December 2024

NEW YORK LIFE REAL ESTATE INVESTORS STRATEGY AND RESEARCH GROUP

2025 MACROECONOMIC AND CRE REVIEW AND OUTLOOK

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The U.S. economy demonstrated resilience in 2024, and we are cautiously optimistic for 2025, despite several economic measures softening. For commercial real estate, the risen cost of capital remains the biggest issue going into 2025. Nonetheless, with the exception of the office sector, we have a more positive outlook for 2025 than we had for 2024. The U.S. economy remains strong. The new administration's proposed tax cuts and deregulation may increase GDP and as a corollary benefit commercial real estate. In addition, slowing construction and steady demand should buttress most CRE sectors.

Key Takeaways

Macroeconomics

- The **U.S. economy demonstrated resilience in 2024 and we are cautiously optimistic for 2025**, despite several economic measures softening. **The election of President Trump** and the Republican majority in the Senate and in the House of Representatives will alter U.S. policy regarding many issues. Tax cuts and deregulation proposed by the new administration may buttress the economy and lead to higher GDP growth but may also increase the federal debt and support higher interest rates. The expected slowdown in immigration following the unprecedented surge from 2022-2024 and possible repatriation policy could be a drag on GDP and housing demand.
- The resilient U.S. **labor market,** renewed industrial investment (reshoring, semiconductor), infrastructure investment, technological innovation, automation, and higher productivity (potentially possible from artificial intelligence) are positive factors for the U.S. economy.
- **Inflation** appears to be moderating, but still remains above the Federal Reserve's 2% target. We expect inflation to remain above the target in 2025, as rising costs are supported by several long-term trends and increased tariffs proposed by the new President.
- The U.S. **federal debt level of $36.1 trillion** is at an all-time high and will need to be refinanced at higher rates.

- **Consumer** debt including credit cards and auto loans are at record highs, up 31% and 21% from pre-Covid, respectively. Rising delinquency rates for auto loans and credit card debt show consumer financial situation has become worse, primarily in younger and lower-income consumers. The challenging debt environment may increase the possibility of both term and balloon defaults in certain sectors.
- Short term interest rates have declined from peak levels – while long term rates are up. After reducing rates by a cumulative 100 basis points since September, the Federal Reserve appeared to indicate that it is in no rush to substantially decrease further (they indicated only two more cuts in 2025). We expect long term rates to increase over the next year and for the 2-year and 10-yr Treasury yields to remain uninverted.
- **Geopolitical** concerns are heightened with conflict in Eastern Europe, the Middle East, the South China Sea, and the Korean Peninsula. Potential for spread of conflict to a wider area elevates economic concerns regarding trade, inflation, and interest rates. Red Sea shipping lanes are the subject of ongoing terror attacks, which have resulted in higher costs, as cargo ships take longer alternative routes.
- **Globalization**, already under stress prior to the pandemic, has suffered mid-to-longer-term damage, which is inflationary, and deglobalization trends will likely be expanded under the new administration.
- Housing market activity in the **residential housing** market did not experience significant improvement in 2024. Mortgage rates remain slightly higher than the previous year at approximately 6.6%. Homeowners with fixed mortgages at below market rates remain hesitant to move, resulting in low inventory of homes for sale. Sales of existing homes are on pace to see 4.04 million sold in 2024, slightly lower than last year, and the slowest pace in 1995.

Commercial Real Estate (CRE)

- With the exception of the office sector, we have **a more positive outlook for 2025** than we had for 2024. The economy remains strong. The new administration's tax cuts and deregulation should increase GDP and as a corollary benefit CRE. In addition, slowing construction and steady demand will buttress many CRE sectors.
- Higher **interest rates** are putting downward pressure on commercial real estate values and making it more difficult to refinance existing loans.
- There is a wave of loan maturities coming due over the next several years that must contend with lower values and refinance rates substantially higher than at origination. This comes at a time of tightened lending standards and less availability of new loan refinancing. We believe there will likely be an increased level of **loan defaults**, particularly in the office sector. Substantial prospects for investing at a low basis are manifesting, but so are the potential pitfalls. Therefore, it is vital that investors are discerning and rely on the **keen investment expertise** of advisors who can differentiate true opportunities from potential minefields.
- The relatively large bid/ask spread between buyers and sellers will likely take time to recalibrate. A reduced volume of commercial properties currently being marketed for sale are attracting a declining number of bidders. Transaction markets are suffering as a result of a broadening disparity of opinion on the extent to which distress may infect future pricing. We expect **transaction activity in 2025** to exceed the prior year, as market participants become resigned to higher long-term rates.
- There are **major demographic trends impacting the economy and CRE** including a stagnant-to-declining working age population, recent unprecedented immigration (and possibly the curtailment or even the reversal of the same), domestic migration to the Sunbelt and the Intermountain West, inter-metro migration from the urban core to the suburbs and exurbs, the astounding number of remote workers, the great number of people living alone, as well as the aging population and the increasingly lopsided ratio of retirees to workers. Discerning CRE investors and developers can capitalize on these major trends.

CRE Sectors and Opportunities

- **Apartment sector** growth in asking rent is flattening, and even declining in some markets on a year-over-year basis, while vacancy rates are up to 110 bps higher than pre-Covid levels. The above notwithstanding, the near-record affordability challenges of single-family homes and the structural shortage of multifamily units has been a tailwind for the multifamily sector. In 2025, we expect apartment sector rent growth to moderate in the beginning of 2025, but then to accelerate through the end of the year and into 2026. We favor investment in growing Sunbelt and Intermountain West markets as well as supply constrained markets in other parts of the nation.
- **Industrial sector** demand and growth are moderating as unprecedented supply has been added to the market over the past several years. The vacancy rate is 140 bps higher than pre-Covid. Supply is moderating, and the trend toward nearshoring some share of manufacturing and trade to the U.S. and Mexico could benefit demand for manufacturing and logistics properties in the Southeast, Southwest, and Midwest as well as logistics properties in border states like Texas, Arizona, and California. We favor targeted investment in select markets in these regions. In 2025, we expect industrial sector rent growth to moderate further, but remain positive.
- The **office sector** continues to be challenged, and the back-to-office trend is progressing very slowly. The sector has experienced a notable revaluation and default rates are increasing; however, no sector is immune. Loan default rates are expected to increase in 2025. Values of many older office buildings with a high level of functional obsolescence are in freefall and there have been a consequential number of property sales at 25% to 50% of pre-pandemic values. Carefully calibrated investment in such buildings in healthy submarkets may provide the opportunity for substantial gains.
- In the **Retail sector**, vacancy rates are historically tight, and supply risk remains low, with construction below the 15-year historical average. Select suburban retail is outperforming including neighborhood centers that are benefiting from remote work. In 2025, we expect retail sector investments to continue to outperform, given limited new supply and resilient retail spending of American consumers. In particular, we are favorably disposed to grocery-anchored shopping centers in areas with growing population.
- We believe there are opportunities in alternative asset types. Substantial demand for **data center space** is expected through 2025 and beyond, fueled by Artificial Intelligence. **Self-storage** generally has lower operating expense ratios and lower labor costs, but performance in 2025 may be subdued. **Single-Family Rentals (SFR)** are benefiting from the housing affordability gap and low inventory. Opportunities abound in the **Medical Office** and **Senior Housing** sectors, as demand has increased as result of the substantial increase in the age 65+ population.
- All sectors have been impacted by **operating expenses increasing** rapidly over the past three years, which is a broad headwind.
- As values recalibrate and lenders' and owners' needs for liquidity mount, generationally attractive investment opportunities are beginning to manifest. We believe this dynamic should accelerate in 2025. Certain sectors in particular markets may have reached their valuation troughs for this real estate cycle. Investors who can play across the capital stack and up and down the risk spectrum can capitalize on the market disruption.
- Investment opportunities include providing **preferred equity** capital to high-quality sponsors to bridge the capitalization gap to allow for business plan completion. We are focusing mostly on multifamily and industrial and are typically seeing returns in the 13-15% range with 20% or more of equity protection.

New York Life Real Estate Investors

Strategy and Research Group

The Strategy and Research Group (SRG) of New York Life Real Estate Investors (NYLREI) analyzes the macroeconomic environment, demographics, legislation, operating fundamentals and leverages proprietary research to craft and inform investment strategy across NYLREI's Equity, Debt, and CMBS platforms.

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Macroeconomics

The election of President Trump and the Republican majority in the Senate and in the House of Representatives will alter U.S. policy regarding many issues which will impact the U.S. economy and commercial real estate. Trade, fiscal, environmental, monetary, regulatory, immigration, and industrial policy will undergo changes which will have influence on GDP, inflation, interest rates, and commercial real estate.

These changes theoretically point to a more positive impact on the U.S. economy and to a more negative effect for Europe. The new Trump administration, along with Secretary of Treasury nominee Scott Bessent, has stated goals which include cutting the budget deficit to 3% of GDP by 2028, spurring GDP growth of 3%+ through deregulation, as well as producing an additional 3 million barrels of oil or its equivalent per day.[1]

Federal Reserve Chair Jerome Powell said the recent performance of the U.S. economy has been "remarkably good." "The economy is not sending any signals that we need to be in a hurry to lower rates," Powell said November 14 in prepared remarks in Dallas. "The strength we are currently seeing in the economy gives us the ability to approach our decisions carefully." The Fed Chair's remarks are consistent with some of the other FOMC members who are advocating a more deliberate approach to potential rate decreases.

The Fed began lowering rates in September and the Federal Funds Rate is now 100 bps lower than its peak range of 5.25-5.50%. However, long term rates have risen, and the 10-YR Treasury Yield is more than 80 basis points higher than the most recent low point of 3.6% in September. The new administration is cognizant of the risks of higher rates. In a note to investors in his Key Square Capital Management LLC, in January 2024, Secretary of Treasury nominee Scott Bessent wrote that "the greatest risk factor" that would prevent Trump from creating an "economic lollapalooza" "would be a sudden rise in long-end rates."

More than a decade of low inflation and easy financial conditions came to an end in 2022. In the 16 months between March 2022 and July 2023, the Federal Reserve raised interest rates 525 basis points to combat multigenerational high inflation. The Fed's efforts have borne fruit, and inflation has moderated but is still above the target of 2%. Inflation may prove stubborn and may even rise in 2025 with much dependent on the extent of implementation of the new President's policies, as articulated during the campaign.

There has been robust discussion concerning if the U.S. economy will experience a hard or a soft landing. So far, it appears that the economy is not landing. The economy in 3Q2024 has been above trend on many metrics.

Real GDP growth of 3.1% at an annual rate in the third quarter, following 3.0% in Q2, and 1.6% in Q1, reveals the U.S. economy has remained remarkably resilient in 2024. Although GDP growth this year has been higher than initial expectations, we anticipate GDP growth to remain strong in the fourth quarter and into 2025. Productivity gains from the use of Generative AI (GenAI) and other similar technological advancements are set to boost medium-term economic growth, but the gains will be spread unevenly across sectors and skew toward the services sector, particularly information, financial services, and R&D side of the economy.[2]

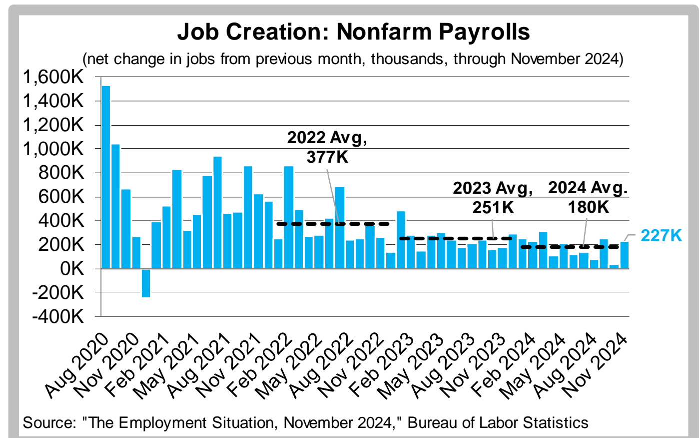
Retail sales – a measure which is more heavily-weighted towards goods than services – slowed, but still remained positive, supporting consumer spending in the third quarter. Over the past year, through November 2024, retail sales grew at a rate of 3.8% on a nominal basis and up 1.0% on a CPI-adjusted basis.[3] Month-over-month growth has been positive on a nominal and real basis in four of the past six months as of November 2024. Resilient retail sales have kept pace with inflation so far in 2024, but may experience a slowdown in 2025.

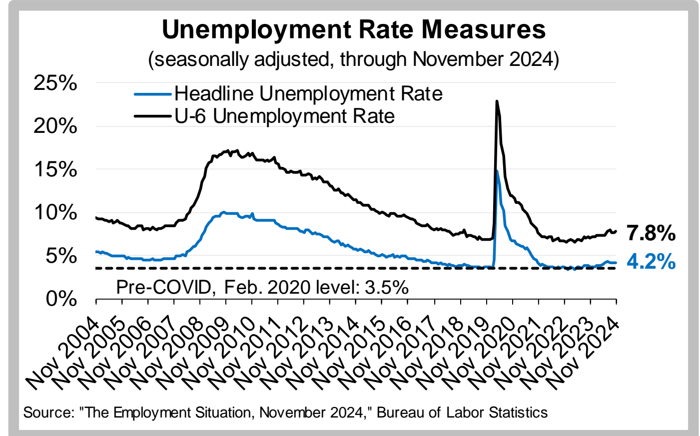
In the labor market, the headline U.S. unemployment measure – the "U3" unemployment rate – rose from 3.7% at the end of 2023 to 4.2% as of November 2024, above the pre-Covid historical low of 3.5% (see chart below).[4] The broader "U-6" measure of the

[1] https://www.wsj.com/politics/policy/scott-bessent-sees-a-coming-global-economic-reordering-he-wants-to-be-part-of-it-533d6e71
[2] Oxford Economics: Global: GenAI productivity gains will skew towards services, November 27, 2024
[3] Source: U.S. Census Bureau.
[4] "U3" unemployment rate is the headline measure of unemployment. "U6" is a broader measure intended to capture underemployment.

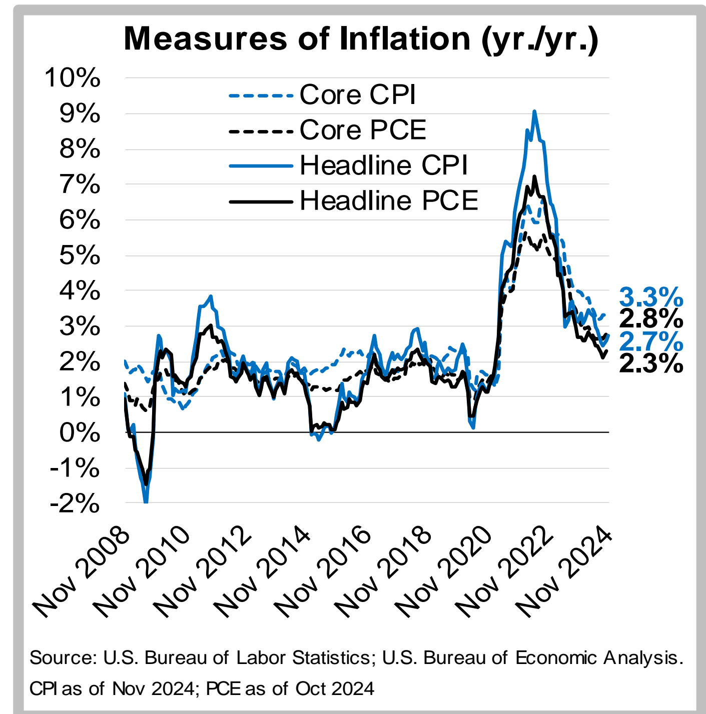
unemployment rate stood at 7.8% as of November 2024, up from 7.1% at the end of 2023, and only 40 basis points above the 7.4% pre-pandemic in February 2020. The post-Covid labor market recovery has seen payrolls exceed their pre-Covid level by seven million jobs. Payroll growth has averaged 180,000 per month so far in 2024, a slower pace than the 251,000 per month in 2023.

Although, the labor market is exhibiting its first signs of weakness, it may prove far more resilient this cycle than in the past. Nevertheless, we expect hiring to slow in 2025 as labor supply slows.





Inflation, a significant threat facing the U.S. economy, has continued to retreat from multi-decade highs. Headline Consumer Price Index ("CPI") inflation, measured on a year-over-year basis, is 2.7% as of November 2024, below 3.4% at the end of 2023, and substantially lower than the peak of 9.1% in June 2022 (see chart above). Core CPI, which excludes the more volatile food and energy components, has slowed to 3.3%, down from 3.9% at the end of 2023, and from a high of 6.6% in September 2022. The Fed's preferred measure of inflation, Core Personal Consumption Expenditures ("PCE"), stands at 2.8% as of October 2024, a slight improvement from 3.0% at the end of 2023, and down from a 39-year high of 5.6% in February 2022. Overall, inflation has softened, but is still significantly higher than the average of the past decade and remains above the Fed's 2% target. In the fight against inflation, much remains to be accomplished, and we expect inflation to remain elevated above the Fed target of 2% into 2025.



The most recent University of Michigan Survey of Consumer Inflation Expectations in December 2024 indicated that Americans expect prices to rise at an annual rate of 2.9% over the next year and 3.1% over the next five years. U.S. Treasury Breakeven Rates (10-Year Treasury-TIPS) imply investor expected inflation to average 2.35% per year over the next five years.

Low-cost labor, goods, and capital enabled inflation to be very low, about 2%, for the past two decades prior to the recent rise in inflation. The U.S. economy no longer benefits from any of those factors to the same extent.

Globalization, already under stress prior to the pandemic, has suffered mid-to-longer-term damage from Covid-19 and the Russian invasion of Ukraine. Meanwhile, the U.S. is seeking to reduce its reliance on China and other countries for critical supplies including semiconductor chips, active pharmaceutical ingredients, generic medicines, and personal protective equipment. This trend has been accelerated by geopolitics and national security considerations. The election of Donald Trump signals even greater deglobalization with expected higher tariffs and other protectionist policies.

