AEW

AEW RESEARCH & STRATEGY

U.S. Economic & Property Market Perspective

Q4 2024

For more information, please contact:

MICHAEL ACTON, CFA®
Managing Director, Head of Research & Strategy, North America
michael.acton@aew.com
617.261.9577

ADRIENNE ORTYL
Director, AEW Research
adrienne.ortyl@aew.com
617.261.9159

RICK BRACE, CFA®
Director, AEW Research
rick.brace@aew.com
617.261.9170

Prepared by AEW Research, February 2025

This material is intended for information purposes only and does not constitute investment advice or a recommendation. The information and opinions contained in the material have been compiled or arrived at based upon information obtained from sources believed to be reliable, but we do not guarantee its accuracy, completeness or fairness. Opinions expressed reflect prevailing market conditions and are subject to change. Neither this material, nor any of its contents, may be used for any purpose without the consent and knowledge of AEW. There is no assurance that any prediction, projection or forecast will be realized.

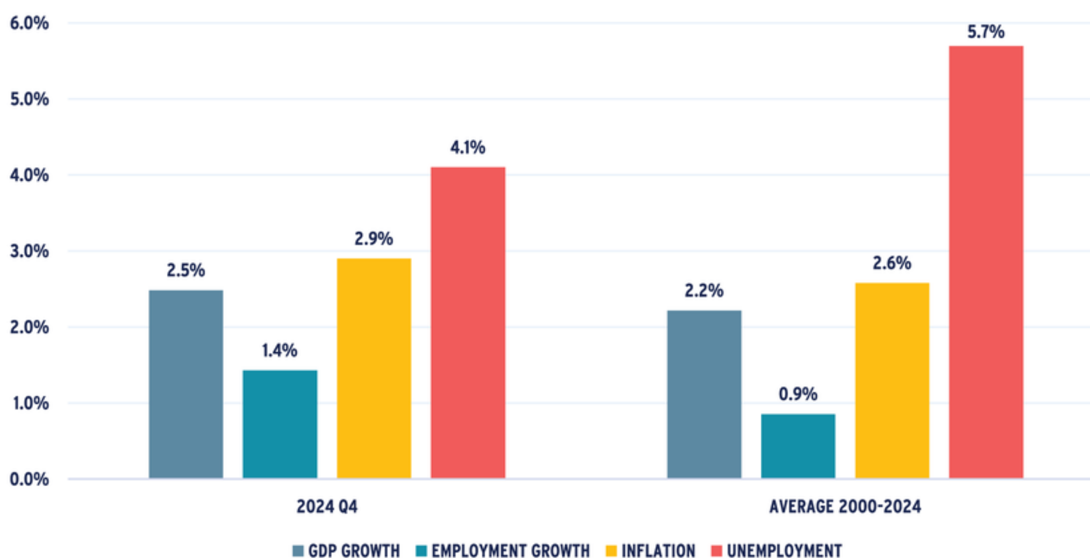
CFA® and Chartered Financial Analyst® are registered trademarks owned by the CFA Institute

Research Update

U.S. Economic and Property Market Outlook

The U.S. economy finished 2024 in generally good shape with real GDP growth for the year of 2.5%, job growth of 1.4%, inflation running slightly below 3%, and an unemployment rate of 4.1%. While inflation remains slightly above the young century average and the Federal Reserve target, each of the other key metrics compare favorably.

FIGURE 1: KEY ECONOMIC METRICS: 2024 VS 21ST CENTURY AVERAGE



As of December 31, 2024
Source: FRED

The near-term economic outlook is marked by heightened policy uncertainty of the Trump 2.0 economic agenda, with elevated near-term risk for higher deficits, higher inflation and interest rates. Broadly, we focus on the four primary policy pillars of the new administration: the tax regime, tariffs and trade, immigration and deportation and the expansion of oil and gas production. The new Treasury Secretary describes the agenda as the 3/3/3 plan: accelerate real economic growth to 3% (currently 2%-2.5%), constrain the deficit to 3% of GDP (currently 6%-7%) and increase oil and gas production by 3 million barrels per day(mbpd) (currently running at 14 mbpd for oil and 30 for oil and gas combined).

To date, there have been few details shared regarding these four policy areas, making specific conclusions difficult. Conceptually, we view what has been proposed through the four key performance metrics: how will it likely impact near-term economic growth, the deficit, inflation and interest rates.

Taxes

Extending and potentially expanding the 2017 Tax Cuts and Jobs Act (TCJA), which is slated to begin expiring this year, would be positive for economic growth, but would likely contribute to higher near-term deficits, inflation and interest rates. Leaving aside any potential expansion of tax cuts, extending the current tax regime is a continuation of the status quo, not net new stimulus. It would, of course, reduce future tax uncertainty and could be stimulative in that capacity. With respect to the projected deficit, however, current Treasury deficit projections typically incorporate current law (i.e., expiration of most of the 2017 tax bill) and therefore extension of the current tax regime produces significant increase in the deficit relative to baseline.

Tariffs and Trade

Tariffs are a form of tax, in this case a tax on consumption of foreign produced goods. The overall impact of tariffs on the economy is likely mixed as tariffs have been used in the past to benefit domestic production but would likely also restrict aggregate consumption of the goods subject to them. Similarly, the impact of tariffs on the deficit is likely also mixed with

some additional revenue collected. With respect to inflation and interest rates, we suspect a robust tariff regime to be negative for both, at least in the near-term.

	ECONOMY	DEFICIT	INFLATION	INTEREST RATES
EXTEND & EXPAND 2017 TAX CUTS				
TARIFFS & TRADE				
LIMITED IMMIGRATION & INCREASED DEPORTATION				
EXPANDED OIL & GAS PRODUCTION				

Limited Immigration and Increased Deportation

While there may be broader policy goals outside of this rubric, we believe reduced immigration and increased forced deportation to be negative to broader economic growth and the deficit while contributing to both higher near-term inflation and interest rates. Documented and undocumented migrant labor represents significant components of the labor supply in specific large industries such as agriculture and construction.

Expanded Oil and Gas Production

Within this construct, expanded U.S. production of oil and gas is uniformly positive, contributing stronger near-term economic growth, lower deficits, inflation and interest rates. Given already record high domestic energy production over the past four years, we do question the likelihood that this is achieved over the next year or two.

