

Market selection matters

The underestimated impact of market selection in commercial real estate.

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Redefining location

The three most important factors in real estate are “location, location, location,” or at least so goes the old saying. What that saying leaves out though, is that each mention of “location” should refer to a different geographic scale. “Market, submarket, micro-location,” does not have quite the same ring to it, but the results of our most recent analysis suggest that it would be far more accurate.

Historically, many commercial real estate (CRE) investors have focused primarily on asset selection, targeting individual assets in specific micro-locations based on physical characteristics and occupancy profiles. For real estate operators and developers with local or regional scopes this may be a prudent approach, but for investors with national or global portfolios it ignores a key driver of performance, market selection. This process involves analyzing economic, property market, and capital market data to determine the cities and regions where investors should focus their asset selection efforts.

Exhibit 1: Location by geographic scale (hypothetical example)



New York Metropolitan Division (Market)

Markets typically consist of major cities and economically linked suburbs and satellite cities.



Midtown South (Submarket)

Submarkets are distinct sections or neighborhoods within markets. They may be joined by transportation linkages, separated by geographic boundaries, or exhibit distinct resident or tenant profiles despite proximity.



Hudson Yards (Micro-location)

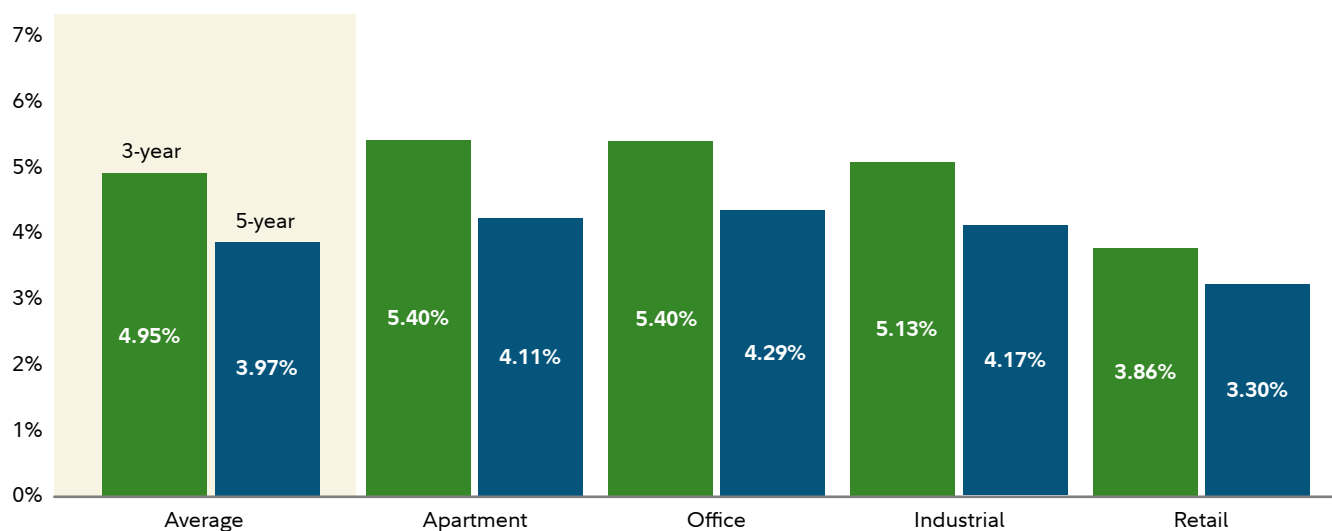
Micro-locations are small areas within submarkets that exhibit distinct characteristics of their own. In the densest submarkets, micro-locations may consist of areas as small as a single street or block.

Measuring the impact of market selection

To measure the impact of market selection we examined 37 years of data from the NCREIF Property Index (NPI), an unlevered index of property level returns and the most popular benchmark for institutional quality CRE. The NPI has recently been expanded to include formerly niche property types such as self-storage and seniors housing, but our analysis focused on the four major property types, apartment, office, industrial, and retail, which still comprise the bulk of the CRE universe and offer much longer performance histories.

Since CRE transactions typically take several months to close, and even short-term strategies are typically underwritten to take at least two or three years to execute, an analysis of quarter-over-quarter returns is of limited value. Instead, we examined 3- and 5-year annual total returns in each property type and market, which produced a total of over 35,000 data points for the period from 1988–2025. We then categorized this data for each period by property type and then by quintile. As shown in Exhibit 2, the results clearly show that market selection has a substantial impact on relative performance.

Exhibit 2: Difference between first and third quintiles (annual total returns).



Source: Fidelity Investments, NCREIF. Figures shown represent the unweighted average of 3- and 5-year annual total returns for the apartment, office, industrial, and retail sectors from 1988–2025 within each property type.

On average across all four property types, properties in the first quintile achieved annual total returns that were 397 basis points higher than those in the third quintile over 5-year periods and an even more dramatic 495 basis points higher over 3-year periods. These large differences in performance are not isolated to any single period or a product of long-term smoothing, remaining present throughout economic cycles and during all periods within them.

These differences were also relatively consistent across property types, with apartment, office, and industrial all showing similar spreads between the first and third quintiles. The exception was retail, which likely comes as no surprise to experienced CRE investors since retail demand is heavily driven by each asset's trade area and the composition of its tenant mix. This creates a greater dispersion of returns within markets, such that the spread across retail markets is modestly narrower. Even for retail though, the spread sits at a still wide 330 basis points for 5-year periods and 386 basis points for 3-year periods.

Conclusion

The results of this analysis are compelling, and they suggest a powerful conclusion. A focus on local knowledge and relationships is indeed important, but focusing on where to be local is just as important. Market selection should guide asset selection, and excelling at both should be the goal of any investor seeking to outperform.

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Endnotes

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