The U.S. M2 money supply and debt-to-GDP ratio are near their highest levels and have contributed to high inflation.[5] Demographic trends in the U.S. and worldwide make labor scarcer and more expensive and may become an additional inflationary catalyst.[6]

Other factors that buttress inflation include the Russia/Ukraine war and the green transition (both may become less prominent as factors during the Trump Administration).

While the risk of widespread bank failure contagion appears to be contained for now, bank failures and banks' focus on bolstering their liquidity and financial strength have led to a pullback in the debt capital markets. Additionally, regulatory scrutiny is increased, which has led to tighter lending standards. Since local and regional banks are a critical source of capital for small and mid-sized businesses as well as for real estate sponsors, the pullback by these lenders has placed additional pressure on the economy. In recent months lending standards have eased somewhat, and banks have become more active.

In the wake of the terror attacks perpetuated against Israel on October 7, 2023, war broke out between Israel and Hamas. Iranian proxies in Lebanon, Syria, Iraq, and Yemen then began launching missiles at Israel. In April and again in October 2024, Iran directly attacked Israel. Israel then retaliated by destroying most of Iran's air defenses. After sustaining 12 months of attacks from Hezbollah, an Iranian proxy, Israel struck withering blows against the terrorist organization which included eliminating several levels of leadership and destroying missiles and weapons depots. The weaking of Hezbollah left a power vacuum in Syria filled by rebels supported by Turkey who conquered the nation's largest cities including Damascus and toppled the regime of Bashir El-Assad. Iran commenced pulling its forces out of Syria and Russia also abandoned most of its positions. The resulting recalibration and realignment of the region is ongoing; however, it does appear that the new reality may be more beneficial to the United States. As a result of these changes as well as the more confrontational approach of President-elect Trump, fears of an expansion of the Iran-Israel War may be receding and as a corollary, the negative impact on oil prices, world trade, and the U.S. economy.

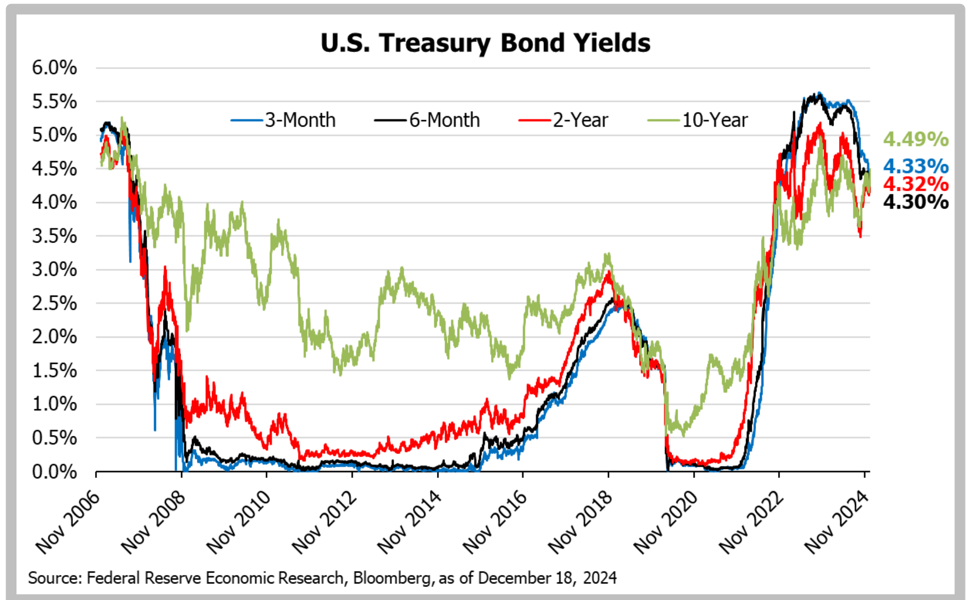
Nevertheless, attacks by Iran via its proxies on ships on the Red Sea persist are causing adverse economic consequences. Escalation at other global flash points including Eastern Europe, the South China Sea, and the Korean Peninsula are noted. North Korean and Yemeni Houthi troops are fighting on behalf of Russia against Ukraine. Expansion of the conflict in Eastern Europe has the potential to negatively impact the global economy. The potential for substantial escalation in the South China Sea as well as the Korean Peninsula could potentially have great negative global implications. China's aggressive moves in the South China Sea are now being met with pushback by its neighbors. Aggressive posturing by nuclear armed North Korea towards its southern neighbor has accelerated and South Korea is now considering getting its own arsenal of such armaments.

[5] M2 is a measure of the U.S. money stock that includes M1 (currency and coins held by the non-bank public, checkable deposits, and travelers' checks) plus savings deposits (including money market deposit accounts), small time deposits under $100,000, and shares in retail money market mutual funds.

[6] Other inflationary tailwinds may include "greedflation" which is when companies raise prices substantially more than necessary as well as climate change causing droughts and other weather-related factors that impact prices for food, insurance, and other products.

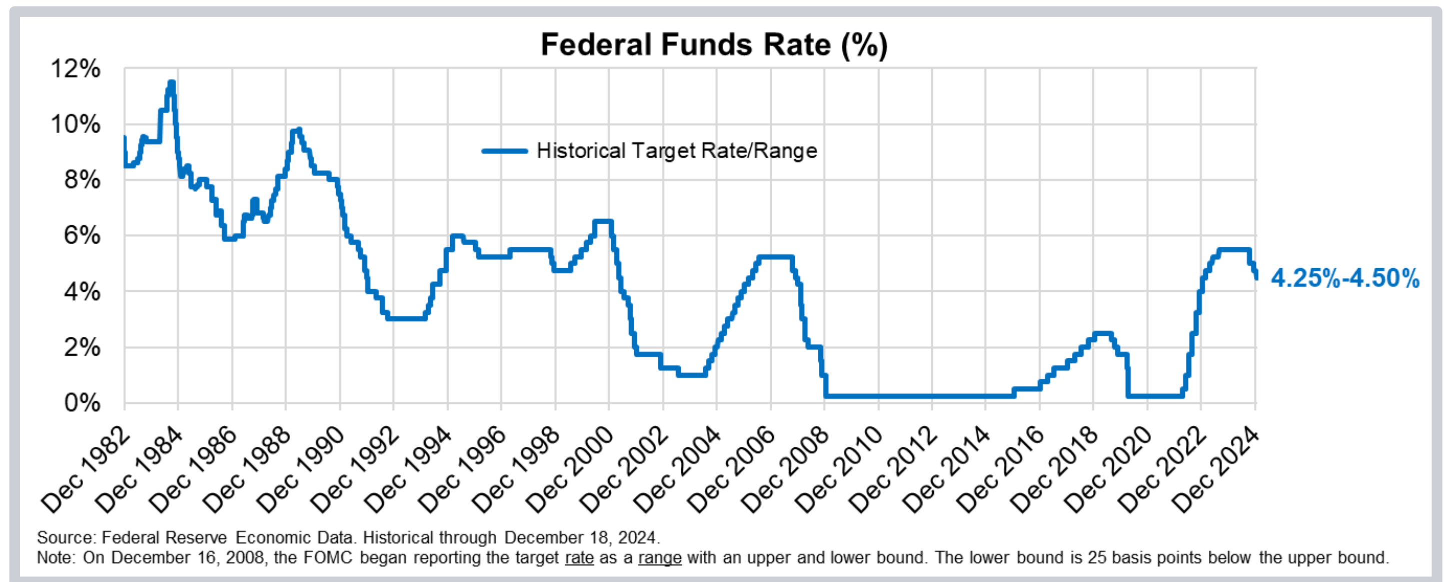
Cost of Capital and its Economic Impact

The elevated cost of capital remained a significant economic impact in 2024. Although rates in 2024 declined somewhat from the highs seen in 2023, all forms of debt, including government, corporate, and consumer debt, will need to be refinanced at higher rates, which will put strain on deficits, budgets, and earnings. Commercial real estate could turn out to be both a perpetrator and a victim of potential crisis. CRE is distributed throughout the U.S. and can have a broad impact. Should rates remain high for an extended period of time, this type of crisis could become more likely.



Source: Federal Reserve Economic Research, Bloomberg, as of December 18, 2024

The rates in place from 2008 to 2022 were atypical in the extreme, and the current interest rate regime is more characteristic of most of human history. The yield on the 10-year Treasury flirted with 5.0% in October 2023 before retreating to about 4.0% to start 2024. The 10-year reached a low of 3.6% in September 2024, before the FOMC cut rates by 50 basis points, which set off a rally in yields on the long end of the curve, climbing more than 80 basis points over three months. As of December 18th, the 10-year yield is 4.5%.



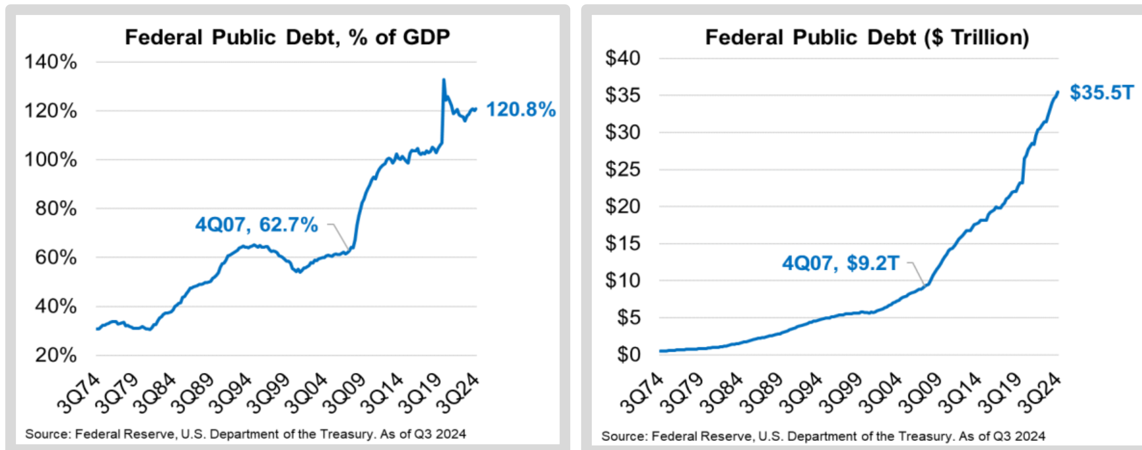
Source: Federal Reserve Economic Data. Historical through December 18, 2024.
Note: On December 16, 2008, the FOMC began reporting the target rate as a range with an upper and lower bound. The lower bound is 25 basis points below the upper bound.

Government debt issuance is likely to stay elevated because of increasing costs, including higher average interest costs on outstanding debt, infrastructure spending, and defense spending. There is also the likelihood that the Trump administration tax cuts get extended and new cuts implemented. The situation is concerning because the government's debt is likely going to be repriced at much higher interest rates than what was in place over the last 15 years. The increased cost of capital has implications for all loans and debt including government, corporate, CRE, and consumer debt.

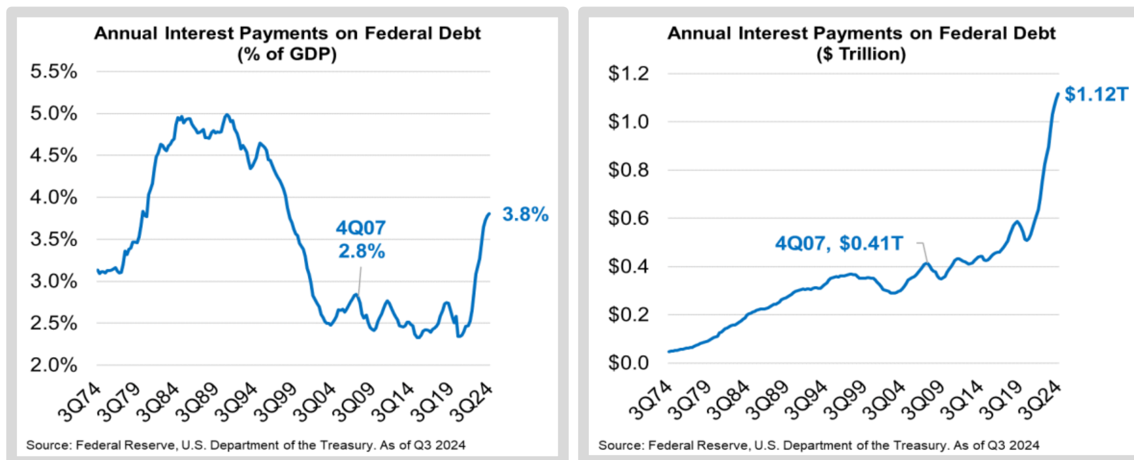
Federal Government Debt

Higher rates are a major challenge to the U.S. budget, since the last time yields were this high in 4Q2007, the federal government debt level was 63% of GDP, whereas the share is currently nearly double at 121%. As of end of 3Q2024, federal debt totaled $35.5 trillion, but official estimates state that by December 2024, this figure has now topped $36 trillion.

According to a Federal Reserve survey of top financial market analysts, the most significant risk facing U.S. financial stability is the fiscal debt sustainability, even greater than the risk of inflation. "Concerns surrounding U.S. fiscal debt sustainability were atop the list this survey, followed by escalating tensions in the Middle East and policy uncertainty," noted the Federal Reserve in its semi-annual financial stability report.[7]



Since the U.S. government continues to borrow and spend at elevated levels and the federal deficit is growing (currently $1.8 trillion in fiscal year 2024), it is unlikely that long-term interest rates will fall significantly in the near term. Interest costs have soared to nearly $1.1 trillion, representing 3.8% of GDP and Fed officials are forecasting that they will stay high for some time.



The $1.1 trillion in annual interest payments is now larger than the U.S. federal government spends on national defense. This comparison is particularly stark when you consider that in 3Q2024, national defense spending grew an annualized 13.9%, the fastest pace of growth since 2Q2003, when the U.S.-led coalition invaded Iraq, as a result of mounting geopolitical tensions. The high level of public indebtedness is not likely to subside, and debt service payments will increase as government debt is refinanced at higher rates.

[7] https://www.federalreserve.gov/publications/files/financial-stability-report-20241122.pdf

Debt and Deficit Are a Major Concern

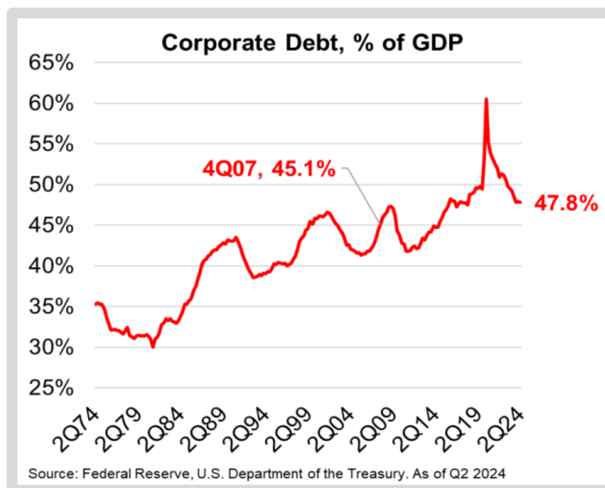
Higher interest rates imply that the new administration will be challenged as it seeks to reduce taxes and increase spending. The Congressional Budget Office (CBO) estimates that the federal budget deficit in fiscal year 2024 is $1.8 trillion. Adjusted to exclude the effects of shifts in the timing of certain payments, the deficit amounts to $2.0 trillion in 2024 and grows to $2.8 trillion by 2034. With such adjustments, deficits equal 7% of GDP in 2024 and 6.5% of GDP in 2025. By 2027, as revenues increase faster than outlays, they drop to 5.5% of GDP. Thereafter, outlays generally increase faster than revenues. By 2034, the adjusted deficit equals 6.9% of GDP—significantly more than the 3.7% that deficits have averaged over the past 50 years.[8]

Reasons the deficit may not rise as much include that President-elect Trump 1) will not be able to implement all the tax cuts he promised during the campaign, 2) government revenues may increase[9] because of deregulation especially in the energy sector, 3) likewise accelerated foreign government defense spending in the U.S will likely benefit U.S. revenues[10], 4) tax cuts for tips, overtime, and social security will increase working hours resulting in more productivity/GDP, and 5) some revenue from tariffs. In addition, Elon Musk and Vivek Ramaswamy as Co-Heads of the new Department of Government Efficiency ("DOGE") may be successful in meaningfully cutting government expenditures.[11]

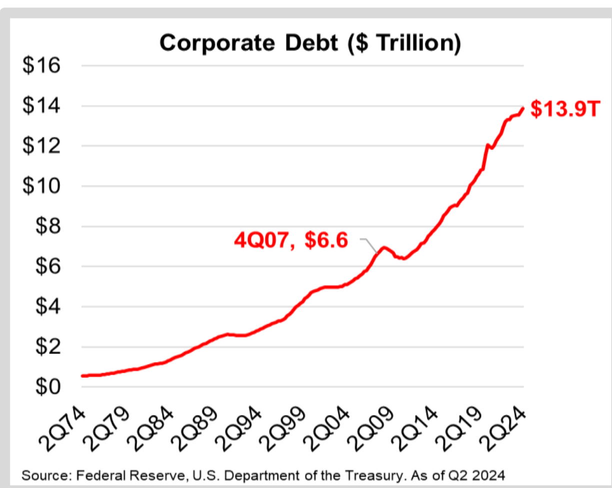
Corporate Debt

Corporate debt also rose in 2024. U.S. companies have issued more than $1.47 trillion in investment-grade bonds this year, up 25%, according to data compiled by Bloomberg.[12] U.S. high-yield issuance has totaled $269.2 billion, up 54%. The above notwithstanding, corporate debt represents 47.8% of GDP, not much above the 45.1% in 4Q2007.

Companies that borrowed funds at low interest rates must now refinance at substantially higher rates. At the very least, these increased costs will damage net revenues. However, it may also lead to default and insolvency, particularly for smaller, weaker, more highly levered companies. According to the Federal Reserve, outstanding corporate debt has risen to $13.9 trillion as of mid-year 2024.



