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How Interest Rate Cycles Restructure Real Estate Pricing Power across Asset Classes

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ABSTRACT: This research paper will look at the restructuring of interest rate cycles on the power of real estate pricing over the various asset classes of residential, commercial, industrial, and retail property. The study is on qualitative research of secondary data that was obtained through academic literature and industry reports. The most important sources are peer-reviewed articles found on Google Scholar and institutional reports provided by such organisations as International Monetary Fund and Deloitte.

The results show that interest rates affect real estate in several channels of transmission such as discount rate, cost of financing, and investor behaviour. Increased interest rates typically cause a drop in property prices because of the cost of borrowing and the demand decreases whereas decreased interest rates trigger the growth in price. The effects are however not universal. The pricing power in the industrial and residential segments is weaker because of the steady demand and income growth, but office and some retail segments are more sensitive to economic and structural shifts.

The paper also points to the contribution of macroeconomic factors and investor sentiment towards increasing these effects. Interest rate movements are exposed to factors like inflation, supply constraints and capital flows which interact to influence market results. In general, the study finds that interest rate cycles are significant in terms of redistribution of pricing power in real estate markets, which has implications on investors, policy makers and market players.

KEYWORDS: Interest Rate Cycles, Real Estate Pricing Power, Asset Class Heterogeneity

I. INTRODUCTION

The interest rate cycles have a critical contribution to real estate market development in that it directly affects the valuation of assets, investment behaviour, and power of pricing in the various property sectors. Being a high leveraged asset, real estate is especially susceptible to shifts in the cost of capital, as the rates of borrowing influence the demand and returns made by the investor (Salah, 2025). There is empirical evidence that even modest shifts in interest rates can have substantial change implications; in some markets, a one percentage point fall in mortgage rates has been linked to house price increases of about 1.5 percent and apartment price increases of about 2.3 percent (Vonlanthen, 2023).

Its transmission mechanism works in several channels, which are changes in discount rates, costs of financing, and comparability with other investments like bonds (Fields, 2018). An increase in the interest rates generally increases capitalization rates, which decreases the valuation of property; a 50-basis-point rise in cap rates would cause an estimated 11 per cent decrease in the value of assets. The effect is not even distributed among asset classes, however (Group, 2022). Indicatively, commercial real estate has seen its valuation fall more than 20 percent in the last tightening cycles, but those areas with robust income growth have held up (Mulvihill and Kennedy, 2025).



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NOI Growth Required to Offset Cap Rate Increases

Cap Rate Increases	Starting Cap Rate				
	3.00%	3.50%	4.00%	4.50%	5.00%
0.25%	8.3%	7.1%	6.3%	5.6%	5.0%
0.50%	16.7%	14.3%	12.5%	11.1%	10.0%
0.75%	25.0%	21.4%	18.8%	16.7%	15.0%
1.00%	33.3%	28.6%	25.0%	22.2%	20.0%

Periods When 10-Year UST Yield Increased 100+ bps	Change in 10-Year UST Yield	Change in NPI Cap Rate	Aggregate ODCE Return	NOI Growth
Jan 1987 to Sep 1987	2.4%	0.2%	5.2%	0.5%
Oct 1993 to Dec 1994	2.4%	1.2%	6.2%	2.4%
Jan 1996 to Mar 1997	1.3%	0.1%	16.4%	3.9%
Oct 1998 to Dec 1999	2.0%	-0.3%	14.0%	6.7%
Oct 2002 to Jun 2006	1.5%	-2.2%	61.5%	14.4%
Jan 2008 to Dec 2009	1.6%	1.1%	-37.1%	-10.7%
Jul 2012 to Dec 2013	1.4%	-0.4%	19.8%	5.7%
Jul 2016 to Sep 2018	1.6%	-0.4%	19.4%	10.0%

Source: (Group, 2022)

The study considers the reorganization of pricing power in real estate asset classes due to interest rate cycles, which are characterized by the interaction of macroeconomic forces, asset-specific fundamentals, and investor expectations.

