2025 OUTLOOK

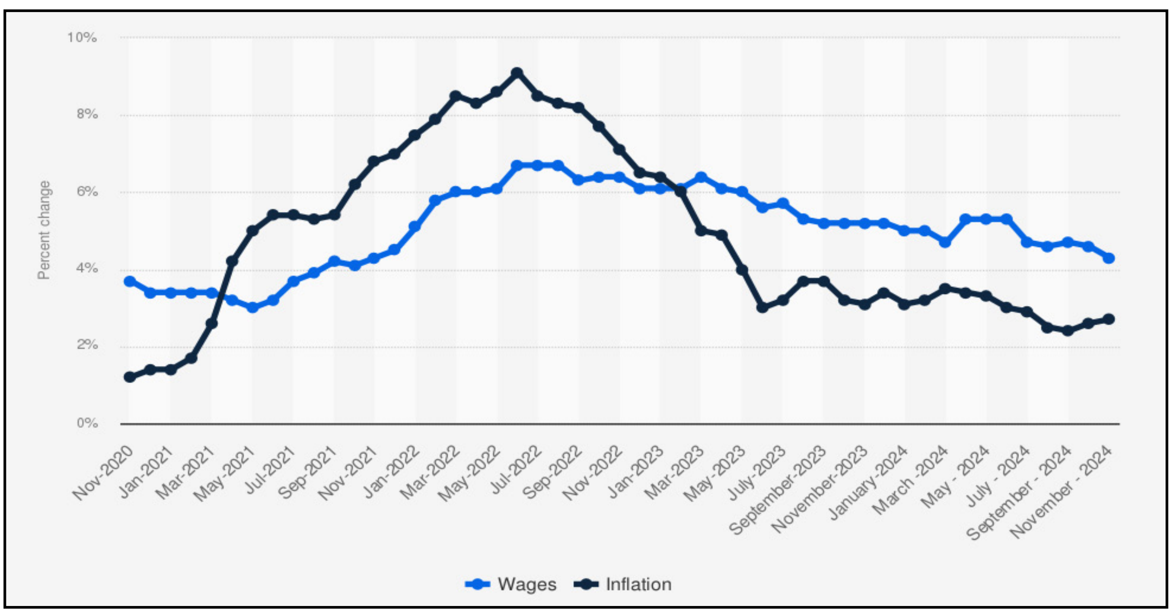
EXPECT RECOVERY TO BE UNEVEN ACROSS PROPERTY TYPES AND LOCATIONS

EXECUTIVE SUMMARY

Commercial real estate faced challenges in the first part of 2024 due to delayed interest rate cuts, election uncertainty, inflation, and stricter lending standards. However, after two rate cuts and legislative clarity following the election, investors across our markets emerged from the sidelines to move forward with deals because they believe 2025 will be a more business-friendly environment. As such, we are cautiously optimistic about recovering rent growth and demand for commercial property over the next few years. As fundamentals stabilize, pricing should improve.