Source: Federal Reserve, U.S. Department of the Treasury. As of Q2 2024



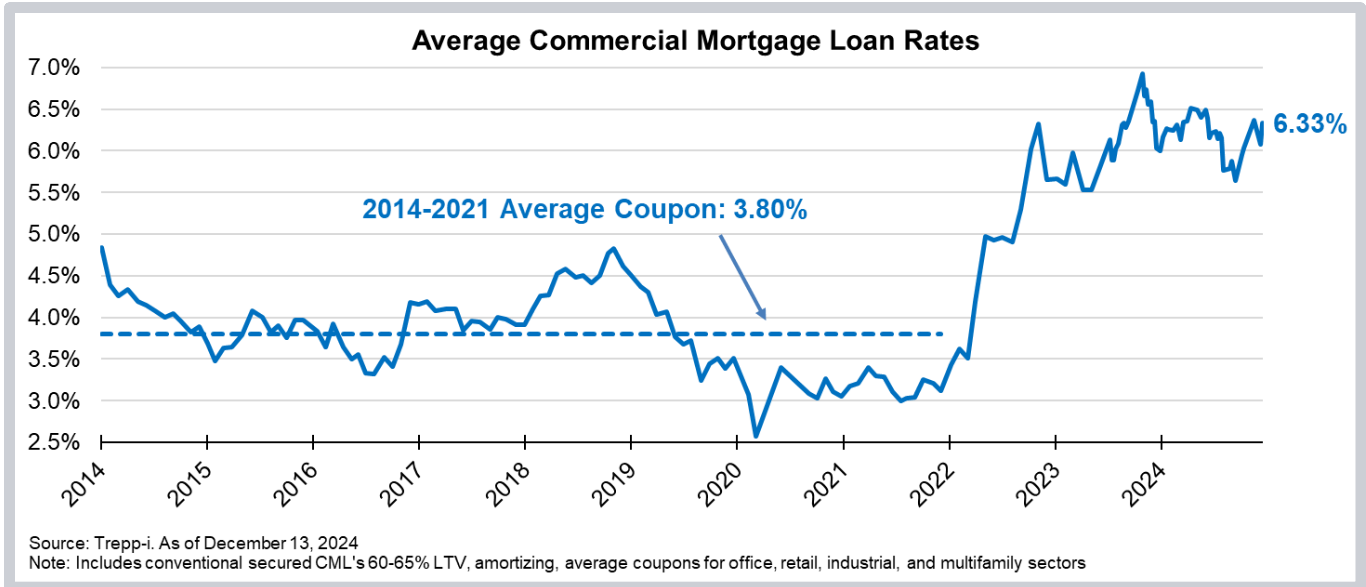
Source: Federal Reserve, U.S. Department of the Treasury. As of Q2 2024

[8] https://www.cbo.gov/publication/60419
[9] This is an indirect benefit to government revenue. If a business's corporate earnings increase, the federal government benefits from increased tax revenue.
[10] IBID
[11] DOGE will focus on reform which will include regulatory rescissions, administrative reductions and cost savings. They will focus on driving change through executive action based on existing legislation rather than by passing new laws. DOGE is also tasked with recommending cuts in government regulations. Elon Musk commented that "a bonfire of nonsense regulations would be epic."
[12] https://www.bloomberg.com/news/articles/2024-11-18/us-blue-chip-bond-issuance-reaches-second-highest-level-ever

Other sources of stress include companies that borrowed at very low rates during the pandemic and used funds for private-equity buyouts. Many of these companies have low credit ratings and much of this debt is adjustable rate and face elevated interest payments. Higher corporate debt borrowing costs damages net revenues and, in some cases, may cause defaults.

Commercial Real Estate Debt[13]

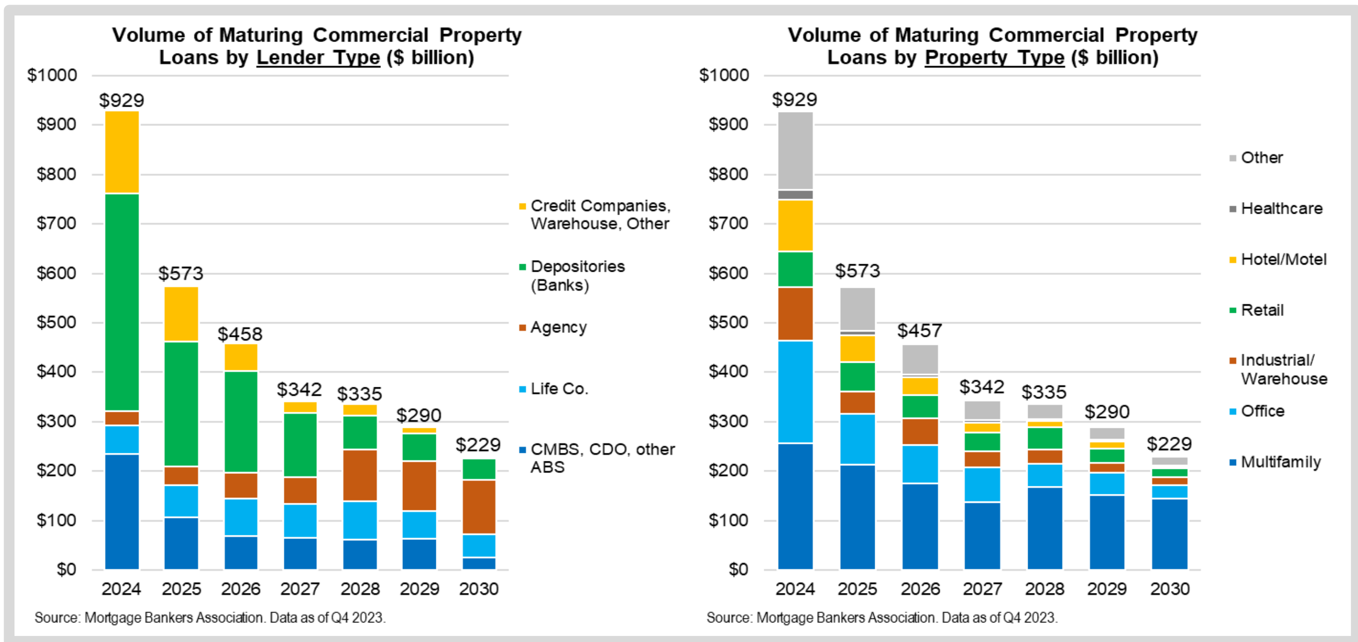
CRE loans sourced during the thirteen-year period of near zero interest rates will face refinancing challenges in the current higher interest rate environment. The current average mortgage rate on a fixed rate commercial mortgage loan is 6.3%, as of December 2024, up from an average of 3.8% from 2014-2021 (see chart directly below). Over the decade prior to 2022, Debt Service Coverage Ratio (DSCR) has not been a leading lending constraint due to low coupons; now it is a major constraint.



Borrowers that leaned into floating rate loans are now exposed to rapidly rising rates which could result in default. The short-term floating Secured Overnight Financing Rate ("SOFR"), currently at 4.4%, is about 100 basis points higher than it was at year-end 2022 and about 20 basis points higher than at the end of 2Q2023. This higher short-term rate raises the cost of floating rate capital, a major factor shaping buyer demand in the commercial real estate sector.

Nearly $1 trillion in upcoming debt maturities were expected to come due in 2024, and another $570 billion in 2025. It is likely much of these 2024 maturities will be extended by lenders into future years. However, pressure to resolve some of these loans are mounting. Properties purchased and/or financed at very low yields with short-term debt will likely be forced to recapitalize with a significant equity infusion and/or third-party rescue capital.

[13] Commercial real estate debt has implications to the broader macroeconomy and is therefore covered here, as opposed to the later section on CRE.



A CRE debt crisis could be precipitated by elevated defaults caused by either an inability to refinance (“balloon default”) or insufficient income to meet debt service (“term default”). These defaults can have a negative impact on the banking system.

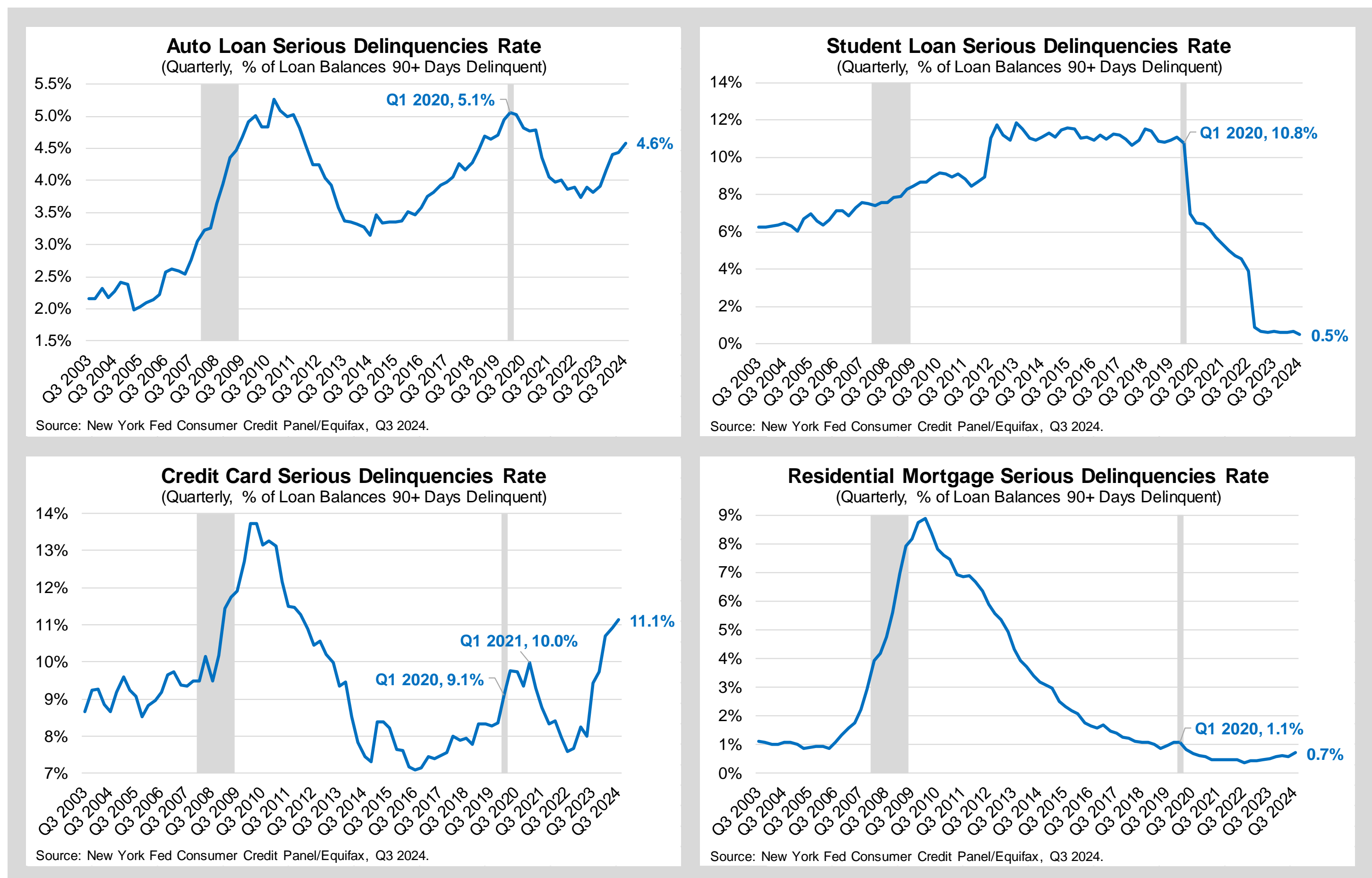
Of the major sources of CRE debt financing, including insurance companies, banks, non-banks, and commercial mortgage-backed securities (CMBS), insurance companies and CMBS (particularly SASB) are most active with banks and debt funds becoming more active.

Consumer Debt: Auto Loans, Credit Cards, Residential Mortgages, and Student Loans

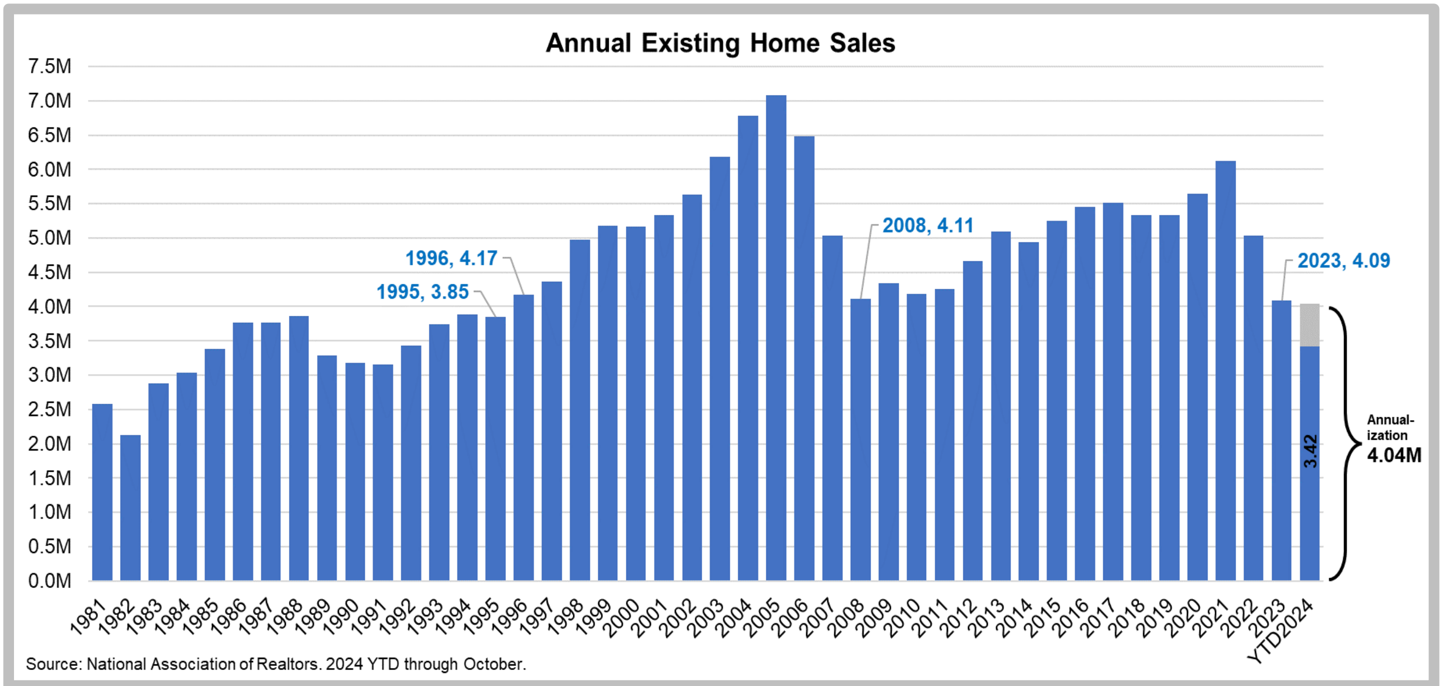
Consumer debt continued to increase in 2024. Both auto loans and credit card debt balances are up 2.3% and 3.3% YTD through Q3, a slower pace of increase than over the same period last year. However, rising delinquency rates for auto loans and credit card debt show consumer financial situation has become worse. The auto loan delinquency rate (90+ days) is now 4.6%, a steady rise over the past seven quarters, and near the pre-Covid level of 5.1%. New delinquencies (30+ days) on auto loans are already above pre-Covid level. According to Fitch Ratings, the subprime auto delinquency rate (60+ days) of 6.1% as of September 2024 is unchanged from September last year, and down slightly from the 6.4% peak reached in February this year.[14]

Likewise, credit card debt delinquency (90+ days) across all ages is 11.1%, higher than its pre-pandemic rate of 10.0%. Over the same period, credit card balances rose by $87 billion to $1.17 trillion, as banks have attempted to get people to open new credit cards, and credit limits were raised on existing cards. Additional consumer credit will support consumer spending in the near term, and spending will likely continue as long as the unemployment rate remains low.

Mortgages and student loans, two other gauges of delinquency looked at for signs of recession, are at very low levels. Mortgage defaults are low because most borrowers are locked in at historically low interest rates. According to an analysis from Redfin, 82% of mortgage holders have a fixed rate below 5% and 62% have a rate below 4%.[15] Moreover, student loan borrowers were not obligated to pay for 43 months during and after the pandemic, with payments resuming only in October 2023, so the delinquency rate remains low.



[14] https://wolfstreet.com/2024/11/16/auto-loan-balances-burden-subprime-prime-delinquency-rates-and-subprime-dealer-americas-car-mart-in-q3-2024/
[15] https://www.redfin.com/news/high-mortgage-rates-lock-in-homeowners-2023/



Residential Housing Market

Activity in the residential housing market did not improve notably in 2024. In 2024, residential mortgage rates rose from January through May, before beginning to decline in anticipation of the beginning of the Fed's rate-cutting cycle. During this period, the housing market began to see some relief, as rates fell from 7.2% in May to 6.1% in September. On September 19, the FOMC cut rates by 50 basis points, which set off a rally in yields on the long end of the curve, climbing more than 70 basis points over two months. As of December 12, the average 30-year fixed mortgage rate is 6.60%, up from low of 6.08% as of 9/26/24, and about on par with 6.61% at the beginning of the year. Although the current rate is about 100 basis points lower than the peak of 7.8% in October 2023, the recent increase in rates will likely put a halt on any progress toward normalization in the housing market.

Homeowners with fixed mortgages at below market rates have been hesitant to move, as they appreciate the asset in the mortgage they hold. Therefore, the inventory of homes for sale has been historically low, which has resulted in low sales volume. In 2024, sales of existing home are on pace for a similar year to last year, expecting to see 4.1 million sales, which will share the distinction of the slowest pace in 1995. For perspective, this is down from 24% from 2019. The combination of high mortgage rates and high prices has led to a significant slowdown in the market, making it increasingly difficult for new buyers to enter and for existing homeowners to upgrade. The high cost of single-family homes has acted as a tailwind for the multifamily sector.

