. So there's pockets of greater strength that can be found and we talked more about those in our house views. But of course, if you dial up all the risk levels of financing, construction, leasing, sometimes even markets and property types to pursue unnaturally high returns, you are going to end up disappointed a good bit at the time.

[9:49] Jeff Giller: Yeah, the investors who are rethinking real estate are tending to ship down the risk spectrum, making it less of a peace substitute and more letting real estate be real estate. Or they're looking for ways to take at least some of the risk off the table. But these approaches point to core plus and value added risk levels is appealing, which also makes sense given the bigger worries, more in place income to weather the storms. Let's turn to the macro issues. The one that is more likely to have more transitory impact is the Iraq war.

[10:20] Margaret McKnight: Yes, so this is an inflationary shock. So for a mild, but enough to push up interest rates and slow GDP growth. So it's deflationary, but as you said should be mostly transitory and inflation is not easy to get rid of.

The implications are largely negative across the board with variations of severity. Energy producers like the US are better positioned to withstand energy shock, while energy importers, Europe, UK, APAC are at significant disadvantages and are also facing possible supply issues. Demands for needs based real estate are likely to prove relatively resilient, while more discretionary sectors see more of a pullback.

The sharp rise in fuel costs specifically hurts hotels relied on air travel, and it means shrinking margins for key industrial occupiers. Infill and last mile industrial, meanwhile, could benefit as occupiers seek to trim transportation costs. The topic of inflationary shocks raises something that's really important about the role of real estate in the portfolio that seems to have been largely forgotten after such a long period of really tame inflation.

I was taught by some of the great minds in the portfolio construction business, to whom the energy shock of the 70s was still a painful memory and not ancient history, that real estate's main role in portfolio construction is protection from rare but potentially disastrous inflationary shocks. This is because real estate has proven very useful in protecting portfolio values during past inflationary shocks. Real estate returns meaningfully outpace both inflation and financial asset performance. So stocks and bonds during the shock that started in the 70s and also during the post COVID inflation surge.

Real estate's best able to do this when landlords have pricing power, which is generally true now, and properties that can reprice faster through shorter leases, which is true of residential categories, for example, access these benefits faster.

[12:21] Jeff Giller: Yeah, well, I've I've gotten pushed back that investors didn't see real estate work as an inflation hedge in the post COVID. Or that it is just an illusion created by the valuation lag.

[12:32] Margaret McKnight: As for the first, we'd be happy to talk to them about their portfolio design. The Odyssey outperformed the charts in the house views. For the second, the illusion. It doesn't actually matter when you hit a period when all the financial asset classes are in the red, sometimes badly so. Both the portfolios, bottom line and behaviorally the headspace of the decision makers is usefully fortified by having something, anything, in this case real estate, do well.

Also, it's not an illusion when the high inflation lasts for eight years, as it did after the OPEC oil shock in the 70s. Finite land and rising construction costs supported the resilience of hard assets such as real estate during this. The ability to sell real estate at higher values than those of the under underwater badly beaten stocks to support what were then inflated funding needs was absolutely critical to maintaining total portfolio viability in that.

[13:31] Jeff Giller: Well, now let's hit AI. We've discussed this a lot, Margaret. As you know, I'm very concerned about tech sector and white collar jobs being displaced by AI and its impact on a real estate occupancy, not to mention the social issues that would come with a largely unemployed population base.

[13:49] Margaret McKnight: You're absolutely right to be and as the first line of defense, it was already true that we were extremely cautious about owning office properties. On the other end, we were early entrance to data centers and still are increasingly careful with respect to new deployments. People are generally in the figuring it out phase about AI. Interestingly, there's some evidence this phase is creating jobs because as we probably all now understand first hand, it's work to figure this out.

Some companies are focusing on using AI to augment productivity, enabling workers to focus on higher value tasks. StepStone Leadership said to us to think of it as a chance to get to all the things on our To Do List, and I like the sound of that. Others aim to use AI to cut jobs and lower costs. The speed of the changes and cuts will matter. The extent to which it allows time for redeployment and retraining.

There's two things in the data worth talking about. First, tech jobs as a percent of total employment jumped in 2020 and have recently fallen, suggesting that the recent tech layoffs which are fueling the fears around AI are likely to include some AI washing of the post COVID over hiring. Secondly, historically, productivity jumps have driven more job growth, usually with a lag, and this is data that goes back to World War 2, so it includes something as major as the advent of the personal or desktop computer.

Before that, in the 1930s, John Maynard Keynes envisioned technological progress leading to a 15 hour work week. Don't worry Jeff, that's not us. For those of you working over 15 hours who now have a computer in your hand, think about what went wrong with that idea.

[15:46] Jeff Giller: Well, Margaret, yours and my debate continues. I've been a bear about AI and jobs and you've been a relative bull, so we'll have to continue to agree to disagree. I'll keep worrying, but maybe hold off on the full apocalypse scenario for now. On the plus side, San Francisco is climbing back out of the bust and is close to booming again. The 3rd trend we should cover that has been brewing for some time is growing income disparity.

[16:12] Margaret McKnight: Yes, in the US and Western Europe, the K shaped economy is firmly entrenched. The most affluent households have consistently grown their wealth, supported by stock market gains and home price appreciation. Meanwhile, lower income households who don't own these assets have been left behind. The three trends we're talking about overlap because it's also true that lower income households are more vulnerable to higher gas prices and the war induced inflation and have less access to the benefits of AI as household wealth expands.

At the high end, these households are in turn driving greater shares of consumption growth, which typically powers the economy. This leaves the economy increasingly vulnerable to a correction in both equity and home prices. AI CapEx is another big driver of USGDP growth. On the plus side, it's keeping US growth projections well ahead of other developed countries. This suggests meaning in the properties catering to higher income households, although that does have risk and focusing more on necessity types, not sectors that rely on discretionary middle class spending. This brings us for example, to private pay senior housing, which also benefits from demographic trends, as does medical office.

[17:47] Jeff Giller: With all the unforeseen idiosyncratic events that the world has been facing since COVID in 2020, the real estate market is as dynamic as I've seen it in my 4 decade career. We have a lot more information with supporting charts and tables on the market and where we see opportunities and risks in our recent House Views report. Please feel free to go online and download a copy of the report and always feel free to reach out to us if there's anything you'd like to discuss. Thank you so much for joining us.

[18:13] Margaret McKnight: Yes, we appreciate your time and interest.

[18:16] Maribel Yoo: That's it for today's episode of RPM. Thanks to Jeff and Margaret for taking us through the latest house views. And thanks to all of you for listening. If there's one thread running through today's conversation, it's that the details matter. Outcomes are driven less by broad sector calls and more by the individual market, individual asset, and the manager behind it.

For the full picture, including data and charts behind today's discussion, visit stepstonegroup.com to read our Spring 2026 real estate house views and catch the rest of our RPM series where we get your podcast. I'm Maribel Yoo. Thanks again for listening.