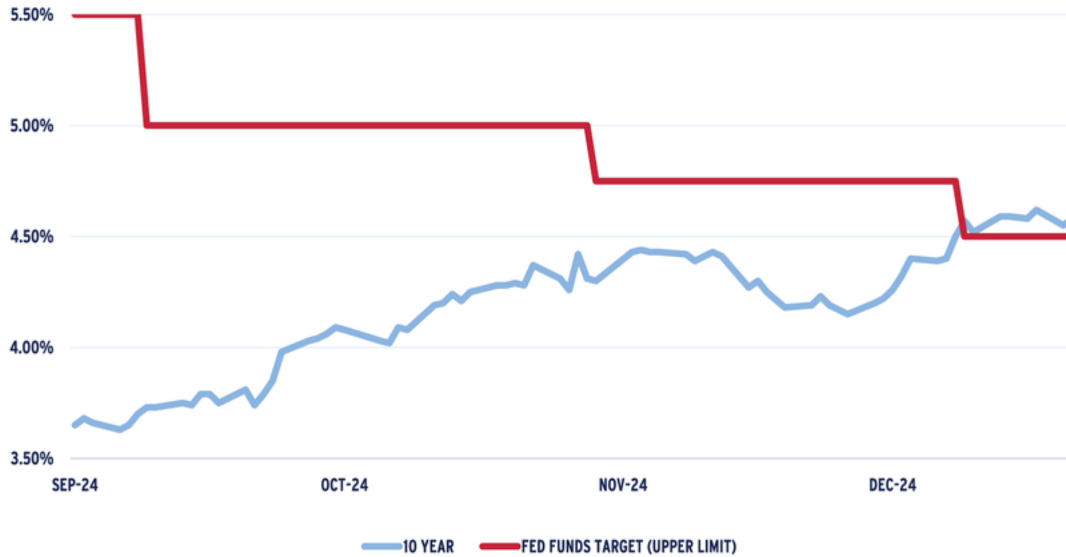
Policy Conclusion

Balancing the uncertainty of what is ultimately included in these policy planks and the timing of any implementation, we expect overall economic growth in 2025 to remain largely in-line with the past two years with real GDP growth in the 2% - 2.5% range with most of the risk for deficits, inflation and interest rates skewed to the upside.

Outlook for Property Investment

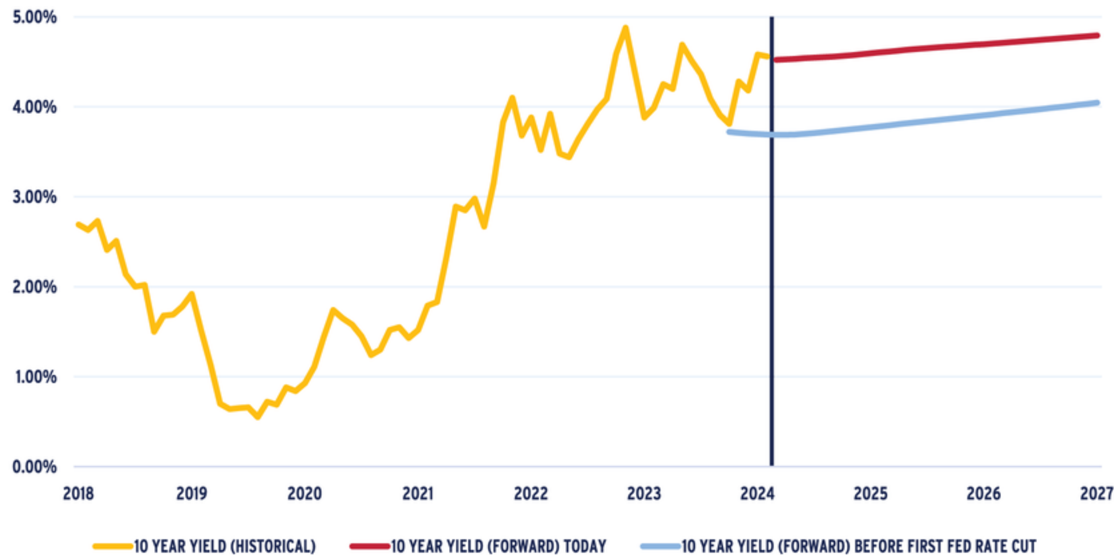
Growth expectations aside, for property investors, the most significant development of the fourth quarter was the divergent rise of longer dated Treasury yields relative to the overnight policy rate (Fed Funds). Since the Federal Reserve began lowering its overnight borrowing rate in September, the movement between the two ends of the yield curve has been in opposition, with short rates declining by 100 basis points and long rates rising by nearly as much. More significantly, market expectations for future yields have also changed considerably since the Federal Reserve began cutting overnight lending rates at the end of the third quarter, also rising by approximately 100 basis points.

FIGURE 2: FED FUNDS RATE AND 10-YEAR TREASURY YIELD



As of December 31, 2024
Source: Federal Reserve

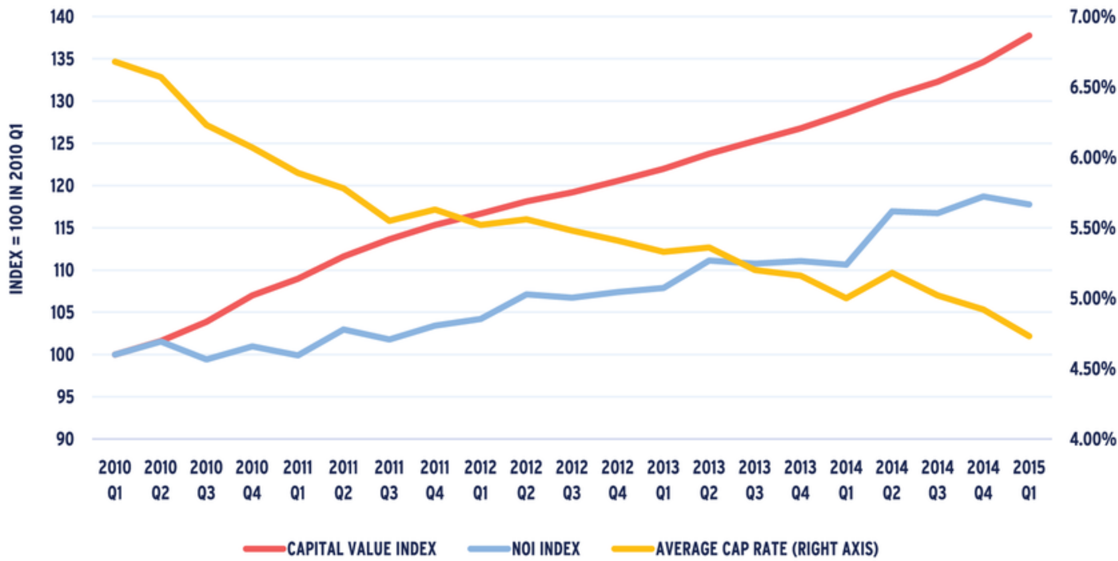
FIGURE 3: 10-YEAR TREASURY YIELD FORWARD CURVE: TODAY AND BEFORE THE FIRST FED RATE CUT



As of December 31, 2024
Source: Federal Reserve, Chatham Financial

This change in the expected path of Treasury bond yields is significant. The last two property valuation up-cycles—the periods following the so-called “Tech Crash” (2002-2007) and the Financial Crisis (2010-2015)—were marked by both cyclical recovery in net operating income (NOI) and significant yield compression. For example, Figure 4 shows the five-year period after the Financial Crisis. Over this period, property income (NOI) increased approximately 20%, but property values increased by nearly 40% as the average property cap rate (yield) fell by more than 200 basis points. Interestingly, the corresponding metrics for the five-year period following the “Tech-Crash” are nearly identical.