Implications for Economy and CRE from the 2024 Election

The election of President Trump and the Republican majority in the Senate and in the House of Representatives will alter U.S. policy regarding many issues which will impact the U.S. economy and commercial real estate. Trade, fiscal, environmental, monetary, regulatory, immigration, and industrial policy will undergo changes which will have influence on GDP, inflation, interest rates, and commercial real estate.

Taxes and Immigration

The new administration's focus on tax cuts, deregulation, and "Energy Dominance" should lead to GDP growth. Trump wants to extend TCJA tax cuts, cut or maintain current rates of corporate and capital gains taxes and eliminate tax on social security, tips and overtime income. This should theoretically maintain or increase economic growth. Eliminating or curtailing the tax on tips, overtime, and social security should lead to greater productivity, since it incentivizes people to work longer hours and also past retirement age.

In contrast, Trump's immigration policy which involves shutting down the border and repatriation of those that arrived illegally, may harm GDP and multifamily occupancy. However, it would put downward pressure on the unemployment rate and foster wage growth as there would be less competition for jobs.

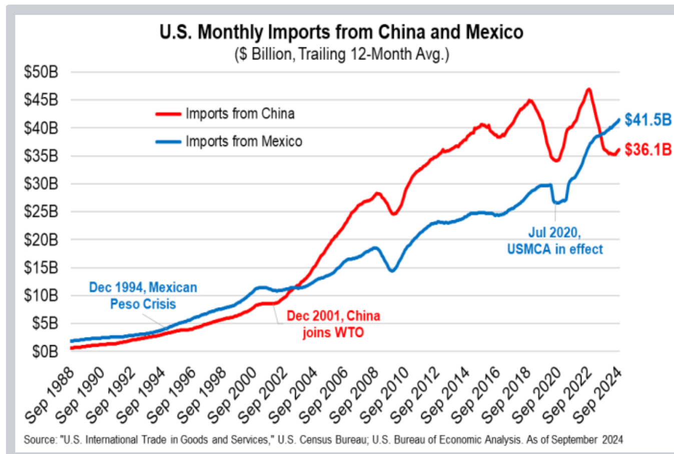
Tariffs

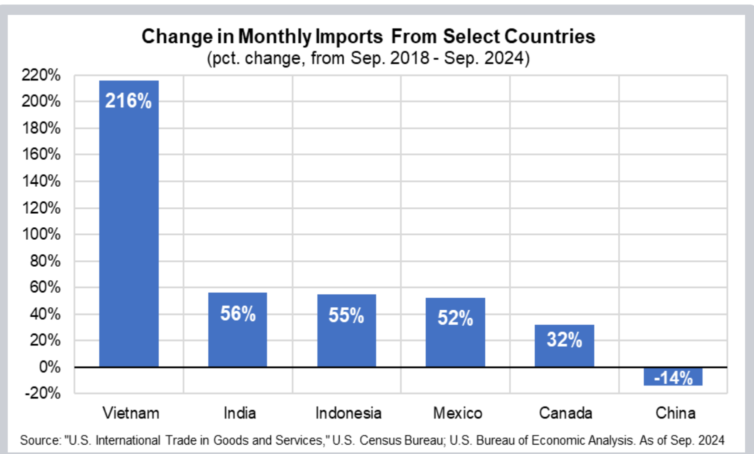
President Biden did not rescind any tariffs imposed during Trump's first term and raised tariffs on steel and electric vehicles. The policy of increased tariffs on goods from China is bipartisan. However, President-elect Trump has proposed a 60% tariff on Chinese imports and 10% on all other imports. Much of this may be an opening gambit which will be negotiated in exchange for other concessions. He has threatened tariffs of 25% on Canada and Mexico if they do not reign in the flow of fentanyl into the U.S. as well as do more to stem illegal immigration. However, even if smaller tariff increases are imposed on China, or if 10% tariffs are not applied to all countries, this may still lead to higher prices for goods and be inflationary. The administration will likely introduce protectionist measures for American-made products particularly in high-tech industries. Other protectionist measures for American-made products will likely be introduced including a tax deduction for interest on car loan payments for American made cars only.

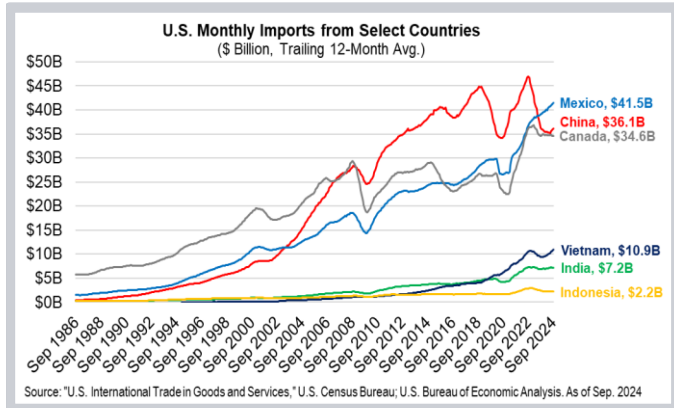
High tariffs could lead to more onshoring with higher paying jobs for Americans. U.S. companies would initially benefit from less competition, but it could eventually lead to decline in innovation and productivity and could increase inflation.

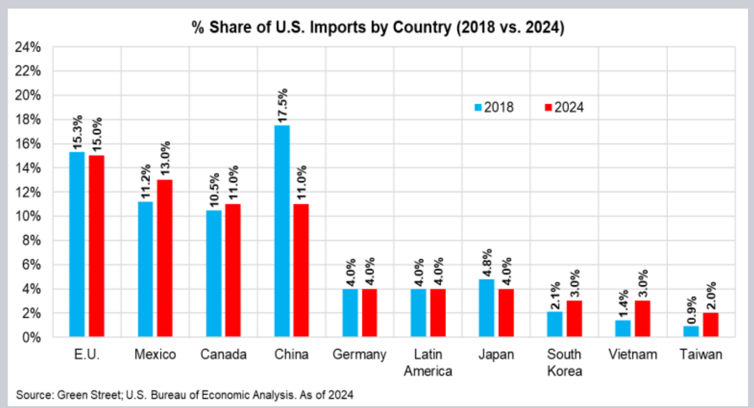
There are signs that Trump's tariff threats may be principally a negotiating tactic. Although he has since argued for tariffs more forcefully as a foreign policy tool. Secretary of Treasury nominee Scott Bessent told investors earlier this year in a letter that the "tariff gun will always be loaded and on the table but rarely discharged."[16]

The effects of tariffs on trade since the first Trump administration are demonstrated in the following charts. Notice the shift away from China that has benefitted other countries such as Mexico.









[16] https://www.wsj.com/politics/policy/scott-bessent-sees-a-coming-global-economic-reordering-he-wants-to-be-part-of-it-533d6e71

Deregulation

President-elect Trump favors many forms of deregulation including those pertaining to the environment and financial markets. He also seeks to streamline the bureaucracy and the cost of the federal government. The administration may possibly repeal some capital requirements for big banks and consumer finance protections and ease up on the regulation of cryptocurrency. In addition, Trump will likely appoint SEC leadership that will expand the pool of retail investors allowed to back private-equity funds. Overall, Trump has stated that he will free Wall Street from "Burdensome Regulation".

Trump also favors deregulation in the fossil fuels sector and wants to remove barriers to drilling and fracking. Consistent with this policy, he looks to freeze new climate regulations, roll back the mandate that publicly traded companies disclose carbon emissions and climate-related risks. His administration will likely reevaluate EPA emissions rules for cars, buses and heavy-duty trucks. Securities and exchange Commission (SEC) climate disclosure rules will likely not proceed. However, many disclosures are still mandated by California and the European Union.

Trump promised to rescind all or part of the Inflation Reduction Act. However, this may not happen as many of these projects are in Republican majority states and congressional districts. EPA emissions rules for cars, buses and heavy-duty trucks that were issued earlier this year with targets from 2027 to 2032 are likely to be reconsidered by the Trump administration.

Trump supports fossil fuels and deregulation. This could lead to lower energy costs, lower inflation, and more American jobs. Deregulation in many categories could charge the U.S. economy in 2025 and beyond.

The Path Forward

The election of Donald Trump as the 47th President is expected to impact the economy and commercial real estate through various policies on trade, fiscal matters, environment, monetary regulation, immigration, and industry. Key proposals include high tariffs on imports, tax cuts, support for fossil fuels, and deregulation. While these policies could lead to inflation and higher deficits, higher long-term interest rates, they may also boost GDP growth, lower unemployment, and increase demand for commercial real estate. His economic agenda could well spur both growth and inflation. Trump's positions on lower immigration and repatriation would increase wages, lower unemployment, increase inflation, and likely cause added costs in the hospitality, manufacturing, construction, food service, lodging, and agriculture sectors.

On the surface the President-elect's policies are inflationary and will leave us with a bigger budget deficit. However, many of his proposals may be opening gambits and the final result will be less impactful. The impact of a more aggressive posture in favor of U.S. energy extraction would be disinflationary. Tariffs would add revenue and a new emphasis on efficiency would lead to lower costs that would mitigate against higher deficits. The purported policies of the new administration could lead to stronger GDP growth, lower unemployment, higher wages, and exalted equity markets which would lead to stronger demand for commercial real estate. However, they could also lead to higher inflation, fiscal budget deficits, and higher interest rates. Which policies get implemented and the magnitude of change will determine the outcome.

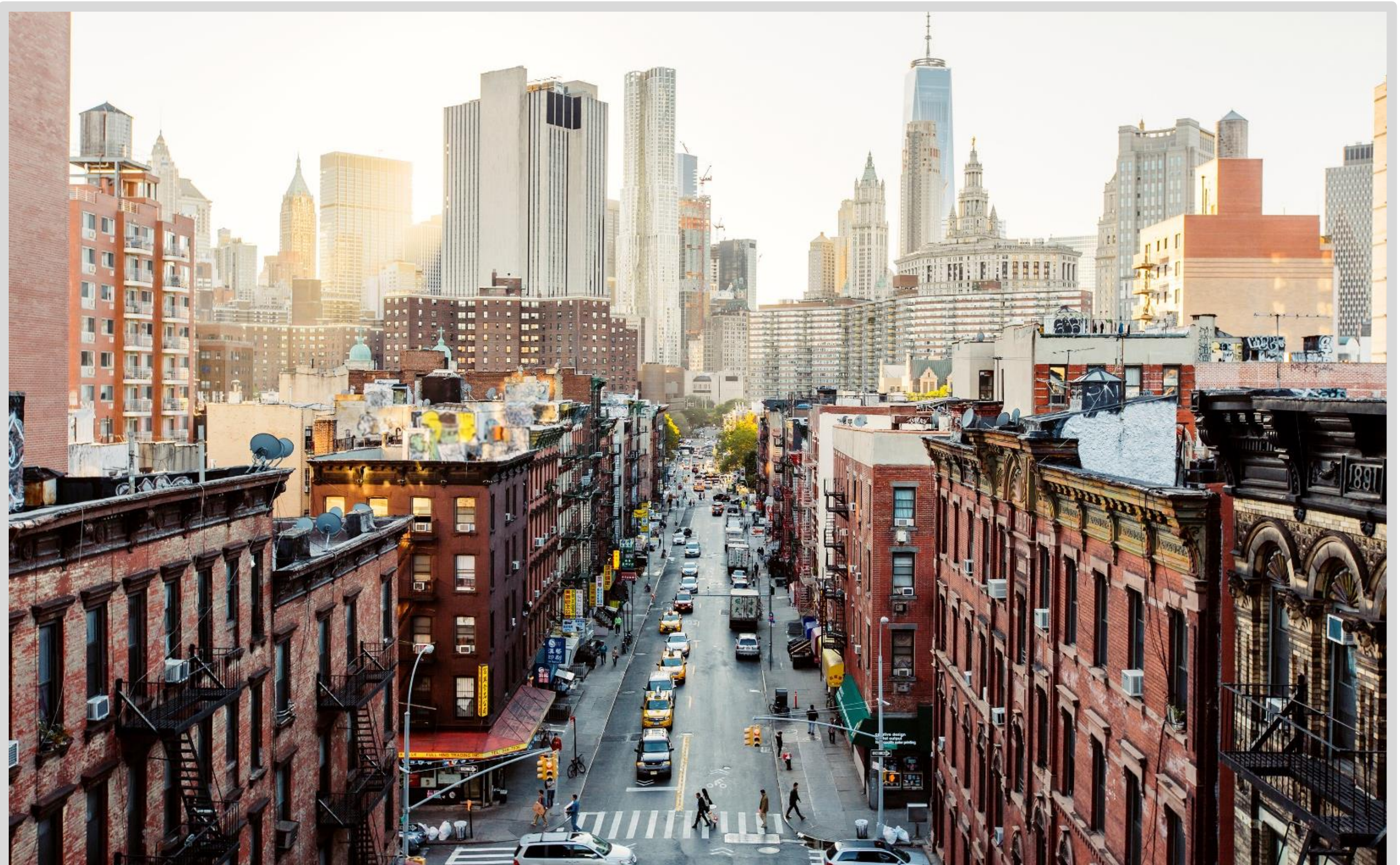
Impact on CRE

Trump's fiscal and deregulation policy will likely provide a tailwind to the economy with stronger GDP growth and increase demand for CRE. Although the net impact on CRE would likely be positive and broad-based, there is the risk of higher interest rates if deficits mount and inflation if policies are poorly executed. Higher deficits would be a tailwind to higher interest rates. CRE property yields would need to move higher to maintain an appropriate risk premium relative to 10-year Treasuries. Higher mortgage rates would make it more difficult to finance CRE and higher cap rates would put downward pressure on CRE values. The new administration's policies on trade (i.e. tariffs, incentives) and immigration may cause higher inflation which would result in higher operating expenses which would be negative for CRE. Curtailed immigration and repatriation would harm apartment occupancy levels. In addition, it could result in some scarcity of workers and added costs, particularly in the CRE related hospitality, manufacturing, and construction segments. Conversely, higher inflation may render CRE attractive to investors as a hedge if inflated rents exceed expense growth.

Macroeconomic Risks for 2025

Looking forward to 2025, we believe that primary risks to the U.S. economic outlook include:

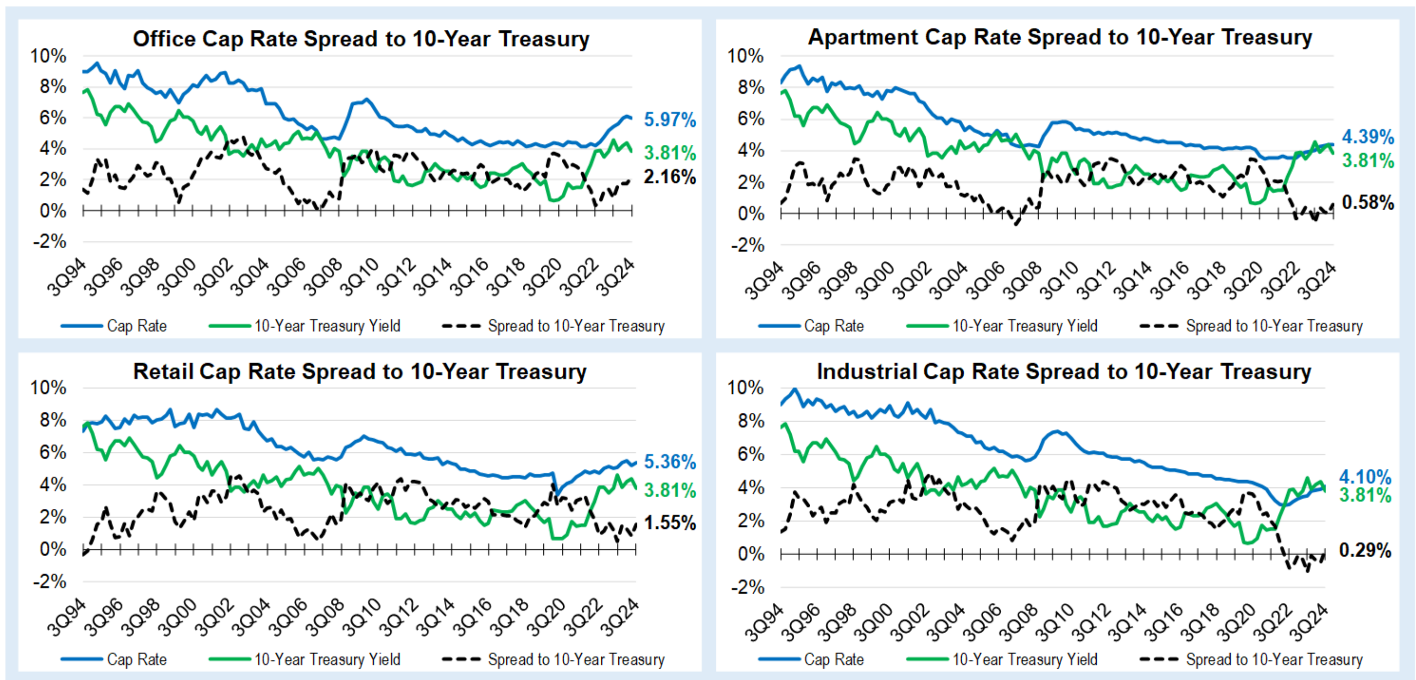
- **A Global Trade War:** The new administration increasing tariffs too high resulting in a trade war and inflation. Deglobalization leads to diminished trade and an increase in U.S./China tensions.
- **Runaway Fiscal Deficits:** The new administration cutting taxes and increasing spending too much resulting in a substantially higher debt to GDP ratio and spurring inflation and higher interest rates.
- **Federal Reserve Mistake:** FOMC rate cuts reignite inflation. An attempt by the executive branch to interfere with the independence of the Fed.
- **Geopolitical Event** (examples – but certainly not limited to):
    - NATO getting drawn in more directly with Russia/Ukraine conflict. Russia expands aggression to other nations in Eastern Europe and drawing the U.S. more directly in to conflict.
    - An expansion of the Middle East conflict involving Iran and its proxies escalating hostilities against the United States, Israel, UAE, or other nations in the region. Iranian proxy attacks against ships in the Red Sea and other global trade routes leads to substantially widened conflict. Concern that the situation in Syria may lead to a civil war that will engulf its neighbors and bring in large outside powers.
    - China getting involved in hostilities with Taiwan or escalating its attacks on Philippine ships.
    - North Korea escalating hostilities against South Korea
- **Debt Crisis** in one or more of the segments of the economy put under pressure by higher rates.
- **Gateway cities do not fully recover** to their pre-Covid-19 economic health and are adversely impacted by crime, open drug use, and homelessness.