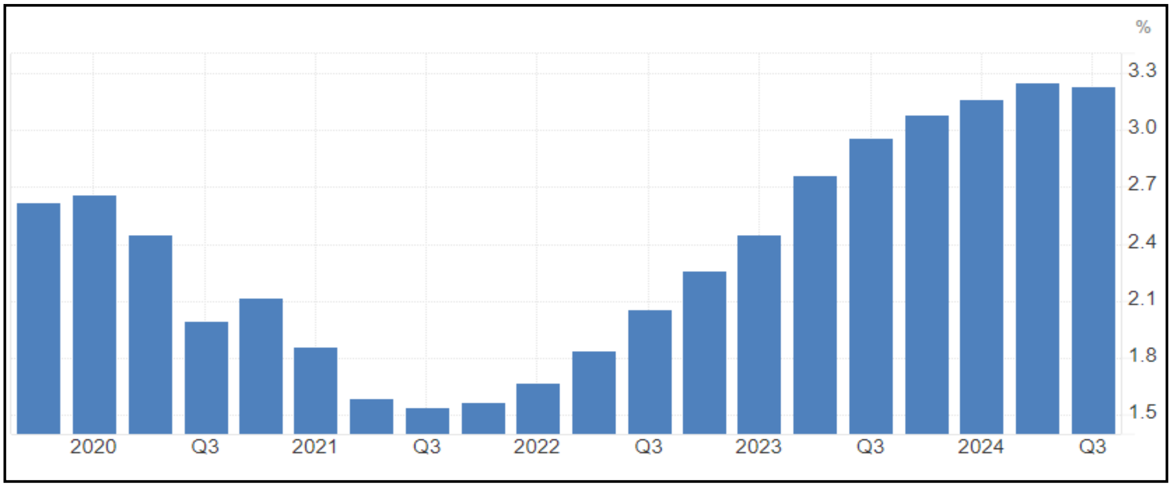
The US economy exceeded expectations in 2024 with strong consumer spending, low unemployment, and easing inflation despite high borrowing costs. Even as hiring slowed, wage growth continued to outpace inflation (Exhibit 1) and household wealth reached new records with net worth up $4.8 trillion and equity holdings up $3.8 trillion in 3Q24 (source: Federal Reserve). While consumers continued to spend in 2024, many have depleted their pandemic savings and are relying on credit cards, which are starting to show strain (Exhibit 2). Looking ahead, expect growth to be driven by higher earners while middle and lower-income consumers cut back (Exhibit 3).

EXHIBIT 1: WAGE GROWTH HAS OUTPACED INFLATION FOR MORE THAN A YEAR



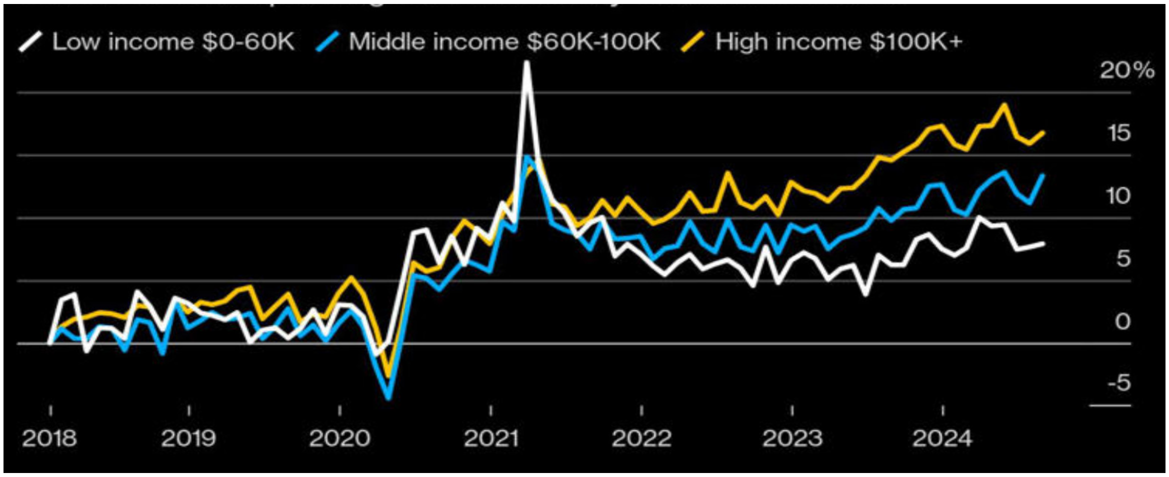
Source: Bureau of Labor Statistics; Federal Reserve Bank; US Census Bureau

EXHIBIT 2: DELINQUENCY RATE ON CREDIT CARD LOANS – ALL COMMERCIAL BANKS



Source: Federal Reserve of St. Louis

EXHIBIT 3: GROWTH OF RETAIL SPENDING BROKEN DOWN BY HOUSEHOLD INCOME



Source: Federal Reserve
Note: Seasonally-adjusted and inflation-adjusted indexed to 2018

With only two Fed rate cuts projected for 2025 (down from the original four expected in September), we are not expecting a sharp rebound this year but anticipating a modest continued improvement in commercial real estate markets. Expect recovery to be uneven across geographies and property types and cap rates to compress in specific markets and sectors.