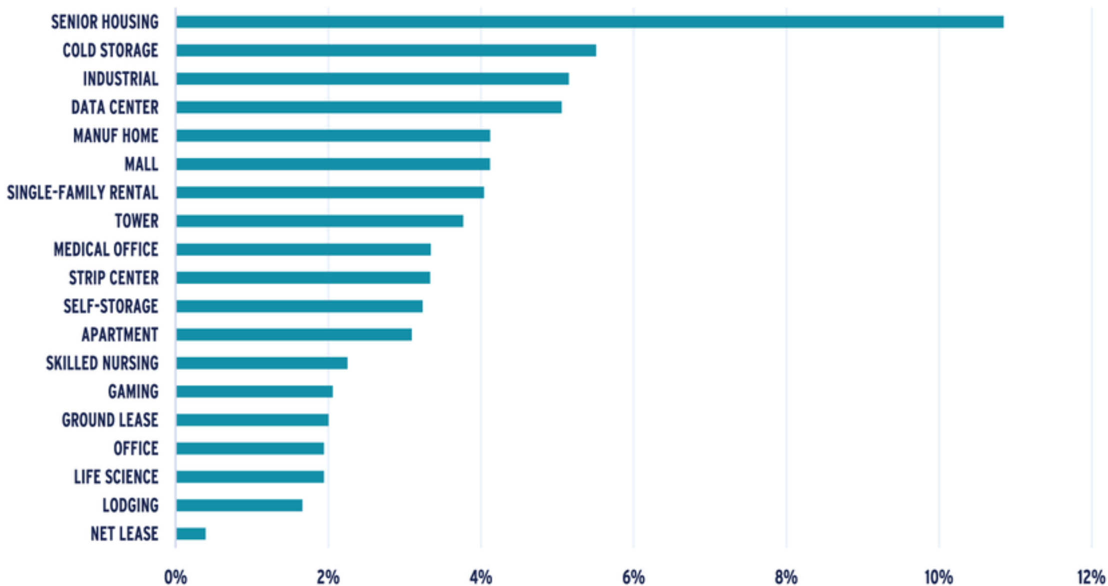
FIGURE 4:PROPERTY VALUES, NET OPERATING INCOME (NOI) AND CAP RATES (YIELDS)



As of December 31, 2024
Source: NCREIF

With respect to go-forward property investment returns, the near-term outlook is nuanced. Since there has been no general cyclical economic contraction during the most recent period of property value decline, it is challenging to underwrite cyclical recovery in property operating fundamentals (occupancy and rental rates) and, ultimately, NOI in most cases. Seniors housing and multifamily, however, are outliers. In the case of seniors housing, the sector experienced something very similar to an economic cycle during the COVID period and is now rapidly recovering in occupancy, rent and NOI. On the multifamily side, the weight of new supply in Sunbelt markets has pushed occupancies and rents down; with supply peaking, we expect fundamentals and NOIs to recover. At the same time, for the reasons mentioned above, it is also more challenging to underwrite near-term yield compression in most cases. Given all of this combined, go-forward returns will be driven almost entirely by NOI growth and the best near-term NOI growth is most likely in sectors such as seniors housing and cold storage.

FIGURE 5: EXPECTED ANNUAL NOI GROWTH 2025-2028



As of December 31, 2024
Source: Green Street

While picking the right sectors and markets is always additive, near-term performance differences will be increasingly determined by individual asset and location selection and old-fashioned asset management (maintaining occupancy, controlling expenses, thoughtful re-investment of cap ex, etc.). Over most of the post-Financial Crisis period, the returns from sound property stewardship were often overwhelmed by the appreciation driven by cap rate compression as central banks around the globe distorted the true cost of capital.

Property Sector Updates

Office

Is the worst over? It feels like we are getting closer, but it depends on your perspective. Office fundamentals seem to be stabilizing, with vacancies plateauing in 2024 aided by a muted supply pipeline putting a cap on new empty space hitting the market. Recent commentary and announcements have brought return-to-office back to the forefront as a topic of conversation shifting the tone a bit on demand. Last quarter it was Amazon and JPMorgan among others who announced a more aggressive stance toward bringing employees back into the office. This quarter it was the Federal Government with the new administration following on the implementation. While maybe not an immediate game changer for demand, on the margin it likely contributed to better absorption in the fourth quarter. A confirmation of value losses highlighted by appraisal and public market pricing indices is gaining more clarity as transaction volumes notched higher. Sellers and lenders appear more willing to move on from stressed investments as more buyers get comfortable with the risk-adjusted return potential at reset values. That said, there remains a wide divide between buildings with value and those without.

Office vacancy rates recorded a 10 basis point (bps) decrease in the fourth quarter to 18.9%, with availabilities slipping to just shy of 25%. The small decline reflected a continued reduction in sublease space, which accounts for 2.2 percentage points of overall vacancy while direct vacancy held steady at 16.7%. Following a difficult first quarter, demand for space has been trending slightly positive in 2024 with a more substantial increase in the fourth quarter on net absorption of 10.2 million square feet (msf) bringing the year's total into positive territory at 6.5 msf. For the most part, the numbers suggest the worst may be behind us although there remains material weakness. Leasing velocity (including both new leases and renewals) in aggregate trended slightly lower in the fourth quarter, averaging about 75% of pre-pandemic levels (CoStar) although high-quality assets have fared better as tenants consolidate into better space.

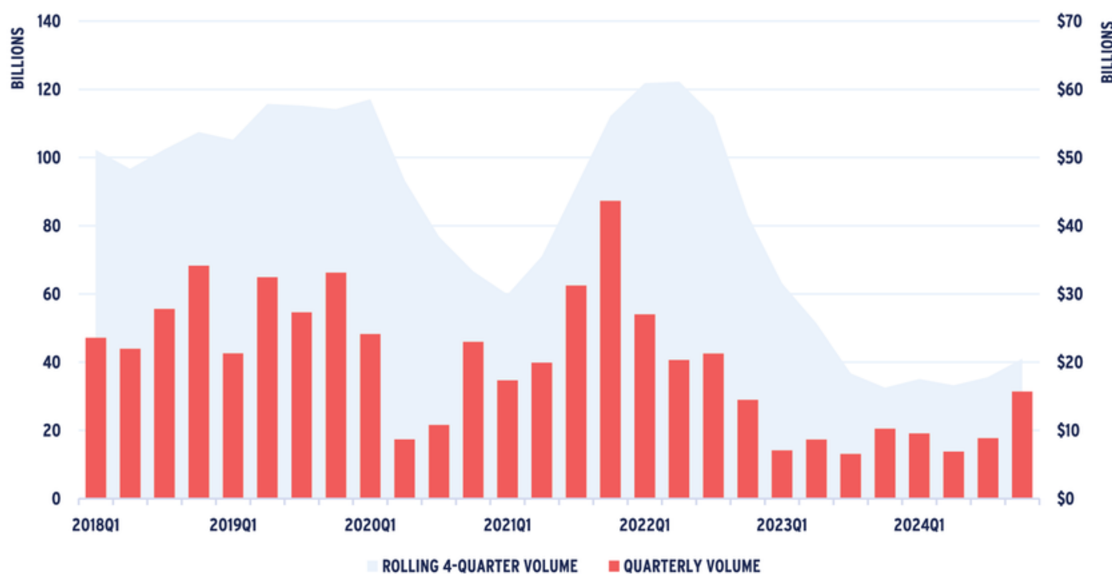
Performance continues to vary widely on a market-by-market basis. Orange County (CA), Manhattan and Nashville all recorded vacancy decreases of more than 100 bps, while Minneapolis, Boston, Portland, Denver, Phoenix, Seattle, Chicago, Orlando and Los Angeles all experienced increases of more than 100 basis points. Boston and Minneapolis increased more than 250 bps with Boston dealing more with new supply.