Commercial Real Estate

The Federal Reserve's Federal Funds Rate increases have impacted lending costs, loan refinanceability, cap rates, values and monthly payments. These higher borrowing costs have hammered rate-sensitive industries, including real estate, and there is likely more pain to come. While short term rates have declined 100 basis points from their peak in September, long-term rates have remained stubbornly high. At this point, we are projecting that rates remain steady in the first half of 2025.

In our view, the biggest issue confronting U.S. commercial real estate is still the cost of capital. Higher borrowing costs impacts value in the form of higher caps rates, which are necessary to provide a premium over the elevated safe rate represented by Treasury yields. Higher cap rates result in lower values. Since industrial and apartment properties traded at lower cap rates pre-Fed rate rise, cap rate inflation is impacting these property types in a bigger way than office, retail, and lodging. In the industrial and apartment sectors, average cap rates based on NCREIF data are currently only somewhat above the 10-year Treasury yield, which may imply that values based on such low cap rates have further to fall if Treasurys remain elevated (see chart below).[17]

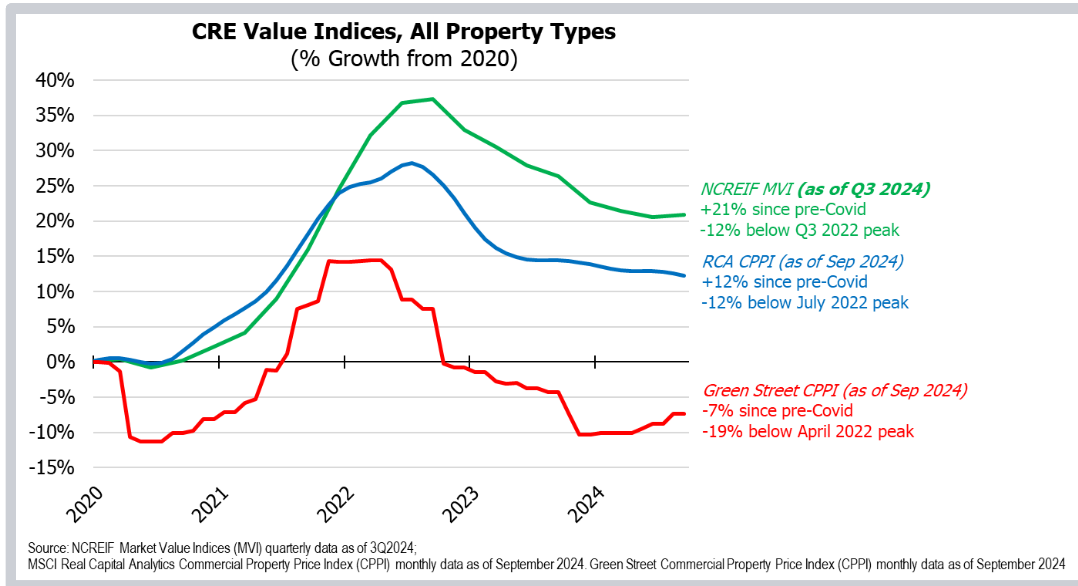


Source: NCREIF Market Value-Weighted Cap Rates, Federal Reserve, As of 3Q24
Note: Past performance is not indicative of future results

Although the Fed has lowered short term rates (which impacts SOFR and helps the ability to finance short term adjustable-rate mortgages), the Fed has little influence over long term rates which have increased by more than 80 basis points[18] since September 2024. The perception that rates will remain at elevated levels has investors focused on a revaluation of all asset classes. Negative leverage is an issue as interest rates are high and sellers are reluctant to sell for cap rates that reflect a premium over the safe rate.

[17] Properties with embedded rent increases or with realistic upside potential would theoretically temper decline.
[18] As of December 12, 2024

When we examine how much values have changed, we track three major value indexes: NCREIF Market Value Index (MVI)[19], MSCI RCA CPPI[20], and Green Street CPPI[21]. NCREIF MVI focuses on valuations, MSCI RCA CPPI on repeat sales, and Green Street CPPI spotlights public markets. Therefore, the three indexes reveal different estimates of value change (see chart below).



Source: NCREIF Market Value Indices (MVI) quarterly data as of 3Q2024;
MSCI Real Capital Analytics Commercial Property Price Index (CPPI) monthly data as of September 2024. Green Street Commercial Property Price Index (CPPI) monthly data as of September 2024

Lodging, self-storage, life science, and office properties have suffered the greatest loss of value over the past year according to Green Street (see table below).

Change in Green Street CPPI Through November 2024

Property Type	1 Month	3 Month	6 Month	1 Year (Nov '23 - Nov '24)	Previous 1 Year (Nov '22 - Nov '23)	2 Year (Cumulative)	Pre-Covid (Feb '20 - Nov '24)	10 Year (Cumulative)
All Property	1.5%	1.5%	3.8%	**4.8%**	-9.5%	-5.2%	-5.8%	9.7%
Apartment	0.7%	0.7%	8.8%	**14.1%**	-12.0%	0.4%	-0.9%	29.2%
Industrial	1.0%	1.0%	2.8%	**1.1%**	-1.0%	0.0%	31.1%	109.0%
Office	1.5%	1.5%	2.0%	**-1.1%**	-25.1%	-25.8%	-37.9%	-27.6%
Mall	7.0%	7.0%	8.4%	**17.0%**	1.3%	18.5%	-10.5%	-27.9%
Strip Center	2.3%	2.3%	5.4%	**7.6%**	-5.7%	1.5%	4.7%	7.9%
Health Care	1.5%	1.5%	4.0%	**4.0%**	-10.6%	-7.0%	-12.1%	-1.2%
Life Science	-1.5%	-1.5%	-4.0%	**-1.3%**	-12.3%	-13.4%	4.6%	56.2%
Lodging	-0.7%	-0.7%	-3.9%	**-3.0%**	-2.1%	-5.0%	-6.1%	-7.1%
Manufactured Homes	0.0%	0.0%	3.4%	**1.3%**	-5.0%	-3.7%	16.9%	125.7%
Self-Storage	-1.9%	-1.9%	-0.1%	**-2.4%**	-11.0%	-13.2%	29.7%	79.6%

Source: Green Street

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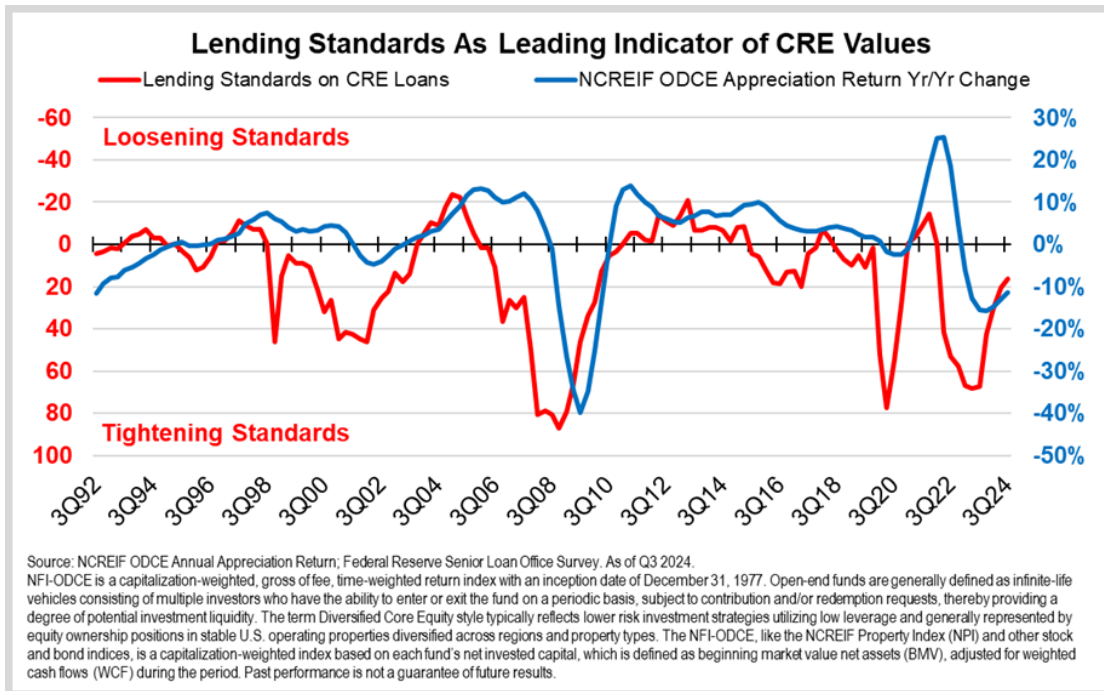
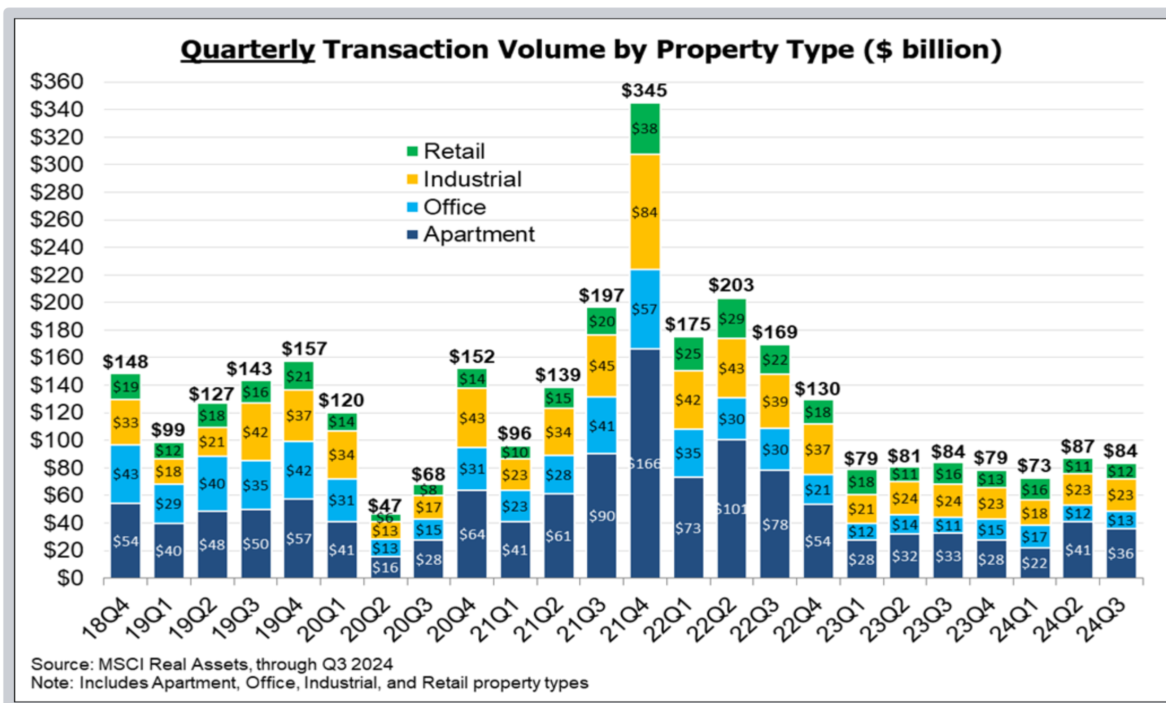
[19] NCRIEF Market Value Index/Indices are a NCREIF quarterly measure of property value change based on same-property appraisals (excluding properties with CapEx)
[20] MSCI RCA CPPI is a value index based on same-property transactions compiled by MSCI Real Assets.
[21] Green Street CPPI: Green Street's Commercial Property Price Index is a time series of unleveraged U.S. commercial property values that captures the prices at which commercial real estate transactions are currently being negotiated and contracted. Features that differentiate this index are its timeliness, its emphasis on high-quality properties, and its ability to capture changes in the aggregate value of the commercial property sector. It is not possible to invest in an index.

When the Federal Reserve's Survey of Senior Loan Officers at banks (SLOOS) indicates a tightening of loan requirements, it is often not only correlated with a recession – but also with a decline in commercial real estate values. However, although still negative, there is a clear upward trend in the past five quarters. (see chart below).



Source: NCREIF ODCE Annual Appreciation Return; Federal Reserve Senior Loan Office Survey. As of Q3 2024.
NFI-ODCE is a capitalization-weighted, gross of fee, time-weighted return index with an inception date of December 31, 1977. Open-end funds are generally defined as infinite-life vehicles consisting of multiple investors who have the ability to enter or exit the fund on a periodic basis, subject to contribution and/or redemption requests, thereby providing a degree of potential investment liquidity. The term Diversified Core Equity style typically reflects lower risk investment strategies utilizing low leverage and generally represented by equity ownership positions in stable U.S. operating properties diversified across regions and property types. The NFI-ODCE, like the NCREIF Property Index (NPI) and other stock and bond indices, is a capitalization-weighted index based on each fund's net invested capital, which is defined as beginning market value net assets (BMV), adjusted for weighted cash flows (WCF) during the period. Past performance is not a guarantee of future results.

Given the continued turbulence in the capital markets, transaction volume across the major property types continued to fall in the third quarter, from $87 billion to $84 billion (a 4% decrease). This continues the sluggish activity that has been occurring for nearly the past two years. Transaction volumes for industrial and retail properties declined from the previous quarter by 2% and 27%, while transaction volume of apartment and office properties grew 9% and 13%, respectively, from the previous quarter (see chart below).



Source: MSCI Real Assets, through Q3 2024
Note: Includes Apartment, Office, Industrial, and Retail property types

This slowdown in activity continues to contribute to reduced clarity on pricing, particularly in the office sector. Financing challenges weighed heavily on transaction volume during the quarter, which registered at levels well below the previous high-water marks and below generally normalized levels. The comparative absence of activity has contributed to both a faded clarity on pricing and broadening opinions on the direction associated trendlines are headed.

The large bid/ask spread between buyers and sellers will likely take time to recalibrate. Comparatively low levels of transactions continue to contribute to reduced clarity on pricing, particularly in the office sector. The reduction in deal activity registered over the past few years has in many ways reflected a battle of endurance, pitting the significant amount of capital raised with a subscribed intent of capitalizing on prospective distress, and sellers waiting for a return to a lower interest rate environment.

Also, influencing the transaction market is more restrictive finance environment. With elevated short- and long-term interest rates, and with banks largely on the sidelines, borrowing costs remain high. Bank lending volumes continue to remain subdued, and will likely remain so over the near term as the banking sector handles increased regulatory scrutiny and likely higher capital requirements. Life companies remain active for preferred asset classes.

Rising interest rates, a potential recession and limited credit availability remain primary obstacles obstructing deal flow. Moreover, an increasing resignation that pricing has more room to decline across all sectors has left many investors on the sidelines. This is particularly true with respect to institutional investors who have been noticeably absent in both concluded transactions and associated bids.

As values recalibrate and lenders' and owners' needs for liquidity mount, generationally attractive investment opportunities are beginning to manifest. We believe this dynamic should accelerate in 2025. Investors who can play across the capital stack and up and down the risk spectrum can capitalize on the market disruption.

Delinquency rates for mortgages backed by commercial and apartment properties increased markedly in 2024, representing the mounting challenges facing CRE this year. CMBS loan balances which were 30 days or more delinquent rose from 4.5% at the end of 2023 to 6.4% as of November 2024, according to Trepp data. Office and apartment investments delinquency rates were up the most, from 5.8% to 10.4%, and from 2.6% to 4.2%, respectively. According to Trepp, markets with the greatest share of non-current CMBS office loans in 2024 were located in Rochester, Albany, Bridgeport/Stamford, and Chicago.

Among capital sources, delinquency rates have been the highest in CMBS, however, delinquent loans held by banks & thrifts, life insurance companies, and GSEs are beginning to increase, according to Mortgage Bankers Association. We expect to see loan stress manifest as even higher delinquency rates in 2025.

OERs Changing

Another issue challenging CRE is substantially higher operating expense ratios (OERs).[22] This has manifested differently for various property types. The higher the operating expense ratio, the more sensitive the property's NOI is to declines in Effective Gross Income (EGI). Accordingly, hotels, and to a lesser extent offices, are the most sensitive. Property types with low OERs such as logistics and self-storage facilities are the least sensitive. In the middle are apartment and retail properties.

Expenses generally rose at a faster rate over the past several years than in previous years and except for the industrial sector, have exceeded rent increases. As a corollary, OERs are up for all major property types except industrial. For a time, rent increases on apartments exceeded operating expense increases – but that is no longer true. Above-trend increases are expected over the next year as well, and will likely outpace revenue growth.

Although a relatively small portion of overall expenses, insurance has grown faster than all other expenses. Other major expense growth contributors include utilities maintenance and administrative costs. Real estate taxes – almost always the largest expense category has increased the most in the industrial sector. Overall, the insurance expense increase has been most notable. The insurance expense change since pre-Covid (3Q19-3Q24) for each sector was Apartment: 181%, Industrial: 146%, Office: 124%. And Retail: 120%.

The following table details cumulative growth of property-level income and expenses per square foot over the past one and five years. The industrial sector was the only to experience income growth in excess of expense growth over both time periods, however over the past one year, retail sector income growth also exceeded expense growth.

Income & Expense Growth

	% YOY		3Q19-3Q24 (Prior 5 Years)	
	Income	Expenses	Income	Expenses
Apartment	7.2%	10.1%	23%	28%
Industrial	12.4%	9.3%	40%	33%
Office	1.3%	5.0%	15%	18%
Retail	7.0%	3.7%	9%	16%

Source: NCREIF Property Index, Data access via Query Tool. Data through Q3 2024.

The following table compares the change in average OERs by property type. The decrease in industrial sector OER is indicative of income growth in excess of expense growth over the past five years.