II. RATIONALE AND OBJECTIVE

The role of interest rate cycles in real estate price determination is becoming more and more relevant in the environment of monetary tightening in the world and economic ambiguity (Greenwood et al., 2018). There are structural changes in real estate markets because increasing borrowing costs decrease the volume of transactions with data indicating that in some markets up to 44% is falling in the past during the increment of the rates. Meanwhile, changes in valuation, like commercial real estate corrections of more than 20 per cent, draw attention to how sensitive property prices are to capital costs and investor sentiment. These effects, however, do not affect all asset classes equally (Sagi, 2021). The common sectors that have a greater ability to maintain pricing power are industrial and multifamily housing since their demand and income growth tend to be more stable than office and retail assets that can be more volatile. Such a divergence generates a necessity of a more detailed perspective of how interest rate cycles transform pricing in the asset classes.



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The logic of the research is thus to close the gap between macroeconomic theory and an asset-level performance through analysing the effect of interest rate movement on valuation mechanisms, rental growth potential and investment strategies.

The following are the key objectives of this research:

1. To study the connection between interest rates changes and real estate prices among major asset classes.
2. To examine the effect of residential versus commercial versus industrial versus retail real estate pricing power in varying interest rate cycles.
3. To determine whether income growth, demand-supply, and investor behaviour counteract or enhance the effect of interest rates.

III. METHODOLOGY

This study will use a qualitative secondary research method, which involves the review of the available academic materials and the data in the industry to investigate the role of interest rate cycle in determining the power of real estate prices of various asset classes. The research is based on peer-reviewed journal articles obtained mainly through Google Scholar, which means the researcher will include credible and scholarly evidence. The keywords that were used to get relevant studies were interest rates and real estate, asset class performance and property valuation and monetary policy.

Besides scholarly materials, the study also uses the data of well-known industry and institutional websites that include reports by International Monetary Fund, Deloitte, and J.P. Morgan so that the statistics and practical information are current. Credibility, relevance, and recency were used to select these sources to be accurate and reliable. Thematic analysis technique was used to group the literature into five major themes to be able to evaluate patterns and relationships among studies in a structured manner.

Ethical considerations were well observed during the research process. No primary data that would involve human participants was employed, and all the data employed is publicly available, thus there is no problem with consent or privacy. The best referencing and citation guidelines were observed to prevent plagiarism and promote academic integrity. Also, the attempts were done to reduce bias through incorporation of different points of view and cross-checking information with various credible sources.

IV. LITERATURE REVIEW

The correlation between interest rate fluctuations and the price power of real estate has been a popular topic of study in the field of finance economics and property investment books. Interest rates affect real estate in several transmission mechanisms such as the costs of financing, the valuation models, and the allocation decision of portfolios by investors. The review is a critical evaluation of literature available on five major themes (1) interest rates and valuation mechanisms, (2) financing and leverage dynamics, (3) asset class heterogeneity, (4) macroeconomic and institutional context, and (5) investor behaviour and market cycles.

Theme 1: Interest Rates and Real Estate Valuation Mechanisms

One of the themes in the literature is the use of interest rates to compute the values of real estate using discounting tools and capital market exchanges. The value of real estate assets is largely based on future cash flows that are anticipated to occur, getting discounted using rates that are directly related to current interest rates (Amromin et al., 2020). When the interest rate decreases, discount rates decrease making the present value of future streams of income high and consequently elevating property prices. On the other hand, an increase in interest rate narrows down the valuations through escalating discount rates and lessening affordability.

There is strong empirical evidence that supports this inverse relationship. In a panel study of various real estate segments in Switzerland, it was discovered that the interest rate is an important factor in determining property prices via the valuation and financing paths (Vonlanthen, 2023). This paper explains that residential properties, especially, are very responsive to variations in mortgage rates which supports the significance of monetary policy in influencing housing markets.



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The effects of the valuation are also expounded on the principle of discounted cash flows (DCF) models, where the interest rates serve as a fundamental determinant of the discount rate. As emphasized in both theoretical and empirical sources, a slight variation in interest rates may have magnified effects on long-term assets like real estate because of the compounding effect on future streams of income (Adkins et al., 2021). This is consistent with the wider financial theory, in which the price of assets is negatively correlated with discount.

Moreover, the capitalization rates (cap rates), which is a major measure of real estate valuation, is also strongly correlated with long-term interest rates. Cap rates are usually correlated with bond yields, which portrays the cost of capital. Interest rate increases cause investors to seek higher returns, which results in an expansion of the cap rates and reduction of property values. This correlation supports the concept that the power of price in real estate is not absolute but it depends on the overall financial conditions.