Having reached the 5-year mark since the pandemic began, most of the shorter leases have been exposed to the new market dynamics. We are now starting to see the effect of many of the longer leases done in the mid-2010s starting to roll. For the most part, the longer leases tend to be larger corporate tenants in the larger markets. Correspondingly, CBRE is reporting that leasing has improved in most Gateway markets, notably Manhattan along with other markets like Atlanta, Chicago, Boston, San Francisco Washington, D.C., and Dallas. Markets where the number of tenants are at or above pre-pandemic averages include Manhattan, Boston, Los Angeles and San Francisco. While these dynamics are certainly positive, the leases that are getting done tend to be smaller (12% smaller according to CBRE). This exposes those markets where more leases are rolling to potential downsizing and space consolidation. As a result, existing landlords remain very aggressive trying to retain tenants and for the most part having some success with the share of renewal running well ahead of pre-pandemic levels. New supply remains less of a factor outside of select markets (notably Boston and Austin) as the pipeline of projects under construction continued to unwind, hitting a cycle low of 43 msf. Of that, 25% is single tenant buildings mostly associated with a few major projects in New York, San Francisco, Seattle and Austin.

The impact on values continues to play out with private equity adjusting at a more measured pace relative to the dynamics seen in the public markets. Through 2024 Q4, NCREIF's capital appreciation index for office reflected an aggregate decline of 37% from previous highs, including a 13% downward adjustment over the past year and a 2.2% adjustment for the quarter. Green Street's estimate of the overall price decline was a comparable 38% for higher quality assets with a bottoming taking place more recently with values essentially flat (-1%) over the past year, albeit up slightly to end the year. That said, the range of value impairment is wide depending on the market, quality of the asset and its relative level of distress. Confirmation of the value impairment began to pick up in the second half of 2024 along with transaction volumes. Annual transaction volume for assets above $20 million remained muted by historical standards but increased to $16 billion in the fourth quarter, bringing the annual total to $41 billion, 26% ahead of last year. For the year, trades were 40% behind the pace averaged prior to COVID. While institutional capital and listed REITs were marginally active buyers, they remained net sellers with the private buyer (including owner/users) being the primary net buyer of office. More specifically, owner/users have seen their share of purchases increase from 12% to 25% of transactions over $5.0 million according to CoStar.

The pressure to transact has increased, coinciding with the amount of office debt maturing over the near-term. Stress is apparent as banks and other lenders increase loan-loss reserves and the CMBS market reports a rising percentage of office loans in special servicing and delinquency. The 30-day office delinquency rate climbed to 11.0% in December from 8.4% in September according to Trepp. Outstanding CMBS office loans in special servicing closed the quarter at 14.8%. Correspondingly, financing is highly constrained with many lenders (and owners) looking to reduce their office exposure. Lender-facilitated sales have become more common solutions to monetizing the most challenged assets as both the equity and debt look to move on. For select deals, the basis reset starts to look appealing. Publicly traded REITs and institutional investors have been reducing their exposure to traditional office assets, while high net worth and private investors have been more active net buyers although the numbers remain relatively small. Overall while fundamentals appear to be troughing and return-to-office presents some potential upside, we anticipate an extended recovery phase with more owner and lenders coming to terms with the new market realities in 2025.

FIGURE 6: OFFICE TRANSACTION VOLUME (ASSETS $20+ MILLION)



As of January 31, 2025
Source: MSCI/Real Capital Analytics

OFFICE	
VACANCY RATE	18.9%
12-MONTH HISTORICAL TREND	
VACANCY CHANGE	↔
RENT	↔
ABSORPTION	↑
COMPLETIONS	↓
CAP RATES	↑
TRANSACTION VOLUME	↑

Apartment

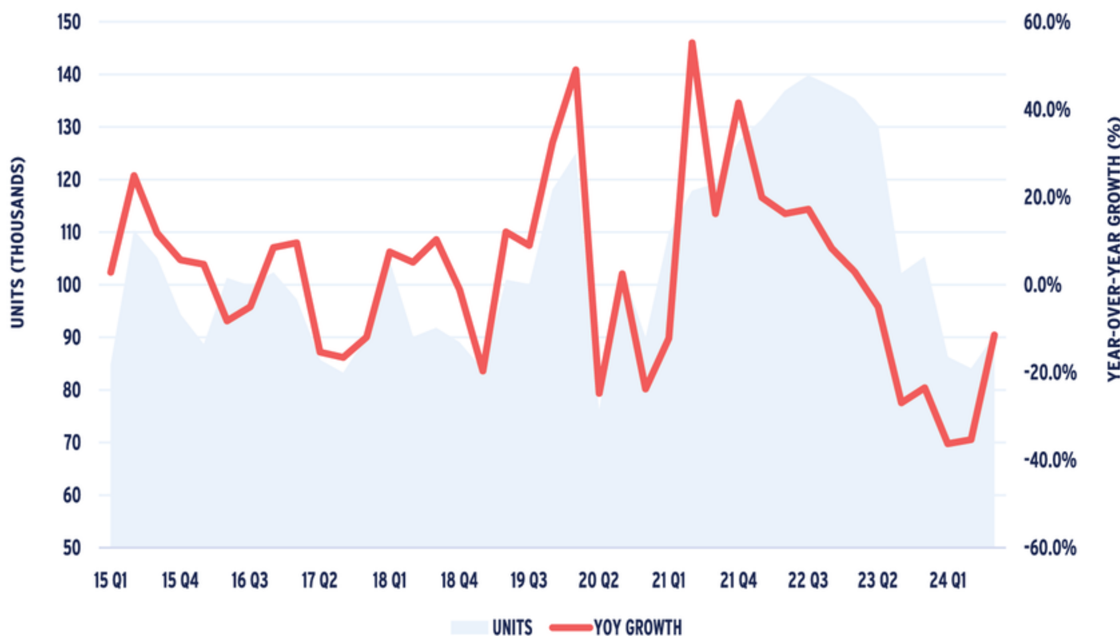
The apartment recovery is in full swing. Apartment vacancies declined by 40 basis points (bps) quarter-over-quarter and 60 bps year-over-year to 4.9% in the fourth quarter. 2024 Q4 marked the first year-over-year decline in vacancies since mid-2022. Further, vacancies are now within striking distance of their 5-year pre-COVID average of 4.7% and are nearly 20 bps below their 10-year pre-COVID average.

Demand was exceptionally strong with 184,000 units being absorbed, the greatest quarterly demand since mid-2021 and roughly three times the 5-year and 10-year pre-COVID quarterly averages. The demand surge was particularly notable given it occurred in the typically slow fourth quarter. Indeed, it was the strongest fourth-quarter demand ever reported; on average, dating back to 1996 when CBRE-EA first tracked apartment markets, demand has been predominately negative in the fourth quarter. From 1996 through 2023, the fourth-quarter average demand was a negative 7,200 units.