Operating Expense Ratios

Property Type	3Q19	3Q24	Change
Apartment	42.5%	44.5%	↑
Industrial	26.2%	25.1%	↓
Office	41.6%	42.9%	↑
Retail	32.2%	34.2%	↑

Source: NCREIF Property Index, Data access via Query Tool. Data through Q3 2024.

The following table compares expense growth over various time periods. Industrial and apartment sector expenses grew the most relative to their historical averages.

Operating Expense Growth (Growth by SF)

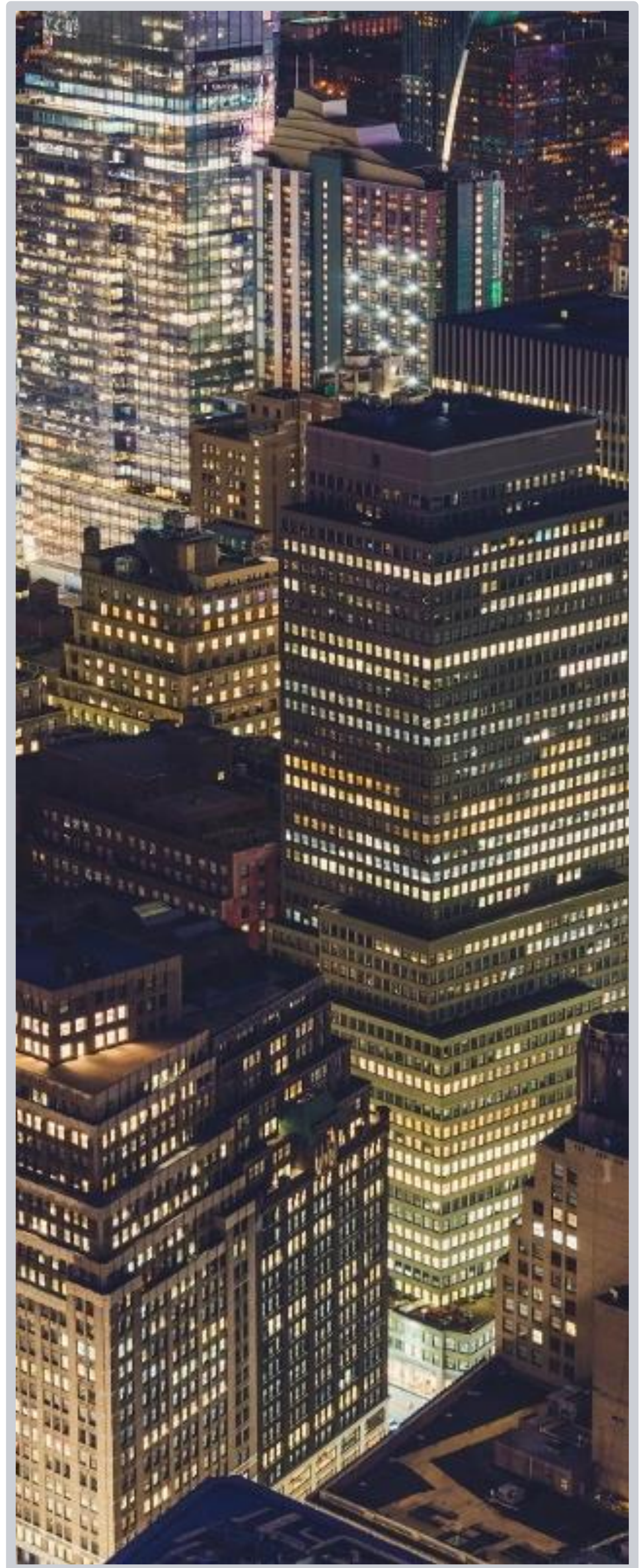
	Apartment	Industrial	Office	Retail
Cumulative Past 5 Years (3Q19-3Q24)	32.8%	41.3%	18.1%	15.2%
CAGR Past 5 Years (3Q19-3Q24)	7.4%	9.0%	4.3%	3.6%
CAGR Past 2 Years (3Q22-3Q24)	7.4%	10.0%	4.0%	5.0%
CAGR 18 Years Before Covid (3Q01-3Q19)	4.5%	0.9%	3.7%	2.9%

Source: NCREIF Property Index, Data access via Query Tool. Data through Q3 2024.

It is important to note that, ultimately, expense reimbursement does not compensate for increased expenses, since gross rent must adjust to maintain market levels. We expect OERs to remain elevated into 2025 and for expense growth to continue to exceed income growth for the apartment and office sectors.

[22] See: Stewart Rubin and Dakota Firenze "Operating Expenses Rising," November 2023.

Demographic/Migration



The U.S. is younger demographically than other advanced economies, despite the anemic growth of its working age population. Accordingly, it is important to highlight where growth is taking place within the U.S. We expect migration from Coastal and Midwestern metros to Sunbelt states such as Arizona, Texas, Georgia, North Carolina, South Carolina, Florida, and Tennessee to continue, albeit at a slower pace compared to previous years. The migration of people of various ages and education levels both precipitates, and is in response to, the relocation of businesses.

A shift in finance jobs has become evident as more corporate headquarters as well jobs shift to Florida, Texas, Tennessee, and Arizona. With migration of jobs and people comes a shift of income and tax revenue. We expect the net migration to the Sunbelt and the Intermountain West to continue, albeit at a slower rate relative to the past few years. Although suffering losses, coastal markets including the Bay Area are very relevant.

Other major demographic trends impacting CRE include unprecedented international immigration, and inter-metro migration to suburbs/exurbs. The astounding number of remote workers are influencing locational demand points and the aging population and the lopsided ratio of workers to retirees are impacting CRE demand and will have implications for the future. The number of Americans living alone and/or without children has implications for apartment demand.

Cities

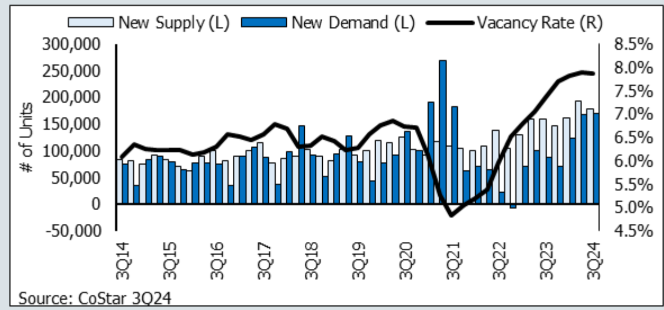
Cities, particularly urban cores, have suffered from an increase in violent crime, homelessness, inadequate facilities for migrants, less pedestrian traffic, vacant office space, and less economic activity stemming from relatively fewer workers in central business districts (CBDs).

The extent that cities do not recover to their pre-Covid stature and are adversely impacted by crime, high taxes, diminished retail, and less in-person office workers, will have a negative impact on associated CRE.

Apartment Sector

Apartment Properties: Performance in the Benchmark	Quarter	1-Year Period Ending				
	3Q24	3Q24	3Q23	3Q22	3Q21	3Q20
Income Return	1.10%	4.39%	3.88%	3.77%	3.68%	4.10%
Appreciation Return	0.03%	-6.85%	-11.10%	14.02%	9.43%	-1.74%
Total Return	1.13%	-2.69%	-7.55%	18.17%	13.37%	2.31%
Garden	1.13%	-2.29%	-6.51%	24.24%	21.19%	4.66%
High and Low-Rise	1.13%	-2.89%	-8.06%	15.55%	10.31%	1.40%
Rent Growth		1.14%	1.06%	5.64%	8.93%	1.17%
NOI Growth		5.18%	3.36%	17.37%	10.57%	-10.33%
Benchmark comparison: Total Return, All Properties	0.78%	-3.47%	-8.39%	16.08%	12.15%	2.00%

Source: NCREIF 3Q24; CoStar Group 3Q24



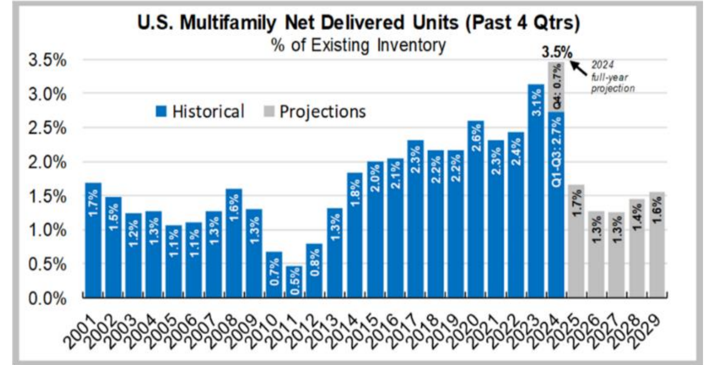
Source: CoStar 3Q24

The apartment sector in 2024 experienced new highs in the level of new supply and slowing rent growth, especially in the Sunbelt. However, the pace of new project deliveries continued to moderate, and the pipeline of future deliveries is pulling back materially.

The average national apartment vacancy rate remained at 7.9% in 3Q, unchanged from the prior quarter's record level, and up from 7.7% at the end of 2023. Average apartment asking rents grew 1.1% year-over year as of 3Q2024, which is up from 0.8% growth through this time last year.

Net absorption of 528,000 units over the past four quarters ending 3Q was notably strong, the highest since 1Q2022. Nevertheless, this pace has not kept up with historical high construction. In 2024, new multifamily supply equal to 2.7% of existing inventory was added nationally year-to-date, and expected to total 3.5% by the end of the year. This constitutes a new annual record in new construction, constituting 670,000 units added to the market this calendar year. In 2025, new apartment construction is expected to decline by nearly 50%, constituting just 1.7% of existing inventory.

The top ten markets with the most robust construction pipelines are located in the Sunbelt. Four of the five top markets are located in Florida, and have at least 10% of existing inventory under construction, more than double the national average, according to CoStar data. Markets with the highest level of new supply include Fort Myers (17% of existing inventory under construction), Miami (13%), and Charlotte (12%). This oversupply has led to declining rents, including in markets like Fort Myers (-6.6%), Austin (-5.4%), Raleigh (-3.2%), Sarasota (-2.7%), Lakeland (-2.7%), and Phoenix (-2.5%).



Source: CoStar Group. Historical data through Q3 2024. Projections begin in Q4 2024.

Midwest and Northeast markets had more balanced supply and demand, leading to favorable asking rent growth including in Providence (+4.5%), Bridgeport/Stamford (+4.1%), Buffalo (+3.8%), and Cleveland (+3.6%) on a year-over-year basis. These markets have experienced notably less construction. More popular markets like Chicago, Orange County and San Jose are also included in this list.

Net absorption of Class B units has continued to improve throughout 2024, recovering from nearly zero at the end of 2022, while absorption of Class A units has cooled since the second quarter of 2024. We expect these trends to continue, and Class B rent growth to outperform Class A in 2025.

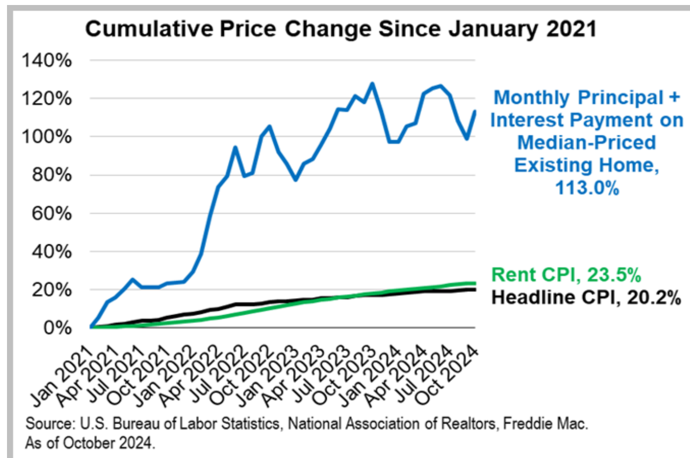
Suburban apartment rent growth is poised to outperform CBD apartment rent growth in the near term. Although suburban locations may have relatively longer commutes to CBD offices, expanded hybrid work has diminished that consideration.

Population growth of the 25–34-year-old age cohort, which is traditionally a cohort with a higher renter population, is expected to slow over the next few years, which could impact rent growth prospects. However, renters have become stickier in 2024. According to a study conducted by RealPage[23], 54%

[23] https://www.realpage.com/analytics/retention-climbs-october-2024/

of market-rate renters renewed their leases in 2024 through October, up 120 basis points from last year.

Additionally, the heightened cost of homeownership may provide a ballast against further softening for the sector. Residential mortgage rates reached nearly triple the pre-pandemic level, and values have not meaningfully corrected in many markets, leaving the principal and interest mortgage payment on a median-priced existing home up more than 113% relative to the beginning of 2021 (see chart below). Homeownership has become more challenging, which is supporting apartment demand.



Source: U.S. Bureau of Labor Statistics, National Association of Realtors, Freddie Mac. As of October 2024.

We expect apartment sector rent growth to moderate in the beginning of 2025, but then to accelerate through the end of the year and into 2026, and for vacancy rates to remain largely unchanged as supply and demand come more into balance. In certain Sunbelt markets, we expect rents to decline further, as supply continues to outpace demand in the short term. The lower level of construction starts and permits provide optimism for rent growth in years beyond this current supply wave. Mighty demand for Class B/C apartments will likely lead to rent growth that continues to outperform Class A in 2025, despite construction greater than Class A units.

Regulatory Update

In the November general election, California voters rejected Proposition 33 that aimed to repeal the Costa-Hawkins Rental Housing Act of 1995, which put certain restrictions on rent control enacted at the local level upon single-family homes, condominiums, and multifamily units built after 1995. The failure of this ballot measure means these restrictions on rent control remain in place throughout the state.

Operating Expenses

Operating expenses across property types have generally grown at a faster pace since Covid, relative to previous years, with the greatest increases experienced in the industrial and apartment sectors. Over the past year, operating expenses at apartment properties increased 7.2%, relative to 4.5% (CAGR) annually over the 18-year period prior to Covid. It is likely that expenses will continue to rise faster than trend over the next year, which could result in even higher OERs, and put pressure on NOI growth. According to projections from Green Street, same-unit property expenses for apartment REITs are expected to grow 4.4% in full-year 2024 and are expected to grow 4.0% and 3.7% annually in 2025 and 2026 respectively.

Investment Returns/Valuations

Like other asset classes, the apartment sector is not immune to the effects of higher cost of capital. Investments in the apartment sector produced a four-quarter unlevered property-level total return of -2.69% as of 3Q2024, which is an improvement from the -7.55% four-quarter return as of this time in 2023. However, on a quarterly basis, Q2 and Q3 in 2024 both experienced positive total return after six quarters of negative total return, indicating that the sector is seeing investment performance improve.

According to the NCREIF Market Value Index, apartment sector property values are down -15.1% from the peak achieved in 3Q2022, shortly after the Fed began raising interest rates, increasing the cost of capital. Over the past four quarters, apartment values are down -5.8%. However, values are still 7.7% above pre-Covid level as of 3Q2024. Value change in this sector is very dependent on geography and observation period, as seen below.

NCREIF Market Value Index (MVI)

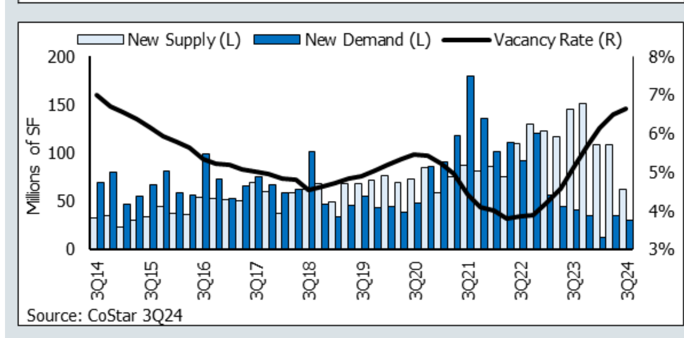
Property Type Region	Decline From Recent Peak	Recent Peak Quarter	% Change From Pre-Covid (4Q19)
Apartment	-15.1%	2022 Q3	7.7%
Northeast	-13.0%	2022 Q3	-0.5%
Mideast	-11.9%	2022 Q3	15.4%
East North Central	-9.1%	2022 Q3	-2.6%
West North Central	-15.1%	2022 Q2	-6.2%
Southeast	-13.4%	2022 Q3	23.4%
Southwest	-12.2%	2022 Q3	14.8%
Mountain	-18.9%	2022 Q3	21.1%
Pacific	-20.8%	2022 Q2	-5.7%

Source: NCREIF; New York Life Real Estate Investors Strategy & Research Group. As of 2024 Q3

Industrial Sector

Industrial Properties: Performance in the Benchmark	Quarter	1-Year Period Ending				
	3Q24	3Q24	3Q23	3Q22	3Q21	3Q20
Income Return	1.04%	3.96%	3.37%	3.34%	4.30%	4.54%
Appreciation Return	0.08%	-4.68%	-8.46%	30.56%	27.22%	5.42%
Total Return	1.13%	-0.86%	-5.30%	34.62%	32.38%	10.14%
Rent Growth		3.31%	7.96%	10.17%	8.16%	5.74%
NOI Growth		13.23%	9.67%	13.57%	10.17%	6.46%
Benchmark comparison:						
Total Return, All Properties	0.78%	-3.47%	-8.39%	16.08%	12.15%	2.00%

Source: NCREIF 3Q24; CoStar Group 3Q24



Source: CoStar 3Q24

The industrial sector in 2024 has benefitted from continued growth in consumer shopping preferences favoring greater spending via e-commerce. However, rent growth is moderating in the face of high construction activity. The above notwithstanding, there is hope for improvement as the pace of new deliveries continues to slow.

Over the course of 2024, industrial vacancy rates increased to 6.6%, from 5.7% at the end of 2023. It is now well above the Covid-era low of 3.8% and even above the pre-Covid level of 5.2% in 1Q2020. Likewise, rent growth has continued to moderate from 7.2% in 2023 to 3.4% year-over-year as of 3Q2024. In 2025, we expect vacancy rates to continue to rise and nominal asking rent growth to moderate further.