BUYER/SELLER SENTIMENT

While CRE activity picked up across the country during the latter half of 2024, buyer/seller sentiment has been mixed. High-growth markets with a lot of new development projects (HQs; factories; sports arenas; hospitals; schools; and housing communities) are seeing strong interest in all sectors. Demand for development land is up across all acreages; new residents are bringing in greater wealth and buying power; out-of-state investors are looking for better deals than in their home state; and private equity is playing a bigger role.

Property sales are steady in markets with well-capitalized buyers and sellers that need to unload. We are seeing big discounts on large assets held by institutions; 10-20% reductions on mid-sized properties that were family businesses; and premiums for small buildings. With expectations for a more business-friendly climate in 2025, people are using cash, 1031 exchanges and private equity to close deals fast. Buyers are showing up in various forms: international investors looking for big trophy buildings; private investors that live locally picking up small buildings; developers buying land for construction later; and companies that need to relocate and are okay with high construction costs. In markets where prices are not dropping enough to justify the cap rates, sellers are offering financing to get buyers to the higher price.

Markets with very low inventory have not seen property prices come down as sellers hold on to pre-2024 valuations; the biggest shortages are in retail, medical office, and triple net assets. Buyers are coming up on price, but mostly for triple net and low maintenance properties. There is a lot of money on the sidelines waiting for prices to come down. It's tough to make deals work unless it's a 1031 running out of time or cash buyer that needs a place to put the money.

Big offices take a long time to close with only a few serious buyers doing deals at very high cap rates. People are still very cautious about investing in office property. Much of the interest in these assets is for redevelopment or repositioning potential. There are millions of square feet of inventory in downtown markets across the country that need to be converted or demolished. While most owners cannot take on large losses, most buyers can't get financing because banks have been closed off since the pandemic. Big offices can't get anyone to look unless the cap rate is 10-11%. Banks won't lend unless the owner occupies at least 50% of the building and puts 30-40% down. Private equity has been funding this space.

ALTERNATIVE LENDING IS KEY TO DOING DEALS

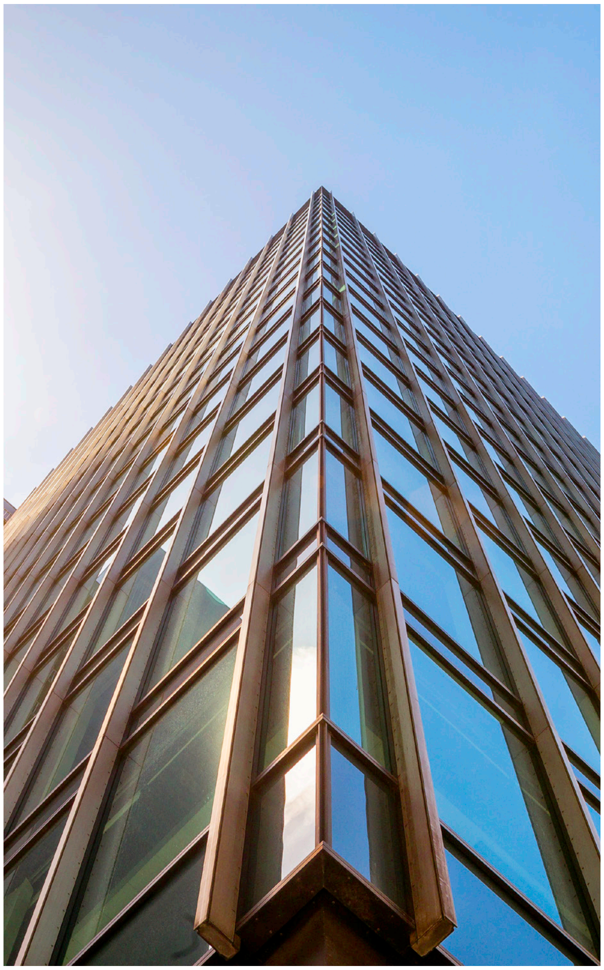
While national banks have little appetite for regular office or multifamily, they're starting to lend again in other sectors with a strong preference for medical office and owner/users. However, they want more guarantees: higher interest rates, more equity (40-50% down), at least 50% occupancy, and no cash-out refinancings. Given such onerous conditions, most CBC professionals see clients using small regional and local banks, credit unions, seller financing and private equity to fund deals. Local banks are able to do deals in the low-7% with 20-30% down payments. Meanwhile more and more owners with no debt on the property are choosing seller financing to get top dollar from the sale.