Nonetheless, the literature also points out the fact that this relationship does not always exist in the same manner over time. An analysis of time-varying effects of interest rates proves that the magnitude of the correlation between interest rates and housing prices changes with economic circumstances (Lee and Park, 2022). In expansionary stages, low interest rates boost demand and lead to price rise, and in tightening stages high borrowing costs reduce demand and decelerate price rise.

Besides, theoretical frameworks that include housing in the term structure of interest rates indicate that real estate markets are strongly entrenched in the larger financial systems (Vergara-Alert, 2018). Housing assets are collateral and interest rates, both short-term and long-term, have an impact on housing assets and how they are used to determine investments and capital allocation in the economy.

On the whole, the literature proves the strong and definite connection between interest rates and real estate valuation. Interest rates affect property prices by changing discount rates, capital flows and expectations of investors on returns. Nonetheless, this is a dynamic and context-dependent relationship that changes depending on the time periods and economic settings (Van Loon and Aalbers, 2017). This is the basis of the reorganization of pricing power in real estate markets by interest rate cycles.

Theme 2: Financing, Leverage, and Credit Conditions

The second key literature theme is about the nature of financing structures and leverage in the transmission of interest rates changes to real estate markets. Real estate investments are highly leveraged and thus more vulnerable to changes in borrowing costs in comparison to many other asset classes (Jahid, 2025). The interest rates directly affect mortgage rates, availability of loans and the ability to service the debt which subsequently affects demand and pricing power.

The sources of financing work mostly with affordability and investment feasibility. When the interest rates go down, borrowing will be cheap and households and investors will be able to borrow more capital. This buying power results in more demand of property and price pressure. On the other hand, an increase in interest rates will make borrowing more expensive thus making it less affordable and limiting demand. An analysis of the housing markets affirms that low-interest rates are a powerful motivator to the housing demand since most consumers do not use income but credit to purchase houses (Lee and Park, 2022).

As an investment, leverage increases returns and risks. Debt is commonly used by real estate investors to increase returns, i.e. profitability is directly influenced by the change in interest rates. High interest rates raise the cost of servicing debt, squeeze net operating income (NOI) and lower investment returns. This relationship may cause repricing of assets, especially in highly leveraged markets like commercial real estate.

The recent writings have shown that increased interest rates have greatly changed the investment conditions. According to a study on real estate portfolio allocation as of 2026, rising rates have posed significant risks to investors, especially in unlisted real estate markets where access to refinance and capital is vital (Lin, Marzuki and Lee, 2026).

Pricing power is also highly influenced by credit conditions. In low interest rates, credit is usually more available, and transaction activity and valuations are exposed to increased activity. Conversely, the monetary policy tightening decreases liquidity in the market, which restricts the number of buyers and decreases the volume of transactions. This



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reduction in the liquidity process may undermine the price power of sellers, compelling them to adjust prices to match with the lowered demand.

Additionally, the literature also highlights that the interplay between interest rates and credit availability is not entirely mechanical but also affected by the risk perceptions of the financial institutions. When the interest rate is high, lenders tend to be more restrictive in their underwriting regulations, focusing on the quality of the assets, the stability of the tenant, and the security of the income (Christophers, 2023). This leads to a change in the investment to more resilient asset classes with riskier assets having more severe valuation falls.

All in all, the financing and leverage channel is a very important process by which interest rate cycles reform the real estate pricing power. Interest rates, by influencing demand, have the added effect of re-defining market dynamics, by exerting a greater effect on the returns of assets and credit access, and by defining which asset types will retain or lose pricing power at various stages of the cycle.

Theme 3: Asset Class Heterogeneity in Interest Rate Sensitivity

A substantial amount of literature indicates that the effect of interest rate cycles on real estate is very disproportionate across asset classes. This heterogeneity is due to variations in demand elasticity, lease structures, and income stability, which eventually define the maintenance or destruction of pricing power due to altered monetary conditions.

The residential real estate is the most susceptible to interest rate as it is the one that is financed by mortgage. As it has been empirically proven, housing demand is highly credit-sensitive; low interest rates make the housing much more affordable and raise prices (Deloitte, 2023).