The recent supply wave putting pressure on fundamentals may be peaking, after 62 million square feet was delivered in 3Q2024, the first time in nine quarters to deliver less than 100 million square feet. So far in 2024, 279 million SF has been delivered to the market, outpaced net absorption of just 78 million SF. As new space is delivered, the active construction pipeline has dropped significantly from 3.9% of existing inventory in 3Q2022 to 1.8% as of 3Q2024, as developers have been slow to seek permits for new buildings. The level of new supply hitting certain industrial markets remains a concern in the near-term, particularly in markets like Savannah and Austin, where more than 10% of inventory is currently under construction.

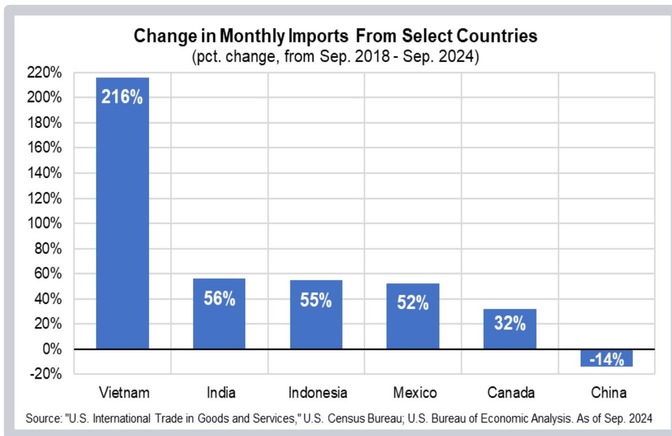
According to the National Retail Federation, this year's holiday shopping season is projected to break records. E-commerce sales are expected to be a main contributor, with online and other non-store sales projected to increase between 8% and 9% from last year.[24] Amazon announced in its 3Q earnings call that it recently opened 15 additional fulfillment centers and made enhancements throughout its network in anticipation of higher holiday season spending.

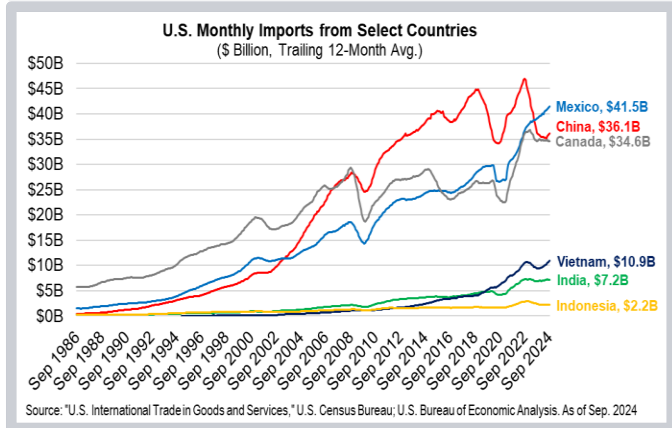
On a nominal basis, e-commerce sales are up +91% since the pandemic began, and +58% on a real basis, and as a share of total retail sales, increased from 15.6% in 3Q2023 to 16.0% in 3Q2024, indicating continued growth, albeit at a slower pace than the Covid-era gains.

There has been diversification of manufacturing away from China and toward certain other trading partners in the wake of Covid, including Mexico. In 2023, Mexico surpassed those from China (on a customs value basis) for the first time since China joined the WTO nearly 22 years ago (see chart below). Since 2018, import volume from Mexico has increased 52%, while China saw volume decline by -14%. Other trading partners like Vietnam, India, and Indonesia saw their import volume rapidly increase, but remain relatively small as a share. The trend toward nearshoring some share of manufacturing and trade to Mexico and other trading partners could benefit demand for logistics properties in border states like Texas, Arizona, and California. This will also benefit the local Mexican logistics market. According to Prologis, every $1 billion invested in Mexican Auto Factories may generate 5-10 million square feet of additional Mexican logistics demand.[25] In the wake of Trump's announcements of intent to impose tariffs on imports from Mexico, certain manufacturers may be looking closely at their manufacturing operations in 2025.

[24] https://nrf.com/media-center/press-releases/steady-sales-growth-expected-2024-holiday-season-according-nrf

[25] https://www.prologis.com/insights/global-insights-research/impacts-nearshoring-demand-mexican-logistics-real-estate





Since Covid, private sector spending on construction of manufacturing industrial facilities has far outpaced spending on warehousing/distribution center construction. Over the past year, manufacturing construction is up 18%, while warehouse construction has declined by 20% as of August 2024. The *Infrastructure Investment and Jobs Act* signed into law in 2021 and the *CHIPS and Science Act* of 2022, as well as reshoring in the wake of supply chain disruptions during the pandemic have charged this growth. The CHIPS Act will likely benefit Austin, Phoenix, and Columbus in particular. Further investment in burgeoning electric vehicle (EV)-focused manufacturing across the U.S. will also support industrial demand.

In 2025, we expect industrial sector rent growth to moderate further, but remain positive, as unprecedented supply is absorbed into the market. Unlike the apartment sector, which we believe may be near peak vacancy for this cycle, we believe industrial vacancy may rise more in 2025 before improving. The supply wave beyond what is currently under construction has declined meaningfully. Demand drivers for logistics space remain strong and unlikely to moderate significantly, considering resilient e-commerce spending and manufacturing tailwinds.

Operating Expenses

The industrial sector is the only sector to experience income growth that has exceeded expense growth since Covid. Over the past five years, operating expenses at industrial properties increased a cumulative 33%, while income rose 40%. Over the past year, this dynamic remains true. As of 3Q2024, expenses are up 9.3% year-over-year, while income is up 12.4%. According to projections from Green Street, same-unit property expenses for industrial REITs are expected to grow 6.8% in full-year 2024 and are expected to grow 5.8% and 6.2% annually in 2025 and 2026, respectively.

Investment Returns/Valuations

Although industrial investments have significantly outperformed the other major property types since Covid began, no asset class is immune from the rising cost of capital. Industrial investments produced a four-quarter total return of -0.86% as of 3QQ2024. Although negative, on a quarterly basis, total return was positive for the first three quarters of 2024, and will likely mean the year will end positive, the first positive annual performance since 2021.

According to the NCREIF Market Value Index, industrial sector property values are down -7.4% from the peak achieved in 3Q2022, shortly after the Fed began raising interest rates, increasing the cost of capital. Over the past four quarters, industrial values are down just -1.7%. However, values are up an incredible 59.6% above pre-Covid, less than five years ago.

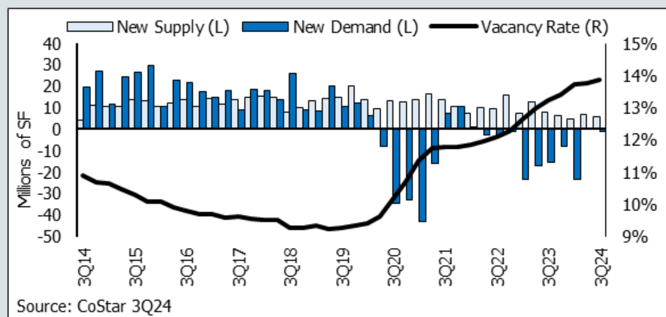
Regulatory Update

Assembly Bill (AB) 98, passed in California in September 2024, aimed at environmental protection will have consequences for the development of warehouse properties in the state. The new law, which targets warehouses larger than 250,000 square feet, includes energy efficiency requirements, as well as restrictions around construction near schools, parks, and homes. These new rules will make warehouse development more difficult and expensive and constitute additional barriers to construction which could benefit the performance of existing industrial properties.

Office Sector

Office Properties: Performance in the Benchmark	Quarter	1-Year Period Ending				
	3Q24	3Q24	3Q23	3Q22	3Q21	3Q20
Income Return	1.48%	5.84%	4.79%	4.30%	4.50%	4.39%
Appreciation Return	-2.54%	-17.17%	-21.12%	-1.06%	0.35%	-1.53%
Total Return	-1.06%	-12.09%	-17.11%	3.21%	4.86%	2.81%
CBD	-1.36%	-14.78%	-20.55%	0.81%	2.27%	1.78%
Suburban	-0.77%	-9.15%	-12.98%	6.33%	8.47%	4.33%
Rent Growth		0.98%	0.81%	1.46%	0.18%	-0.57%
NOI Growth		-4.30%	4.41%	-0.81%	3.44%	1.68%
Benchmark comparison:						
Total Return, All Properties	0.78%	-3.47%	-8.39%	16.08%	12.15%	2.00%

Source: NCREIF 3Q24; CoStar Group 3Q24



Source: CoStar 3Q24

The office sector continues to face significant challenges and an uncertain outlook. In the second quarter of 2024, net absorption turned positive for the first time after eight quarters of consecutive declines, however, in 3Q2024, the metric turned negative again. Office sector net absorption in 3Q2024 once again turned negative, losing 1.3 million square feet nationally, following a positive 1Q of just +700,000 square feet. Nevertheless, more than 200 million square feet of occupied space has been lost on a net basis since pre-pandemic. Although net absorption may continue to be negative in 2025, the velocity of decline may be near the bottom.

The direct office vacancy rate rose from 13.4% at the end of 2023 to a new record 13.9%, while at the same time, the availability rate, which includes space offered for sublease, rose slightly from 16.3% at the end of 2023, to 16.4% in 3Q2024 (although an improvement from 16.6% the prior quarter). We believe direct office vacancy rates will likely rise further within the coming five years; however, performance will vary by market. Vacancy rates will potentially begin to normalize at a higher level, once some of the excess amount of office inventory has been removed, as discussed in more detail by the *REI Strategy and Research Group* in our recent article "Not Back to the Office" in IRE Americas magazine.[26]

Return-to-office physical occupancy has stagnated for most of 2023, according to Kastle Systems. In January 2023, average weekday office occupancy surpassed 50% of equivalent-day, pre-pandemic level for the first time, but has not improved much over this year, currently standing at 53.0% as of November 20, 2024.

Another proxy for "return-to-office" is average weekday ridership in major U.S. metro areas, which continue to vary widely across the nation. In New York, ridership on MTA commuter railroads (LIRR and Metro North) averaged 82% of pre-pandemic level on weekdays in October 2024, an improvement over 73% in January (see table on the next page). In Boston, MBTA weekday ridership remains lower at 66% of pre-Covid-19 levels, while the Washington, D.C. Metrorail and Chicago Metra had weekday ridership rates of 62% and 64%, respectively (based on most recent data available). The Bay Area's BART system lags other major metros at only 44%. According to other sources attempting to quantify the return-to-office trend, *WFH Research* found workers spent 27% of days working remotely as of November 2024.[27] The *Flex Index* has found 32% of workers are fully in-office, while 43% had a structured hybrid schedule, and the remaining 25% were either fully-remote or employee's choice, as of 4Q2024.[28]

Post-Covid Transit Ridership in Major U.S. Investment Markets (% of Pre-Covid Level)	Weekdays Only - For Select Months										
Transit Agency	Oct '22	Jan '23	Apr '23	Jul '23	Oct '23	Jan '24	Apr '24	Jul '24	Aug '24	Sep '24	Oct '24
MTA Subway (NYC)	62%	69%	66%	65%	67%	70%	67%	66%	65%	70%	71%
MTA LIRR (NYC)	61%	64%	65%	67%	74%	74%	75%	77%	77%	83%	83%
MTA Metro-North (NYC)	59%	64%	63%	66%	71%	72%	72%	75%	71%	78%	79%
Chicago Metra	41%	46%	48%	52%	56%	54%	57%	60%	55%	62%	N/A
D.C. Metrorail	40%	51%	49%	51%	53%	59%	61%	60%	60%	63%	64%
San Francisco BART	37%	34%	39%	37%	40%	38%	40%	39%	41%	44%	44%
Boston MBTA	61%	62%	62%	57%	62%	61%	63%	59%	63%	66%	N/A

Source: MTA, NJ Transit, Chicago Metra, D.C. Metrorail, San Francisco BART, Boston MBA
"N/A" indicates data for this month is not yet available.

At the same time, in 2024, artificial intelligence companies began to emerge as a growing office demand generator. This could be a hopeful sign for the Bay Area, which retains its long-standing reputation for access to abundant tech talent and venture capital funding.

[26] See: Stewart Rubin and Dakota Firenze, "Not Back to the Office," IRE Americas, November 2024.

[27] https://wfhresearch.com/

[28] https://www.flexindex.com/stats

In addition to remote work trends, continuing tenant flight to higher-quality office buildings, and existing and expanding environmental emissions laws will likely challenge the performance of older office buildings, particularly Class B and C buildings. Newer, Class A office buildings will likely outperform in 2025. Furthermore, office properties located in metros with shorter and more pleasant commutes as well as office tenants with greater security needs are more likely to have higher office attendance. Life science properties, which have heretofore exhibited strength, are beginning to weaken in the face of robust construction and less venture capital funding.

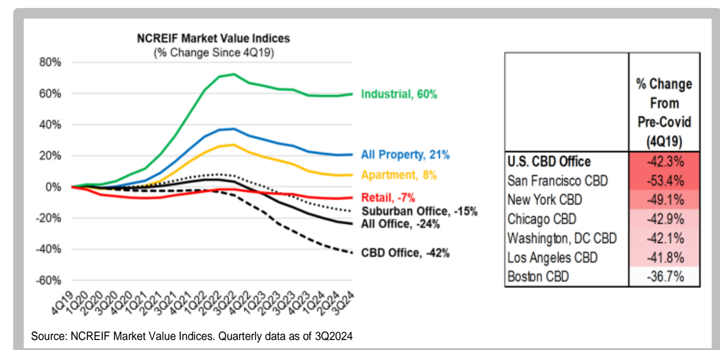
The Washington, D.C. office market is particularly exposed to changing policies at the federal level. The federal government accounts for 22.1% of employment in the area, according to the Bureau of Labor Statistics, and government office space accounts for about 20% of all office space in the D.C. market. The newly formed commission called the “Department of Government Efficiency” DOGE headed by Elon Musk and Vivek Ramaswamy has indicated their intent to compel federal workers to come back into the office five days per week, which they believe will result in a wave of resignations from federal workers “that [they] welcome”[29]. If DOGE fulfills its mandate, the federal government will likely shrink its leased office footprint of 174 million square feet, which is already greater than what it actually utilizes. About 52% of federal office leases will either expire or can be otherwise terminated by the end of Trump’s term, according to an analysis from S&P Global Ratings.[30] Trump has also indicated his intent to relocate 100,000 federal workers outside of D.C. What the net effect of these policies will be on office space remains to be seen, but real challenges are likely to persist.

As a result of these evolving secular challenges, in our view the office sector could become a more “managed” asset class. Office will require more, active consistent effort for landlords to continue to attract tenants to its buildings. This could result in certain office assets moving to buyers who are better capable of managing the increased complexity of these assets (i.e., REITs, Life Companies).

The office sector continues to be challenged, and the back-to-office trend is progressing slowly. In the latter half of 2024, office CMBS delinquency rates began to rise, and in 2025, we expect office sector stress to become more pronounced. However, we expect transaction volume to improve in 2025, if only slightly, which could lead to greater price clarity, and opportunities to take advantage of some of the stress in the sector.

Returns/Valuations

Investments in the office sector produced a four-quarter unlevered property-level total return of -12.1% as of 3Q2024, which is an improvement from the -17.1% four-quarter return as of this time in 2023. On a quarterly basis, total return has been negative for the past nine consecutive quarters, and improving (becoming less negative) over the past three quarters.



	% Change From Pre-Covid (4Q19)
U.S. CBD Office	-42.3%
San Francisco CBD	-53.4%
New York CBD	-49.1%
Chicago CBD	-42.9%
Washington, DC CBD	-42.1%
Los Angeles CBD	-41.8%
Boston CBD	-36.7%

Source: NCREIF Market Value Indices. Quarterly data as of 3Q2024

Office valuations, on a national level, continue to decline as associated user demand continues to be negative. According to the NCREIF Market Value Index, office sector values are down -27.1% from the peak achieved in 2Q2022, before the Fed began raising interest rates, with offices in central business district (CBD) locations down -40.4%, and suburban office properties down -21.7% over that same period. In some badly impacted office markets, for example in the San Francisco CBD, the values of office properties are down almost 54% from their 2020 peak, according to the NCREIF MVI.

Operating Expenses

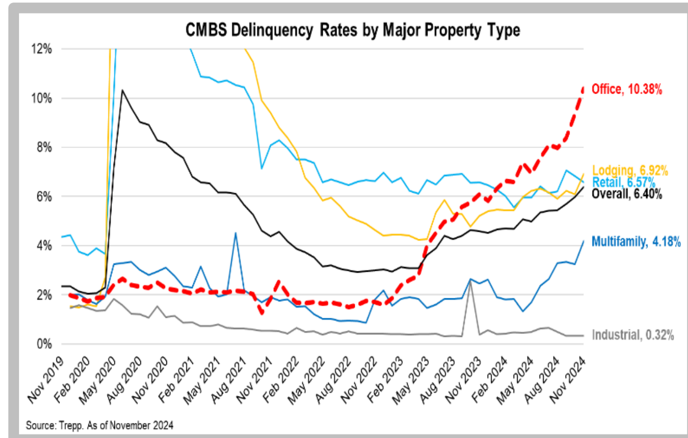
Another factor negatively impacting the office sector, like other property sectors, is rising operating expenses. Since Covid, office expenses have risen faster than income. Over the past five years, operating expenses at office properties increased a cumulative 18%, while income rose 15%. Over the past year, this

[29] https://www.wsj.com/opinion/musk-and-ramaswamy-the-doge-plan-to-reform-government-supreme-court-guidance-end-executive-power-grab-fa51c020

[30] https://www.bisnow.com/national/news/office/52-of-federal-government-office-leases-can-be-terminated-by-end-of-trumps-term-127140

dynamic remains true. As of 3Q2024, expenses are up 5.0% year-over-year, while income is up just 1.3%. It is likely that expenses will continue to rise faster than trend over the next year, which could result in even higher OERs, and put pressure on NOI growth. According to projections from Green Street, same-unit property expenses for office REITs are expected to grow 3.2% in full-year 2024 and are expected to grow 3.0% and 2.9% annually in 2025 and 2026 respectively.