Supply, meanwhile, remained robust but continued to slow. Nearly 114,000 units were delivered in the quarter, muting the impact the strong demand had on vacancy improvement. This marked the third consecutive quarter in which completions topped 100,000 units and the sixth time over the past nine quarters with completions above that mark. While supply is slowing quickly, with starts and permits down 35% and 34%, respectively, from their mid-2022 peak, there remains nearly 609,000 units underway. Roughly 456,000 units are due to be completed in 2025, while only 153,000 units are underway for completion beyond 2025. Should the target completion dates hold, 2025 would be the peak for new deliveries, just edging out the 450,000 units completed in 2024. However, it is more than likely that some projects underway will be pushed to 2026 for completion, meaning 2024 was likely the peak of the current development cycle.

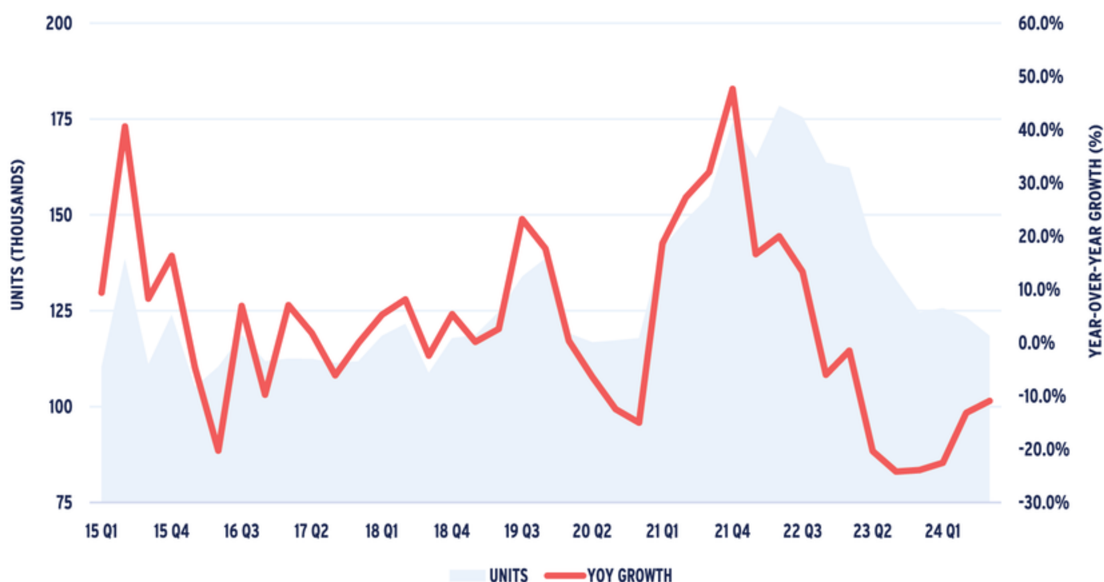
FIGURE 7: SUPPLY IS SLOWING QUICKLY

MULTIFAMILY STARTS



As of 4Q 2024
Source: Haver Analytic, U.S. Census Bureau

MULTIFAMILY PERMITS



As of 4Q 2024
Source: Haver Analytic, U.S. Census Bureau

As we've noted in the past, supply remains concentrated in Sunbelt markets. In 2024, Austin, Jacksonville, Raleigh, Charlotte, Orlando, Nashville, Tampa, San Antonio, Denver and Salt Lake City reported the greatest levels of construction activity. Among the aforementioned markets, completions as a share of current inventory ranged from a high of 9.2% in Austin to 4.7% in Denver and Salt Lake City, far surpassing the 2.6% share reported nationally. Gateway markets were on the other end of the spectrum, with New York, San Francisco, Boston, Riverside, Orange County, Los Angeles and Chicago all reporting completions as a share of inventory of 1.6% or less. Many tertiary markets and Midwest metros also reported low levels of construction.

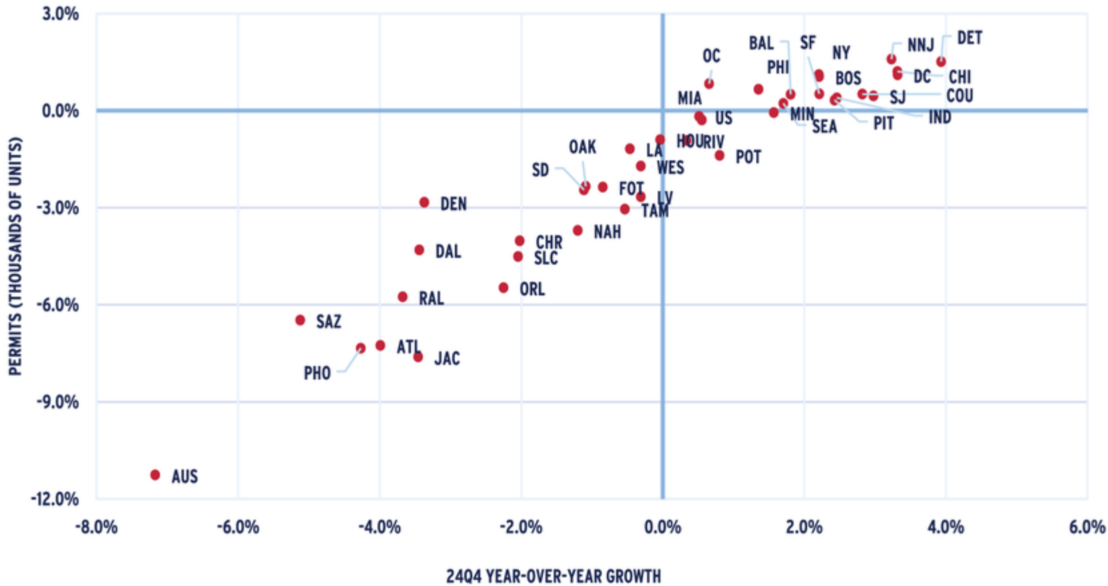
While construction has been strong in the Sunbelt, demand has also been exceptionally strong, leading to improving vacancies. Primary Sunbelt markets reporting a substantial and above-average improvement in vacancies as of the fourth quarter included Las Vegas (-200 bps, 5.4%), Jacksonville (-170, 6.2%), Houston (-110, 6.2%), Phoenix (-100, 6.3%). Salt Lake City (-90, 5.7%) and Nashville (-80, 5.5%). Reporting more modest declines in vacancy were Raleigh (-70, 6.1%), San Antonio (-70, 8.0%), Charlotte (-50, 6.5%), Austin (-30, 6.1%), Orlando (-30, 5.7%) and Denver (-30, 5.7%). The vacancy improvement in Gateway markets was more tempered; however, the Gateway markets tend to be significantly tighter relative to their Sunbelt counterparts. Boston, Chicago, Los Angeles, New York and Orange County posted vacancies ranging from only 3.5% to 4.6%.