By comparison, commercial real estate has high cross-sector divergence. Office segment has been a particularly susceptible area to tightening in recent periods. Statistics indicate that in 2025 there was 19.6% office vacancy rates and some markets had more than 20% vacancy rates as an indication of low demand and low pricing power (Kaplan, 2025). Also, there was a drop in asset values in the office market of approximately 10 percent, which underscores the compounding impact of increased interest rates and structural change like hybrid work.

According to more recent evidence, this trend has only been worsened, with office vacancies reaching 21% in major markets by 2026, which is a sign of structural weakness and lack of pricing power in this type of asset (Malovaná et al., 2023).

In comparison, industrial real estate has proved to be very resilient and price powering even in an environment with a high interest rate. This has been greatly influenced by structural demand associated with e-commerce and logistics. In recent years, industrial rent increased by 18.6 percent in North America, 10.8 percent in Europe, and 6.4 percent in Asia-Pacific, which is significantly higher than other sectors (Deloitte, 2023). Moreover, the vacancy rates in industrial properties are not quite high (approximately 6.8), as in the office markets it is significantly higher.

The retail and multifamily markets have contradictory results. The retail vacancy rates are also low at 4.2% which is facilitated by low new supply and constant demand of important retail spaces. Multifamily structures also prove to be resilient, having vacancy rates at approximately 6.5, indicating the continuing housing crunch and affordability challenges (Anderson, 2026).

Intersector comparisons also prove that pricing power is closely related to income dynamics. The industrial and residential property has the advantage of higher growth in rental and lower demand risk, and the office and some retail sectors have low occupancy and a lower income growth (Hoffmann et al., 2019). According to the International Monetary Fund, property values in industrial and residential properties surged after 2020, while retail and office real estate lagged, particularly during reduced financial conditions.



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Emerging headwinds

Global growth in commercial real estate prices has slowed down as financial conditions have tightened.



(Deghi, Natalucci and Qureshi, 2022)

All in all, the literature shows that interest rate cycles do not have a standard impact on real estate. Rather, the concentration of pricing power is in the high-structural demand and malleable income sectors. Conversely, the valuation pressures of asset classes with inflexible lease structures or falling demand (e.g. office) are disproportionately large (Deghi, Natalucci and Qureshi, 2022). This heterogeneity is essential towards the comprehension of reallocation of capital across real estate sectors at various stages of interest rate cycle.

Theme 4: Macroeconomic and Institutional Environment

The macroeconomic and institutional context is very important in determining the impact of interest rate cycles on the real estate pricing power. Interest rates are not as independent variables, but rather they are incorporated within broader economy-related factors like inflation, economic growth, labour markets, and regulatory frameworks (Hofman and Aalbers, 2019). All these variables decide the direction and the extent of real estate price adjustment.

Economic factors like inflation and GDP growth have a high impact on the real estate performance. Increased inflation usually causes an increase in interest rates because central banks restrict the monetary policy, and this may lower property values through higher discount rates. Simultaneously, the inflation will be able to bolster the growth of rentals, partially neutralizing the decrease in valuations. To illustrate, commercial real estate is generally run with debt relative to asset value ranging between 50-65 percent, i.e. the higher the interest rates, the more the financing costs and investor returns are pressurized (Morgan, 2024).

Monetary policy and capital market conditions are also institutional factors which are decisive. Financial restrictions decrease the liquidity and investment in the real estate markets. It has been proven that the volumes of real estate investments have fallen significantly in the world in the last rate rises, but in 2025, there were some signs of improvement as the returns become better (Botzem and Dobusch, 2017). As an example, real estate that is listed globally returned an average of 14.1 as compared to major equity indices, including the S&P 500, which returned at 11.7, showing a slow but steady recovery with elevated rates.