COMMERCIAL REAL ESTATE PICKS UP AT CREDIT UNIONS

Credit unions significantly increased their holdings of CRE loans from March to June 2024, growing four times faster than the national average. According to NCUA data, credit unions held $154.7 billion in CRE loans by June 30 (up 11% from last year and up 3% from March 31). These loans were held by 1,642 of the nation's 4,631 credit unions, representing 3.3% of the total market.

In comparison, the Mortgage Bankers Association reported that CRE loans across all investors reached $4.69 trillion by June 30 (up only 1% from March). Commercial banks, which hold the largest share (38%) of commercial mortgages, grew their holdings by just 0.2%, while life insurance companies saw the largest gain at 1.8%. Despite a slowdown in loan origination, CRE mortgage balances have continued to grow due to fewer loans being paid off. With long-term interest rates now lower than a year ago, the MBA anticipates increased loan origination in the coming quarters.

SALES TRENDS: CAP RATE RECOVERY WILL LIKELY BE UNEVEN

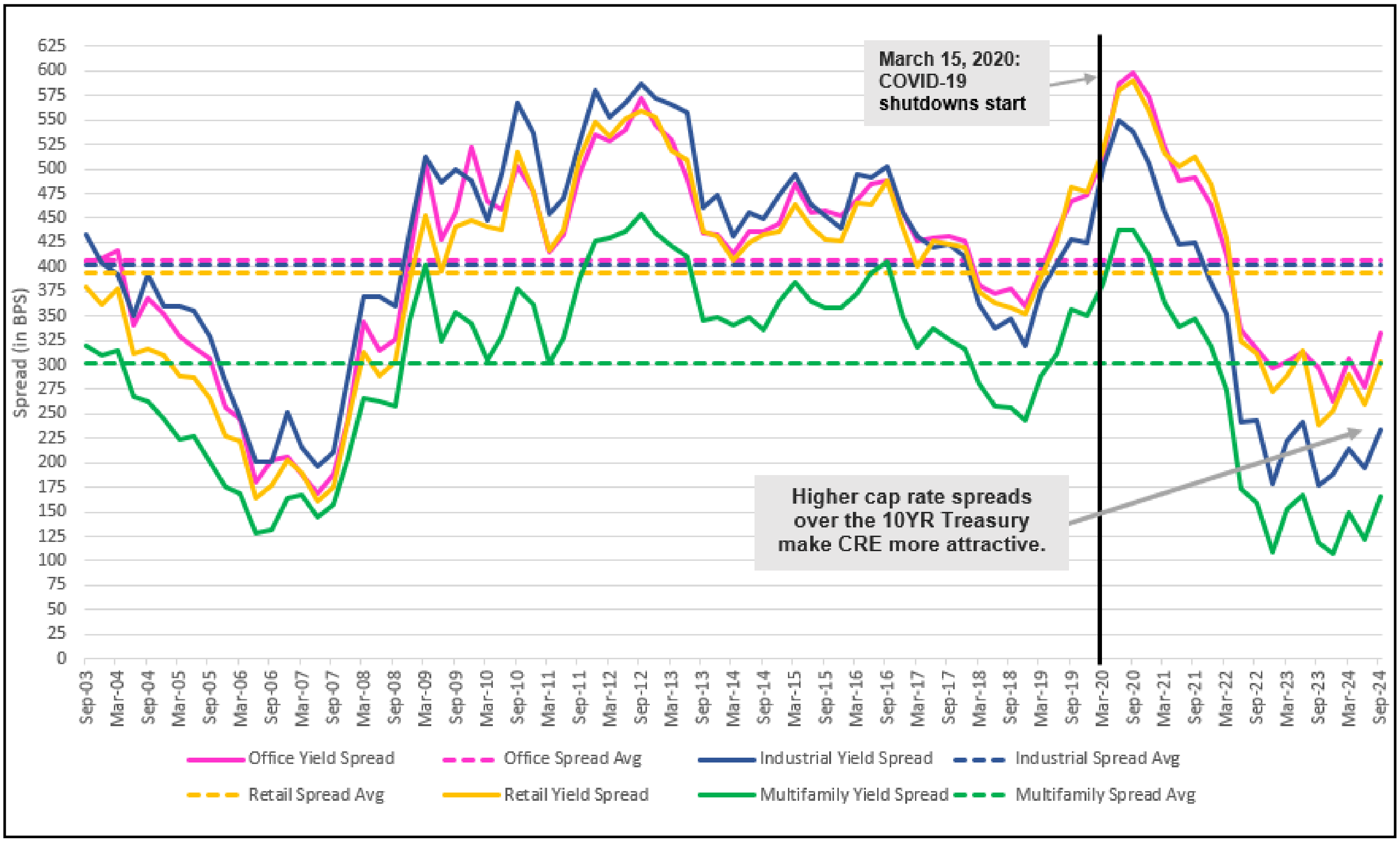


While optimism for CRE is returning, recovery will be uneven and sector-specific. As office and industrial struggle with vacancies and multifamily rents are unpredictable, retail and land remain strong with high occupancy rates and new construction projects. Cap rates moved up 50-100 bps over the past year, but there's still a lot of cash on the sidelines waiting for prices to come down more – especially in markets with severe inventory shortages. Valuations are bottoming out for Class A buildings; however, Class B and C properties (particularly in office and multifamily) still have room to decline.