Lastly, San Francisco, which was disproportionately harmed by COVID and trailed in recovery, finally appears to be turning the corner. Vacancies in San Francisco improved to 3.7%, down 130 bps year-over-year and the first time vacancies have been below 4% since early 2022. Overall, vacancies in San Francisco are now 90 and 60 bps below the 5-year and 10-year pre-COVID averages. The improvement in the market has allowed rents to improve; however, they remain 7% below their pre-COVID high, making San Francisco the only market where rents are currently below their pre-COVID high. A greater push to return to the office within the tech and financial sectors should support future apartment demand in the market while supply remains minimal, keeping fundamentals tight and allowing for future rent growth. Overall, rents should finally return to their pre-COVID levels later this year or in early 2026.

In terms of rent growth in other markets, roughly two-thirds of market reported positive rent growth on a year-over-year basis in 2024 Q4. Not surprisingly, given their overall outperformance recently, Gateway markets have continued to report healthy rent gains. Washington, D.C., Chicago, San Jose, San Francisco, Boston and New York have reported rent growth ranging from 2.2% to 3.3%, more than four to six times the U.S. average. Midwest markets also posted strong rent growth as they have escaped the supply pressure that has plagued the Sunbelt. Like the Gateway markets, Midwest markets generally experienced rent growth ranging from 2.2% to nearly 4%. The Sunbelt markets, on the other hand, continued to see rental rate declines despite the improvement in vacancies. In Austin, rents declined 7.2% year-over-year in 2024 Q4 while the average rent in the second half of 2024 was down 11.3% from the pre-supply wave peak. Likewise, Atlanta, Dallas, Jacksonville,

Phoenix, Orlando, Raleigh, Salt Lake City and San Antonio all reported sizeable year-over-year rent declines and 2024 H2 rents that are currently 4.3% to 7.6% below peak, or roughly half a month to one-month's rent.

FIGURE 8: GATEWAY AND MIDWEST RENTS ARE GROWING WHILE SUPPLY IS IMPACTING SUNBELT RENTS



As of 4Q 2024
Source: CBRE-EA

Going forward, despite the current supply pressures in the Sunbelt, we believe the nation remains undersupplied in housing and today's supply/demand imbalance is temporary, particularly as we are seeing a substantial slowing in multifamily starts and permit issuance. Meanwhile, demand should remain healthy across all markets, supported by continued employment and population growth, a lack of affordability in the for-sale sector and strong rent-to-mortgage payment metrics, where it is cheaper to rent than own across most markets tracked by CBRE-EA. Against this backdrop, in the near-term, landlords in Gateway and Midwest markets will continue to have pricing power. Vacancies will likely linger around their current rate or improve modestly, allowing rent growth in the 3.5%-4.5% range over the 2025-2026 period, with variation by market. In the Sunbelt, meanwhile, the markets will continue to recover; however, still-healthy supply pipelines will push out the recovery in rents. Pricing power is likely to shift to landlords in 2026 or 2027, again depending on the market and the supply currently underway. After lagging in 2025, rent growth is expected to accelerate and average between 4.0%-5.0% over the 2026-2028 period.

On the capital markets side, we believe capital values are at or near bottom. With the weight of new supply expected to ease, occupancies and rents should pick up, allowing for an outsized recovery in NOIs, particularly in the Sunbelt. With the forward curve notably higher and cap rates expected to increase modestly over the coming years, appreciation will be tempered; thus, the bulk of future returns will be from income growth. Overall, however, healthy, outsized total returns relative to treasuries are expected in the coming years. Indeed, the 2024 Q4 PREA consensus survey projects a total apartment return of 6.7% in 2025 before accelerating to 7.7% in 2026 and over 8.0% in both 2027 and 2028; a healthy spread to the 10-year that is expected to increase from roughly 4.5% in 2025 to nearly 5.0% in 2027.

RESIDENTIAL

VACANCY RATE	4.9%
12-MONTH HISTORICAL TREND	
VACANCY CHANGE	↓
RENT	↑
ABSORPTION	↑
COMPLETIONS	↔
CAP RATES	↑
TRANSACTION VOLUME	↑

Industrial

The industrial market performance in the most recent quarter fell short of expectations. Availability, which appeared to be stabilizing, edged up to 8.6%, a 30-basis point quarterly increase and a 1.5 percentage point year-over-year increase. Moreover, demand, which accelerated in the second and third quarters, moderated notably in the fourth quarter. Nearly 11 million square feet (msf) was absorbed on a net basis in the quarter, roughly one-fourth and one-third the demand reported in the prior two quarters and only a tenth of the 5- and 10-year historical Q4 demand. The overall increase in availability, however, was tempered by the slower pace of deliveries. Completions totaled ~68 msf in the quarter, roughly matching the previous quarter but well below the 123 msf quarterly pace from 2023. Further, the four-quarter completion total eased to 331 msf, down 33% from the nearly 493 msf four-quarter total from a year earlier.

While Q4 was somewhat softer than expected, it is believed the slowdown is temporary and was tied to a few factors: 1) tenants pausing on leasing decisions until after the U.S. election; 2) disruptions at the East and West Coast ports from strike activity in the quarter; and 3) higher mortgage rates and their impact on housing-related tenants. The most measurable impact was in the housing-related sector, where Home Depot is looking to sublease nearly 5 msf of space, Big Lots shuttered a 3+ msf facility and tenants like Hoover, Ashley Furniture and Malouf (mattress manufacturer and retailer) all closed facilities that totaled several million square feet.

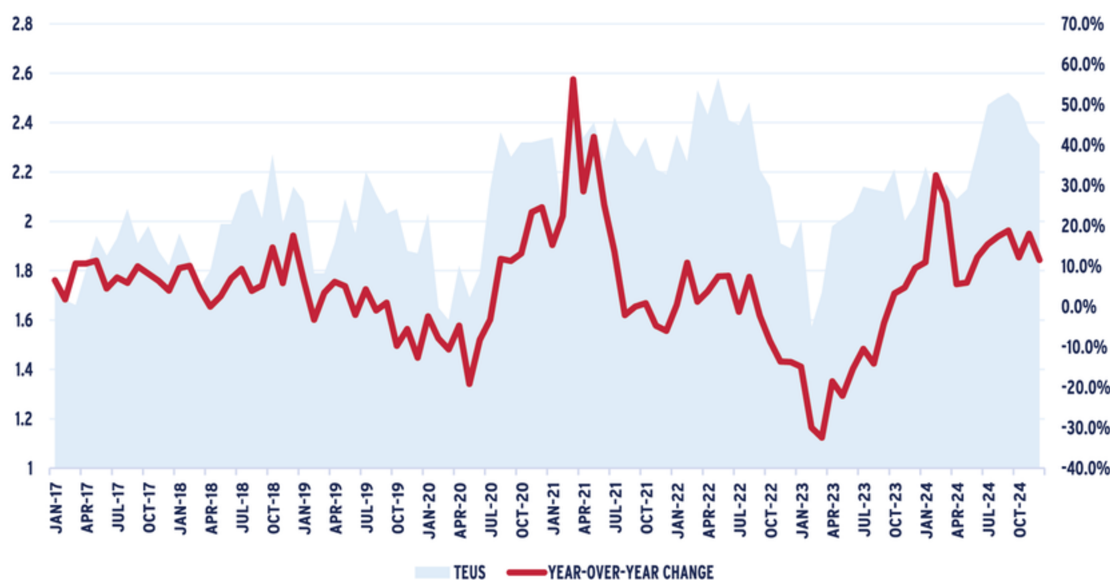
Despite the headwinds in the most recent quarter, recent developments from large tenants such as Amazon, the largest industrial tenant nationally, are a clear signal that fundamentals should improve over the coming year. Following a more solid performance for the e-commerce giant in late 2023 and into 2024, Amazon has reaccelerated building out its distribution network. Further, the company has surpassed analyst expectations over the past four quarters, perhaps suggesting stronger demand ahead. Per CoStar, Amazon executed 47 leases (including 13 for 1+ msf), totaling 18.5 msf in aggregate in the year. Amazon's 2024 leasing volume was up 23% for the year, following three consecutive years of declines in leasing volume.