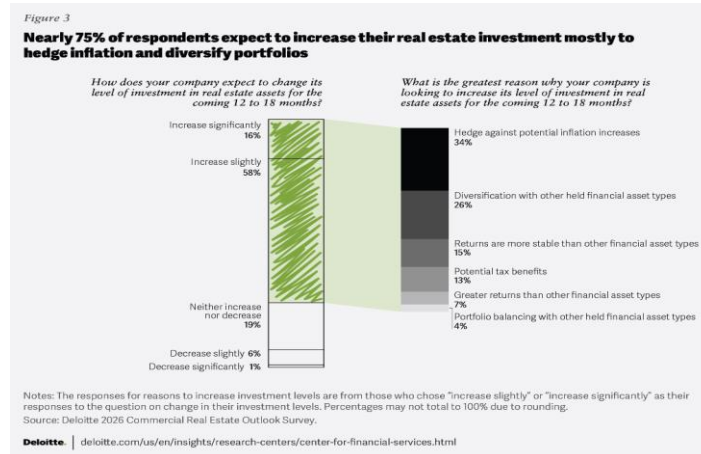
Supply dynamics is another important macroeconomic factor. Increased interest rates will greatly limit the new development activity as it would raise the cost of financing construction. According to empirical evidence, construction activity in key real estate industries has fallen sharply during tightening periods, by up to 75 per cent of peak levels, creating a lower future supply (Deloitte, 2024). The contraction may ultimately increase pricing power over the existing assets by generating shortages of supply. The real estate demand is further dictated by labour market conditions and demographic trends.



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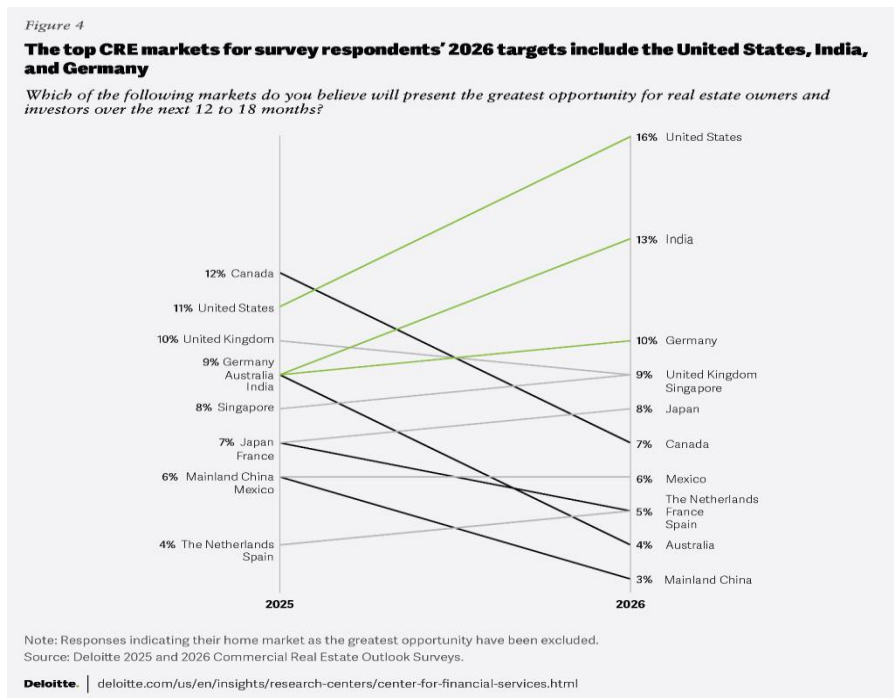
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High employment rates facilitate housing demand and rental growth, and the structural change, including remote working, has undermined demand in some areas, including office real estate. As an illustration, the global office markets have had a chronic vacancy issue, with vacancy rates of over 19-21 years in the recent years, which is an indication of structural and macroeconomic strain (Morgan, 2024).



(Deloitte, 2024)

Pricing dynamics are also affected by regulatory and institutional frameworks. The zoning laws, tax policies and financial regulation can either restrict or catalyze real estate development and investment. Stable regulatory frameworks and clear-cut legal frameworks are likely to bring more institutional capital to the market, which reinforces the value of properties even in times when interest rates are on the increase (Waldron, 2018).



(Deloitte, 2024)



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In general, the literature shows that interest rate cycles can be combined with a set of complicated macroeconomic and institutional factors (Deloitte, 2024). Although an increase in interest rates tends to cause the downward trend in real estate value, the end result on the pricing power is dependent on the bigger economic factors such as inflation, supply restrictions, and capital market forces. This is the reason why some real estate industries will be resilient even in the presence of unfavorable monetary conditions, whereas others will undergo massive value corrections.

Theme 5: Investor Behaviour and Market Cycles

The behaviour of the investors is instrumental in determining the impact of the interest rate cycles on the power of real estate pricing. In addition to basic valuation models, the market dynamics are significantly impacted by the sentiment of investors, expectation and capital allocation strategies all of which vary in various stages of interest rate cycle.