Cap rates have moderated for everything except higher-end assets like corporate-backed tenants and Class A trophy offices in major cities which command 4-6% caps. Most other properties trade at 6.5%-7.5% cap rates and occasionally hit 10%. International investors are paying 5% cap rates for extravagant Class A buildings. Local business owners are buying small buildings downtown and in the suburbs for 7% caps. Private investors (from California and the Northeast) are redeploying funds into fast-growing "cheaper" markets across the Sunbelt region. Developers are driving up demand for shovel-ready residential and retail land. New construction is trading at 6-7% cap rates while existing buildings need to be priced at an 8% cap to draw attention. With interest rates sitting right above average cap rates in our markets, most deals are closed with cash, 1031 exchanges, and private equity.

There have been very few distressed sales in 2024. However, we expect this activity to pick up in 2025 as a wave of loans mature.

EXHIBIT 4: CAP RATE SPREADS OVER 10YR US TREASURIES ARE RISING



Source: CBC Research, MSCI Real Capital Analytics, Federal Reserve

LEASING TRENDS

Leasing activity is up substantially in most of our markets. Office landlords are the biggest players, cutting rates by 20-30%, signing shorter leases, spending money to upgrade space, offering turnkey deals, and taking on nontraditional tenants (e.g., startups). Retail is not far behind. While demand is strongest for 1000-5000 SF spaces, anything over 5000 SF has been hard to fill as lots of companies continue to downsize. Only markets with an influx of big corporations have had healthy demand for all box sizes.