In addition to the turnaround from Amazon, Prologis also pointed to better times ahead for the industrial sector. In their recent Q4 earnings call[1], Prologis reported strong post-election leasing activity and, per CEO Hamid Moghadam, "ongoing conversations with customers support our expectation that the market is nearing an inflection point."

Further, imports of goods remain strong. Per PIERS and S&P Global, U.S. containerized imports averaged 2.44 million TEUs in the second half of 2024, up 13% from the first half of the year and nearly 16% from the second half of 2023. Further, import volumes are up 25% from their three-year pre-COVID average. We expect import growth will remain healthy, supported by continued consumer spending, which, in turn, will support industrial demand surrounding East and West Coast ports. Potential tariffs, however, do present some downside risk to the outlook. That said, this may be offset by both increased domestic manufacturing and an uptick in manufacturing in Mexico. The increase in manufacturing will likely benefit Mexico-U.S. border states while increased domestic manufacturing will aid the Sunbelt and Midwest states. Industrial demand will also be supported by distributors continuing to build out their supply networks to be nearer to the end-user, the consumer.

[1] *January 21, 2025*

FIGURE 9: U.S. CONTAINERIZED IMPORTS



As of 4Q 2024
Source: PIERS, S&P Global

With respect to supply, meanwhile, construction activity has peaked and new deliveries are moderating quickly. Developers have responded quickly to the softening of fundamentals and the sharp increase in interest rates. Indeed, per CoStar, industrial starts fell to a 10-year low in late 2024 and have continued to decline since then. Given the more moderate supply outlook and solid demand expectations, availability should stabilize early this year with a more earnest recovery occurring in the latter half of 2025 or in early 2026. The points of stabilization and recovery will vary by market with some Sunbelt markets (Savannah, Austin, Raleigh, Las Vegas, Jacksonville, and Phoenix) still reporting healthy supply pipelines underway, ranging from roughly 4% of stock to over 11% of stock. At the other end of the spectrum are the port/Gateway markets where supply underway as a share of stock is generally less than 2%.

With market fundamentals stabilizing, the monetary tightening cycle ending, and the 10-year yield moderating slightly, valuations are likely at or near bottom and should pick up in the coming quarters. Per NCREIF, industrial appreciation was up modestly in 2024 Q3 and 2024 Q4, ending a two-year depreciation cycle. Further, both the equal and value-weighted NCREIF industrial appraisal cap rate dropped roughly 20 bps in the quarter to 4.1% and 3.9%, respectively, the first meaningful decline since mid-2022. The decline in cap rates, however, is likely temporary as the Chatham Financial forward curve suggests a roughly 5.0% 10-treasury yield by 2027. While this may put upward pressure on cap rates, the still notable loss-to-lease in the sector, which stands at an estimated 36%, per CBRE-EA data, should help offset any cap rate expansion. Indeed, even if cap rates expand by an additional 100 bps, in response to the projected increase in treasuries, NOI would need to increase by roughly 20% to keep values flat; the current 36% loss-to-lease suggests that is more than possible, particularly as it does not include future rent growth, which should be strong as the market shifts back to a landlord market in the coming years.

Against this backdrop, it is not surprising valuations are expected to rise. Indeed, per the 2024 Q4 PREA Consensus survey, industrial capital values are expected to increase by over 3.0% annually from 2025 to 2028, the largest gain among the four core property sectors; this combined with solid income is expected to yield a total return of 7.5%-8.0% annually for 2025 to 2028, a healthy spread to the projected 4.5%-5.0% treasury rate. Overall, this suggests this year/early next year is a reasonable entry point for investors to take advantage of the shift in the market.

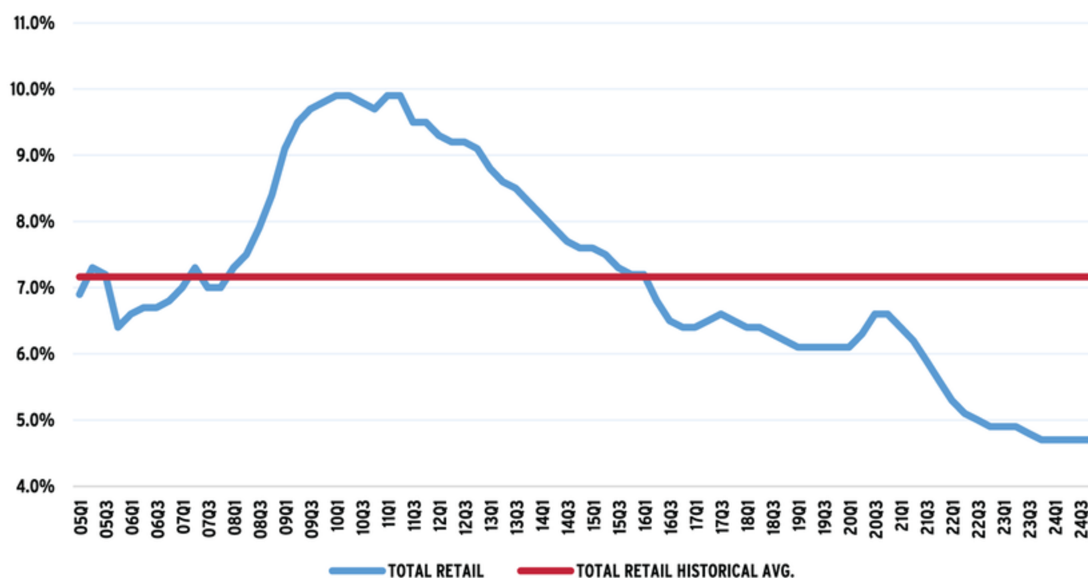
INDUSTRIAL

AVAILABILITY RATE	8.6%
12-MONTH HISTORICAL TREND	
AVAILABILITY CHANGE	↑
RENT	↓
ABSORPTION	↓
COMPLETIONS	↓
CAP RATES	↑
TRANSACTION VOLUME	↔

Retail

It was a fairly quiet quarter for the retail sector with total availability remaining at 4.7% for the fifth consecutive quarter in 2024 Q4. Availability over the past three years has averaged only 4.9%, 140, 170 and 300 basis points (bps) below the 3-year, 5-year and 10-year pre-COVID averages, respectively, highlighting how exceptionally tight the market is today.