Portfolio reallocation is one of the most important behavioural responses to the change in interest rates. Bonds and other fixed-income securities will be more attractive when interest rates increase because they yield higher returns, and real estate investments will be less attractive as a result (Giglio et al., 2021). This change may result in decreased capital inflows in the property markets and asset price decline. It has been shown that the volume of transactions of real estate transactions significantly decreased during the tightening cycles over the last few years, which testifies to the low activity of investors and liquidity constraints.

Meanwhile, investors are becoming increasingly concerned with quality of assets and income stability in high-rate settings. Studies indicate that when interest rates go up, market participants abandon the speculative investments in favor of investments that have solid fundamentals such as stable cash flows, high occupancy levels, and creditworthy tenants. This change in behaviour leads to a flight to quality, which sees first-mover assets continue to command pricing as secondary assets decline in value at a faster rate.

These dynamics are enhanced by market cycles. The real estate markets usually swing through expansion, peak, contraction and recovery stages and interest rate cycles are one of the major stimulating factors. Recently, as an illustration, there has been a sharp repricing in the global commercial real estate with property values dropping more than 20 percent in certain areas especially in office properties. At the same time, the volume of transactions decreased because investors used a wait-and-see strategy, postponing acquisitions until the price stabilised (Cornaggia et al., 2017).

Investor behaviour is however, not reactive only, but also determines future market conditions. With interest rates higher, restricting the possibility of new development, the supply pipelines narrow, providing the preconditions of the future rise in rent and restoration of pricing power. This action-oriented behaviour is the reason why institutional investors tend to re-enter the market at the beginning of the recovery period to realise long-term value.

Also, the capital flows across the world also contribute a lot towards strengthening market cycles. Pension funds and sovereign wealth funds are institutional investors who will invest in different regions depending on the relative returns and risk perceptions. There is an indication that real estate has been gaining investment interest as a long term investment despite the recent volatility owing to its income generating nature and diversification advantages. As an example, the global real estate performance was around 14.1% in 2025, which exceeded various equity points, which demonstrated that investors were regaining their confidence (Deloitte, 2024).

Moreover, the behavioural finance views emphasise the importance of expectations and market sentiment. In the time of falling interest rates, positive expectations tend to cause higher leverage and inflation of the price of assets (Borio and Hofmann, 2017). On the other hand, an increase in rates will cause pessimism and decrease the risk appetite and speed up the correction of the prices. These boom and bust cycles in sentiment are a source of the volatility that is being experienced in various asset classes of real estate.

Finally, market cycles and investor behaviour are the key topics in the explanation of how interest rate changes to real estate price outcomes. Although financial conditions are determined by interest rates, the ultimate distribution of pricing power across the asset classes in various stages of the cycle are the decisions made by investors based on expectations, risk tolerance, and capital flows (Stockhammer et al., 2021).



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V. CONCLUSION

This study has established that interest rate cycles are decisive in the reorganization of real estate pricing power by asset classes, largely in terms of their effects on valuation, financing terms and investor behaviour. The literature supports the fact that the increase in interest rates boosts discount rates and cost of borrowing, resulting in negative trends in property values, whereas the decrease in interest rates boosts demand and property value benefits. These impacts are however not homogenous and differ enormously in different real estate sectors.

One such observation is that pricing power is heterogeneous. Residential and industrial properties are likely to be more resilient because of the underlying demand and the ability to grow incomes, whereas office and some retail segments are more susceptible to economic and structural changes. The disproportionate effects of tightening of monetary conditions are pointed out by empirical evidence, such as valuation drops that reached more than 20 percent in certain commercial areas and also high vacancy rates of office space, which stood at more than 20 percent in the past years.

Moreover, these dynamics are enhanced by macroeconomic factors and investor behaviour. The interaction between inflation, constraints in supply and capital markets in relation to interest rates affect market outcomes, whilst investor sentiment and capital allocation decision making determine cyclical changes in prices.

In general, the research findings suggest that interest rate cycles do not just affect the price of real estate, but they actively reallocate the pricing power among asset classes, preferring those industries, which possess strong fundamentals, flexibility and sustainable income streams.

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