RETAIL SECTOR

Retail tenant activity remains competitive across all CBC markets due to very limited inventory, low vacancies, and robust consumer spending. Strong demand for fast casual, professional services, grocery and value retail is pushing rents and property prices higher across our markets. New development is up in neighborhoods with a rise in purchasing power from higher-income households moving in. Strip centers, grocery-anchored formats and drive-thrus are the most popular, attracting all types of investors and restaurants that want to own. Despite high borrowing and construction costs, land prices have climbed sharply as national brands and developers look to build their own drive-thrus.

There is not nearly enough retail product to meet demand (aside from malls) – everyone from national brands to mom & pop restaurants; gyms; coffee shops; med spas; doctors; pharmacies; gas stations; banks; hotels; and dollar stores are expanding. Many shopping center projects are fully leased before coming to completion. Big box stores are being replaced by pickleball, grocery, and experiential retail.

EXHIBIT 5: RETAIL RENT GROWTH: TOP & BOTTOM MARKETS

Rank	Retail: Top 10 Markets	12mo Asking Rent Growth
1	Salt Lake City	9.0%
2	Phoenix	6.6%
3	Tucson	6.1%
4	Columbus	5.1%
5	Jacksonville	5.0%
6	Dayton	4.9%
7	Norfolk	4.9%
8	Greenville, SC	4.8%
9	Las Vegas	4.7%
10	Raleigh	4.6%

Rank	Retail: Bottom 10 Markets	12mo Asking Rent Growth
168	Tiffin, OH	-0.3%
169	Holland, MI	-0.4%
170	Akron	-0.6%
171	Los Angeles	-1.2%
172	Milwaukee	-2.1%
173	East Bay	-2.2%
174	Tulsa	-2.4%
175	Memphis	-2.5%
176	Hartford, CT	-3.2%
177	San Francisco	-3.3%

Source: CoStar.

INDUSTRIAL SECTOR

Industrial demand remains bifurcated. CBC professionals have noted that big spaces are not moving well as markets continue to absorb the barrage of new supply from last year. Pressure from spec development and downsizing tenants have led to high vacancy rates for buildings over 100,000 SF (compared to very low vacancies the last 3 years) – landlords are giving away free rent and pricing discounts. Smaller spaces in our markets are not negotiated and go quickly, with tenants taking whatever they can get. Rents and property prices for buildings under 30,000 SF are up significantly year-over-year. Incubators remain the most popular (with near-zero vacancies) and often go to high-quality tenants such as lawyers, engineers, pharmacies, manufacturers, food distributors, and logistics.

With most users looking for 1,000-3,000 SF and 5,000-10,000 SF, large single tenant buildings are not as functional as big spaces that are divisible. The challenge many markets face is that there are not enough developers building these kinds of spaces. With so much demand, owners have a huge revenue opportunity: spend the money to subdivide large buildings or build 30,000 SF multi-tenant warehouses from the ground up – both of these options will enable landlords to charge higher rents.

EXHIBIT 6: INDUSTRIAL RENT GROWTH: TOP & BOTTOM MARKETS

Rank	Industrial: Top 10 Markets	12mo Asking Rent Growth
1	Jacksonville	7.4%
2	Cincinnati	7.2%
3	Dayton	6.6%
4	Orlando	5.7%
5	Atlanta	5.7%
6	Boston	5.5%
7	Nashville	5.5%
8	Cleveland	5.4%
9	Memphis	5.1%
10	Tampa	5.1%

Rank	Industrial: Bottom 10 Markets	12mo Asking Rent Growth
91	Orange County	0.4%
92	Greeley, CO	0.4%
93	Pittsburgh	0.2%
94	Yuba City, CA	0.1%
95	Napa	-0.1%
96	San Jose	-0.1%
97	San Francisco	-0.2%
98	Inland Empire	-0.9%
99	Austin	-1.6%
100	Los Angeles	-5.4%

Source: CoStar.