Stress in the Office Sector



We believe the pace of office asset sales is likely to accelerate in 2025, with an increasing number of deals being brought to market in search of qualified buyers. Furthermore, the number of stressed office assets for sale is also expected to continue to rise in 2025. At the start of 2024, the CMBS delinquency rate on office loans was 5.8%. As of November, the rate is 10.4%, up one full percentage point since the prior month, and just 30 basis points from the high of 10.7% experienced during the height of the Global Financial Crisis, according to data from Trepp.

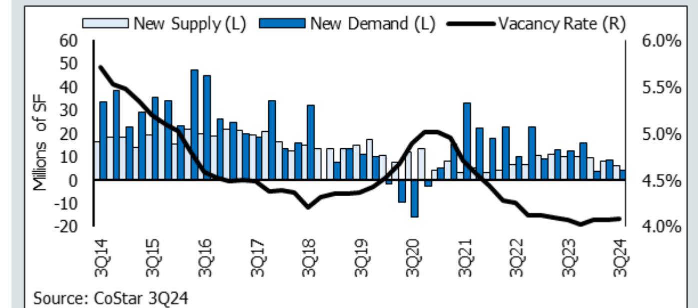
Amid these challenges in 2024, however, a growing number of buyers with an investment thesis and conviction have been acquiring office assets in markets such as San Francisco, D.C., and Chicago for prices significantly below prices secured pre-Covid and pre-Fed Rate Rise.

Retail Sector

Retail Properties: Performance in the Benchmark

	Quarter	1-Year Period Ending				
	3Q24	3Q24	3Q23	3Q22	3Q21	3Q20
Income Return	1.37%	5.53%	5.19%	4.98%	4.49%	4.20%
Appreciation Return	0.48%	-3.14%	-6.33%	1.60%	-3.62%	-10.15%
Total Return	1.85%	2.26%	-1.39%	6.65%	0.74%	-6.27%
Malls**	1.43%	1.20%	-2.47%	4.78%	-2.62%	-8.76%
Non-Malls**	2.19%	3.14%	-0.48%	8.38%	4.20%	-3.37%
Rent Growth		2.39%	3.88%	4.24%	3.04%	2.09%
NOI Growth		4.00%	4.25%	4.01%	17.45%	-27.21%
Benchmark comparison: Total Return, All Properties	0.78%	-3.47%	-8.39%	16.08%	12.15%	2.00%

Source: NCREIF 3Q24; CoStar Group 3Q24



The retail sector has proved resilient despite the impact of cumulative inflation on consumers. In terms of occupancy, the retail sector has performed the best, the only property type to experience tighter occupancy relative to pre-Covid, supported by low net new supply and durable demand. Retail sector fundamentals had relatively strong 3Q2024 with the average vacancy rate remaining at 4.1%, unchanged from the prior quarter, and only slightly above the record low 4.0% achieved in 4Q2023.

New supply remains minimal, with construction below the 15-year historical average, adding just 24 million SF (net) so far in 2024. In addition, 98 million SF of obsolete retail space has been demolished over the past four years (260 million SF over past decade), which reduces overall supply and supports remaining inventory.

Over the past decade, the rate of population growth has outpaced the growth rate of new retail space in 55 of the top 88 markets. Of markets with population growth greater than 22% over this period, only Austin had retail inventory growth that surpassed 10%. Generally, metro areas where population growth outstrips retail construction may be at less risk of oversupply, as discussed in *REI Strategy and Research Group's* recent whitepaper "Demographic

Changes and Stagnant Inventory Creating Retail Opportunities”.[31]

Overbuilt retail markets in the U.S. tend to be concentrated in areas that have experienced stagnant to declining population change. In general, these markets include features of post-industrial economies. The pandemic was also a catalyst for migration. In the period from 2018 to 2024, the U.S. population grew 2.2%, while some markets with high retail per capita saw population growth which was slower or declined, like Dayton (+0.4%), Albany (+0.7%), Birmingham (+1.3%), Rochester, NY (-1.4%), Milwaukee (-0.8%), Cleveland (-1.3%), Memphis (-0.5%), and Buffalo (-0.9%). In fact, eight of the ten markets with the highest retail per capita also had population growth below the national average over the 2018-2024 time period.

Highest Retail Per Capita

Rank from Top	Metro Area	Retail Per Capita (SF/Person)
1	Dayton - OH	75.4
2	Albany - NY	74.4
3	Birmingham - AL	73.8
4	Little Rock - AR	73.7
5	Rochester - NY	73.2
6	Milwaukee - WI	73.1
7	Cleveland - OH	70.9
8	Memphis - TN	70.0
9	Oklahoma City - OK	69.6
10	Buffalo - NY	69.5
11	Tulsa - OK	68.8
12	New Orleans - LA	68.7
13	Greensboro - NC	68.5
14	Pittsburgh - PA	68.2
15	Omaha - NE	66.6
	88 Market Average	**54.6**

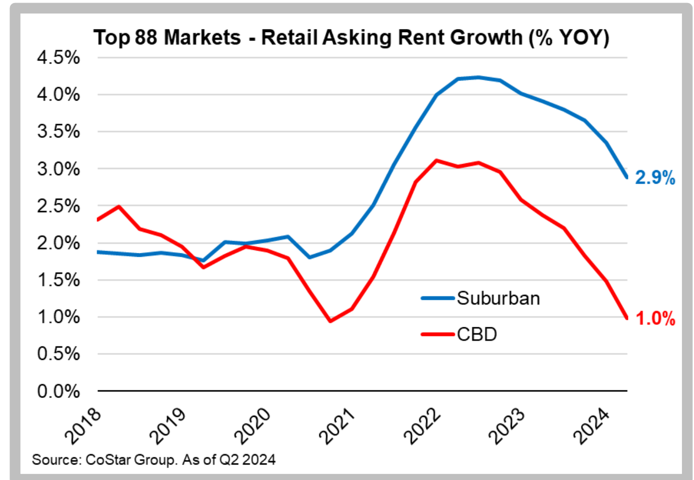
Source: CoStar Group. As of Q3 2024

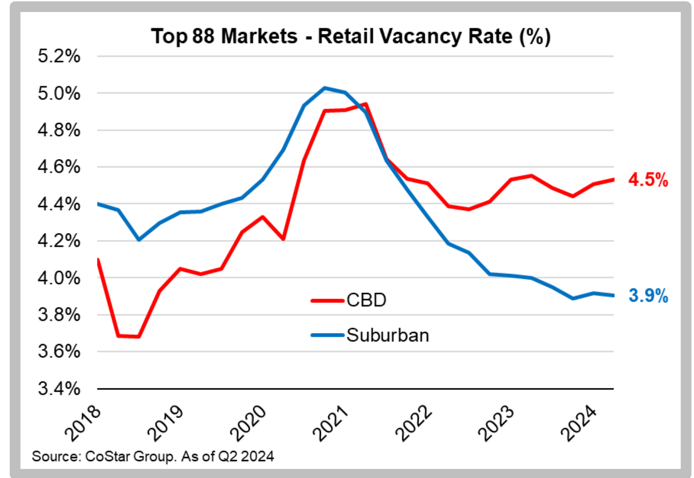
Lowest Retail Per Capita

Rank from Bottom	Metro Area	Retail Per Capita (SF/Person)
1	Bakersfield - CA	38.8
2	Stockton - CA	39.4
3	Lakeland - FL	40.4
4	San Jose - CA	41.2
5	Honolulu - HI	42.1
6	Washington - DC	42.2
7	San Diego - CA	42.8
8	Inland Empire - CA	43.0
9	Seattle - WA	44.6
10	New York - NY	44.6
11	East Bay - CA	44.7
12	Orange County - CA	45.8
13	Sacramento - CA	46.4
14	McAllen - TX	46.7
15	Los Angeles - CA	47.0
	88 Market Average	**54.6**

Source: CoStar Group. As of Q3 2024

Demand for urban retail has been weakened by less daytime foot traffic in certain urban cores stemming from remote work. Conversely, suburban neighborhood centers are seeing some of the benefits from remote work. According to Green Street, strip center foot traffic was up 6% from 3Q2019, the strongest post-Covid change in foot traffic among retail formats. Grocery-anchored shopping centers are favored. According to an SRG analysis of 88 top retail markets, suburban asking rent growth of 2.9% year-over-year as of Q2 2024, outpaces CBD rent growth of 1.0%, and has since the beginning of Covid. Likewise, suburban retail vacancy rates average 3.9%, while CBD retail averages 4.5%.





Resilient retail sales, which have kept pace with inflation thus far in 2024, have been a positive for the retail space. During the pandemic, Americans’ excess savings climbed to a high of nearly $2.1 trillion in August 2021, boosted by a combination of fiscal stimulus and inability to spend on services during the pandemic. However, this excess savings has now been exhausted, and the level is lower than prior to the beginning of the Covid response, according to the San Francisco Federal Reserve.

In 2025, we expect the retail sector investments to continue to outperform, given limited new supply and resilient retail spending of American consumers. Challenges in the office sector, coupled with supply woes in the apartment and industrial sectors, have driven renewed institutional interest in retail investments. In 2024, vacancy rates tightened to historic lows, and we expect the vacancy rate to remain similar in 2025. Suburban retail will likely continue to outperform, including neighborhood

[31] See: Rubin, Stewart and Dakota Firenze, “Demographic Changes and Stagnant Inventory Creating Retail Opportunities,” New York Life Real Estate Investors, October 2024.

centers that are benefiting from remote work. Grocery-anchored shopping centers are favored.

Returns/Valuations

Despite solid fundamentals, the retail sector is not immune to the effects of higher cost of capital. Investments in the retail sector produced a four-quarter unlevered property-level total return of +2.26% as of 3Q2024, the best performing of the four major property types, and the only to provide a positive total return on a four-quarter basis. On a quarterly basis, total return was positive in the first three quarters of 2024, and exhibited improving performance as the year has progressed. Institutional interest in retail strip centers is on the rise, given this outperformance, as evidenced by Blackstone's $4 billion purchase of Retail Opportunity Investments Corp (ROIC), which owns 93 shopping centers focused on the West Coast.

Changes in retail property values differ geographically, with certain regions benefitting more from population growth and elevated consumer spending. According to the NCREIF Market Value Index, retail sector values are down -7.0% from pre-Covid levels in 4Q2019. Declines were most significant in the eastern Midwest and Northeast regions, -19.6%, and -16.0%, respectively. Conversely, the Southeast region was the only to see retail values rise, up 5.1% since before the pandemic began. We expect continued migration to the Sunbelt to provide a broad tailwind to the retail sector.

Operating Expenses

Another factor negatively impacting the retail sector, like the industrial and apartment sectors, are rising operating expenses. Since Covid, retail expenses have risen faster than income. Over the past five years, operating expenses at office properties increased a cumulative 16%, while income rose 9%. However, over the past year, retail income growth has exceeded expense growth, 7.0% versus 3.7%, respectively. This shows OERs in the retail sector have recently declined, and may provide a tailwind for NOI growth in the near-term.

Hotels

In 2024, hotel RevPAR has grown 4.1% from a year earlier as of October. This puts RevPAR up 20.6% over the past 5 years, with cumulative ADR growth of 23.2% compensating for a 1.4% percentage point decline in average occupancy. Luxury and upper midscale hotel chains have performed the best over the past five years.

In 2025, the level of hotel occupancy will likely remain similar or decline somewhat, particularly on the lower end of the chain scale, according to CoStar projections. Additionally, ADR is expected to grow only marginally, resulting in RevPAR growth of less than 1% expected in 2025, with economy and upscale favored relative to midscale. Construction across hotel scales is down meaningfully and more in-line with 2018 levels, which are a tailwind to the sector.

Tourism has rebounded in most major U.S. destinations but has yet to fully recover to pre-pandemic levels. For full-year 2024, visitation estimates project Los Angeles, New York City, and San Francisco to still be below 2019, down 1%, 3%, and 9%, respectively.

RevPAR growth over the past five years has been highest in the CBD hotel markets of New York (Midtown West/Times Square) up +30.9%, relative to CBD markets which have been up in Seattle CBD (+12.7%), Washington, D.C. CBD (+12.0%), and Los Angeles CBD (+6.0%), while RevPAR declined since Covid in San Francisco Market Street (-44.9%).

Alternative Property Types

- **Data Center** new supply picked up notably in 2024, but this supply continues to fall short of demand. By the end of 2024, over four million square feet is expected to come online in the D.C. metro area, the largest data center market. The swift adoption of AI has led to a shortage of available space, compressing vacancy rates, which are at an all-time low. AI expansion will also put strain on electric power demand. According to Blackstone, the $1 trillion spent in the U.S. on data centers in the next few years could increase power

demand by approximately 40% in a decade.[32] In 2025 and beyond, substantial investment opportunities exist, but property location analysis will be critical.

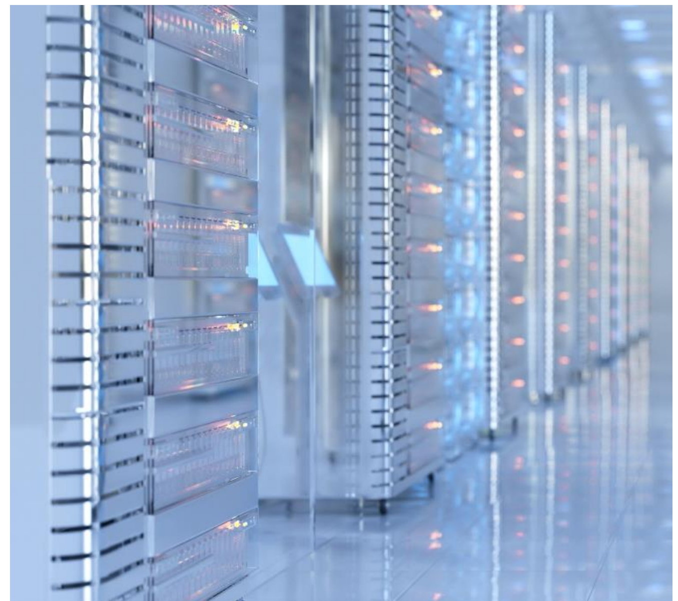
- **Self-storage** properties have appreciated by 30% since pre-Covid (Feb 2020), the best performing alternative sector over that period due to growing institutional interest over the past several years. So far in 2024, values have declined -2.4% YOY, according to Green Street. This sector generally has lower operating expense ratios and labor costs, making it particularly attractive as operating expenses rise across different property sectors. Additionally, although new supply is expected to be below the historical average in 2025, the sector has experienced an unprecedented wave of supply over the past several years which will take time to digest. In 2024, self-storage fundamentals were negatively impacted by fewer home sales, which typically buttresses demand. This dynamic will likely continue in 2025.

- **Single-family rentals (SFR)** are benefiting from the gap in housing affordability and low inventory. Since the start of 2021, the principal and interest mortgage payment on a median-priced existing home has increased by over 113%. Demand for SFRs is driven by renters seeking specific neighborhoods or school districts where traditional apartment options are limited. Additionally, SFRs provide more living space for growing families and those frequently working remotely. According to Green Street, SFR occupancy remained historically high in 2024, and NOI is expected to grow 4.2% (CAGR) over the next four years, greater than projected NOI growth of 3.1% for traditional apartments. We remain positive for the sector in 2025.

- **Senior Housing** has seen increased investor demand and outsized returns due to favorable demographics. For every 100 people of working age (25-64) in the U.S., there are 35 people age 65+. This ratio is projected to increase to 44 per 100 by 2050. Moreover, very low construction means new supply is diminished. According to Green Street, 3Q2024 represented the 20th consecutive quarter of decelerating construction starts for the sector. Independent living is particularly favored, which saw occupancy rates continue to tighten to nearly 90% in 2024. The sector experienced rent growth of 5% in 2023 and is expected to finish 2024 up about 4%, above the historical average of about 3%. In 2025, rents are expected to grow an additional 4% supported by consistent demand, according to Green Street. We remain positive for the sector in 2025.

- **Medical Office** properties benefit from some of the same favorable demographic tailwinds as senior housing, including an aging demographic. Medical office properties offer better fundamentals and have experienced cap rate stabilization more quickly than traditional office. National occupancy of 93% at medical office properties far outstrips 79% traditional office occupancy, and has remained stable during the Covid period, according to a JLL analysis. Strengthening demand for outpatient facilities away from hospital campuses has fostered medical office rent growth to outperform relative to traditional office, which we expect to continue in 2025. We remain positive for the sector in 2025.

- **Student Housing:** Demographic and educational trends point to a slowdown in college attendance and, as a corollary, the demand for student housing. The differences between university growth levels, proximity to campus, and barriers to entry demonstrate to the need for caution as well discernment when approaching the asset class in 2025.



[32] https://www.bloomberg.com/news/features/2024-12-08/georgia-s-blackstone-backed-qts-data-center-hits-resistance-over-ai-power-needs

CRE Opportunities and Risks for 2025

CRE is confronted by several challenges in the coming year, including interest rates remaining high and adversely impacting values, loan defaults increasing because of high refinance rates, tighter *local* regulations, and higher operating expenses.

On the positive side, CRE will likely benefit from the expected GDP growth and increased domestic manufacturing and logistics and deregulation on the federal level. The office sector remains challenged by the secular changes spawned by remote work. However, these challenges and disruptions will likely be accompanied by opportunity. Retail has stabilized and offers opportunities in growing areas. The structural shortage in multifamily housing as well as the high cost of homeownership should buoy the property fundamentals in 2025. The industrial sector will likely benefit from growing demand and less supply in the coming year. Alternative property types including medical office, seniors housing, data centers, and single-family rentals are backed by demographic and technological megatrends.

During the era of low rates which was accompanied by a good economic environment, many investors benefitted from rising values across asset classes. In the new paradigm of higher rates, a still well-performing economy, and declining values, substantial prospects for investing at a low basis are manifesting, but so are the potential pitfalls. Therefore, it is vital that investors are discerning and rely on the keen investment expertise of advisors who can differentiate true opportunities from potential minefields.

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