FIGURE 10: THE RETAIL MARKET REMAINS EXCEPTIONALLY TIGHT TODAY



As of 4Q 2024
Source: CBRE-EA

Demand was relatively modest in the quarter and for the year overall, again reflecting the low-level of availability today. Only 5.7 million square feet (msf) was absorbed on net in the quarter, making 2024 Q4 the second-lowest quarter for net absorption over the previous 16 quarters; only 2024 Q1 reported a smaller demand tally at 3.3 msf. Annual demand, meanwhile, totaled only 22 msf, the lowest level of demand on an annual basis since 2009 (excluding the COVID year of 2020). On the supply side, activity was also exceptionally modest in the quarter and year. Only 4.0 msf was completed nationally in 2024 Q4, the lowest new supply delivered in a quarter since CBRE-EA began tracking the market in 2005. On the year, a mere 25.5 msf was completed, again a historic low for supply on an annual basis.

Performance among the retail subtypes varied slightly over the quarter and year. Not surprisingly, as the largest retail subsector at 3.0 billion quarter feet (accounting for 37% of all retail space), the neighborhood and community shopping center (NCSC) segment of the market performance mirrored the broader market. Availability stood at 6.5% for the fifth consecutive quarter. Demand was moderate with net absorption of only 5.0 msf for the year, the lowest annual demand since 2010 (again excluding 2020). Meanwhile, less than 6.0 msf was added to the market, a historical low and less than one-fifth the annual historic average.

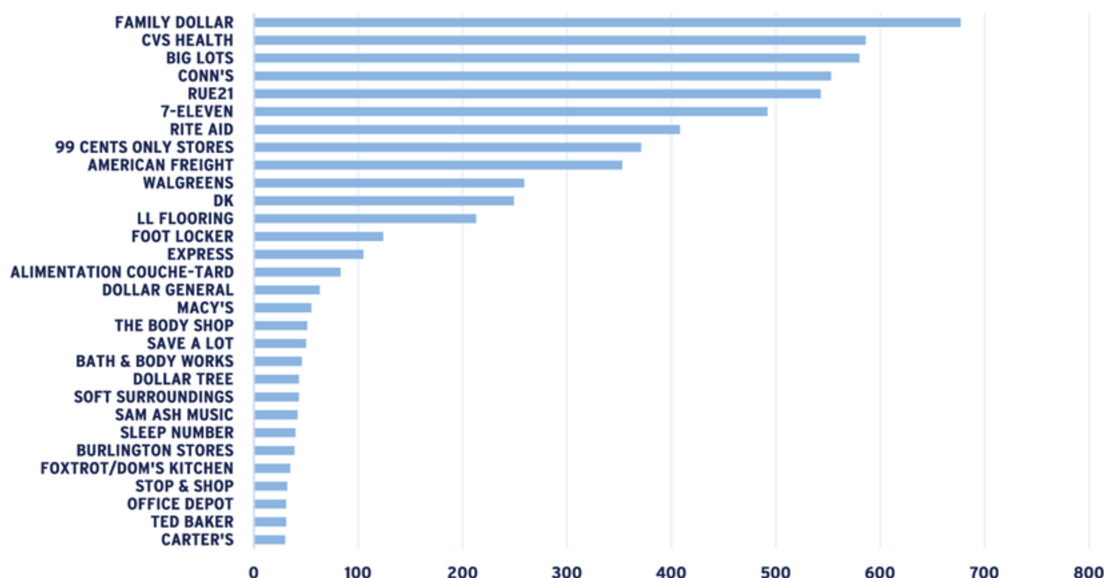
The second largest subtype, lifestyle and malls (L&M), with roughly 775 msf or 9.0% of inventory, showed continued improvement in the quarter. Availability declined to 5.4%, down 10 bps quarter-over-quarter and 20 bps year-over-year. Demand, too, was modest but was roughly two times that of the first, second and third quarters at 815,000 sf. Meanwhile, a mere 391,000 sf was competed in the quarter and only 807,000 sf was completed over the course of the year, a historic low and nearly one-tenth the 7.3 msf historical average.

Lastly, the power center (PC) segment of the market, which encompasses 670 msf or 8.0%[2] of the overall market, saw availability increase 10 basis points to 5.1%, the third consecutive quarterly increase. Net absorption was negative in both the

[2] *The total retail market tracked by CBRE-EA includes free-standing properties; thus, the total share of space among the NCSC, PC and L&M subtypes does not equal 100%.*

third and four quarters but was essentially flat on the year while 1.0 msf of space was completed. The weaker demand stemmed from bankruptcies and store closures among Big Box retailers, including Party City (bankruptcy, ~700 stores); Big Lots (bankruptcy, 580 stores); Conn's (bankruptcy, 553 stores); LL Flooring (formerly Lumber Liquidators, ~100 store closures); Burlington Stores (39 store closures); Office Depot (31 store closures); and Macy's (55 store closures, some in power centers), to name a few. For the most part, the vacated stores are expected to be backfilled in short order; Ollie's Outlet Bargain, Variety Wholesalers, Burlington Stores, Aldi, Hobby Lobby and Dick's have all purchased former Big Lots leases. Despite the slight uptick in PC availability, the segment remains roughly 250 bps below the COVID-high and 100-140 bps below the 3-, 5- and 10-year pre-COVID averages.

FIGURE 11: TOP 30 CHAINS FOR NUMBER OF STORE CLOSURES IN 2024



As of 4Q 2024
Source: Coresight

The backdrop to the overall sound retail fundamentals is the strength of the indebted consumer. Despite high credit card debt and higher interest rates, consumers were out in full force this holiday season. According to Mastercard's SpendingPulse™ report, holiday sales (excluding autos), increased 3.8% for the season (November 1-December 24, 2024). The increase was driven by 6.7% year-over-year gains in online sales and 2.7% growth in in-store sales. Meanwhile, Bain & Company is projecting slightly higher growth at 4.2%, outpacing the 2014-2023 average growth of 3.6%. On the year, meanwhile, sales were up 3.8% over 2023, an acceleration from the 3.1% increase in 2023 and besting previously projected growth of 3.2%.

Going forward, while we remain cautious with respect to the consumer given the historic peak in credit card debt, their overall debt burden as a share of income remains relatively low. This low debt burden should help to keep consumer spending positive. Additionally, the Millennial population, the largest generational cohort today, is entering their prime wage earning and spending years. As they continue to age, form their own households and hit milestones like parenthood, their spending should accelerate. There is downside risk to this outlook, however, fueled by potential policy changes highlighted in our "U.S. Economic and Property Market Outlook" (tariffs, deportations, less immigration), which could be inflationary and cut into the consumers' ability to spend. Given the downside risks, we expect necessity-based and off-priced retail will outperform, while lifestyle centers and malls, which generally have more discretionary-based tenants, would likely be more adversely affected should spending slow in response to policy changes.

RETAIL	N&C SHOPPING CENTER	LIFESTYLE & MALL	POWER CENTER
AVAILABILITY RATE	6.5%	5.4%	5.1%
12-MONTH HISTORICAL TREND			
AVAILABILITY CHANGE	↔	↓	↑
RENT	↑	↑	↑
ABSORPTION	↓	↓	↓
COMPLETIONS	↓	↓	↓
CAP RATES	↔	↓	↔
TRANSACTION VOLUME	↔	↓	↓