OFFICE SECTOR

Similar to industrial, small is key right now. Hybrid work models and "flight to quality" are straining the office market. CBC professionals have noted that downtown buildings remain weak with 20-30% vacancies, which is affecting other sectors – retail lunch spots are going away; hotels are empty; and less multifamily is being constructed. To retain tenants, landlords are allowing 2-3 year leases; giving away refreshes and TI; offering turnkey deals; lowering rents by 20-30%; splitting up spaces into 1500-3000 SF and signing startups. Property values for large buildings that cater to traditional office users have fallen 40-60% from their peak.

We are seeing small offices in the suburbs thrive with high occupancy and rising rents. While 10,000 SF buildings are getting offers, the greatest demand is for 1000-4000 SF spaces and medical offices. Users range from small professionals (CPAs, insurance brokers, lawyers, doctors, med spas) to big corporations who are downsizing. New businesses are entering these markets in droves and willing to pay higher rents.

With millions of square feet of negative absorption, office conversions are rising in our markets. Many traditional buildings are being redeveloped into other uses such as: medical office (which also dominates new construction); mixed use (services, restaurants, fast casual and retail stores on bottom with offices on top); and experiential retail that will draw people out. We are also seeing conversions into self-storage and retail pad sites; very few are converting to multifamily (due to exorbitant costs).

Institutional investors have become net sellers of top office properties. Corporations, international and private investors have been competing for the best deals all year, motivated by deep discounts. Strategic investors may find value in smart renovations and well-located properties as the market recovers.

EXHIBIT 7: OFFICE RENT GROWTH: TOP & BOTTOM MARKETS

Rank	Office: Top 10 Markets	12mo Asking Rent Growth
1	Miami	5.0%
2	Palm Beach	4.2%
3	Sarasota	3.9%
4	Fort Lauderdale	3.1%
5	Fort Collins, CO	3.1%
6	San Jose	2.9%
7	Long Island	2.8%
8	Orlando	2.6%
9	Inland Empire	2.6%
10	Charlotte	2.4%

Rank	Office: Bottom 10 Markets	12mo Asking Rent Growth
71	Orange County	0.6%
72	Los Angeles	0.6%
73	Washington, DC	0.5%
74	Columbus	0.4%
75	Dayton	0.0%
76	Seattle	0.0%
77	Jacksonville	-0.1%
78	East Bay	-0.4%
79	Boston	-0.9%
80	San Francisco	-2.8%

Source: CoStar.

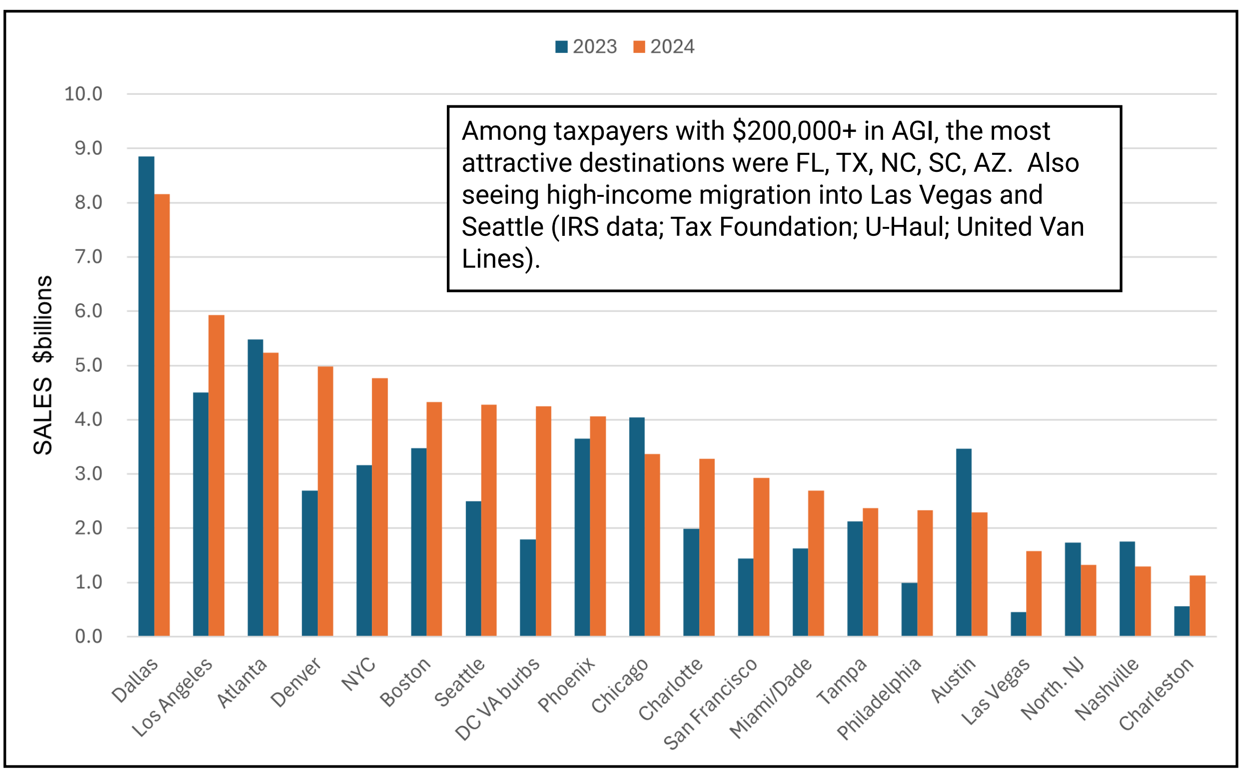
MULTIFAMILY SECTOR

Despite higher wages and recovering rent growth, oversupply and high construction costs have led to a slowdown in multifamily development in most of our markets. Developers have shifted their focus to single-family master-planned communities. CBC professionals have noted that multifamily owners remain on the sidelines because they can't take big risks; banks don't want to fund this space; and properties currently for sale need to come down on price. Sellers keep asking for 4-5% cap rates, but buyers can't pay these prices unless interest rates come down.

We are seeing demand for higher-end buildings in markets like Phoenix, Las Vegas and Boston due to little inventory and a lot of high-income households moving in. Furthermore, as high interest rates keep home buying at historic low levels, the alternative is higher-end rentals. Buyers range from national and regional builders to high-net worth private investors that need to invest in something. Multifamily permits are expected to drop from over 500,000 in 2024 to less than 300,000 in 2025. This slowdown could lead to tighter supply in some markets, which may support rent growth going forward.

Single-family construction permits are up 8% through November (US Census Bureau). The Midwest led with a 12% increase; the West followed with an 11% increase; and the Northeast saw a 9% rise. The South saw smaller growth of 6% (following 2-3 years of big expansion).

EXHIBIT 8: MULTIFAMILY SALES VOLUME: TOP MARKETS



Source: Source: MSCI Real Capital Analytics, CBC Research.

SUMMARY

While we are not expecting a sharp rebound in 2025, the market is ripe with opportunities for strategic investors. As we wait for valuations to bottom out, investors should not rely solely on lower interest rates or declining cap rates. People should focus on pockets of growth where rent and net operating income will increase. Look for markets that are growing from big business expansions, new healthcare services, new entertainment projects and new school construction. Alternatively, focus on refurbishing well-located, older buildings because they are less expensive and often easier to finance. Lastly, with many CRE loans coming due this year, well-capitalized investors will likely find plenty of discounted assets. Expect recovery to vary by geography and asset class, with cap rates compressing in high-demand markets and sectors.

Jane Thorn Leeson is Director of Research at Coldwell Banker Commercial.

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Updated: February 3, 2025

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