Wafra Insights

Real Estate

Why It Is An Attractive Entry Point for Commercial Real Estate

May 2025

Key Takeaways

For the first time in a generation, commercial real estate ("CRE") values have declined absent a recession due to rising interest rates. The prospects of improving fundamentals due to stabilizing capital markets and the resilient economy underpin our conviction that **now is an opportune time to invest in CRE**. The CRE recovery timeline would be prolonged, however, if economic growth slows.

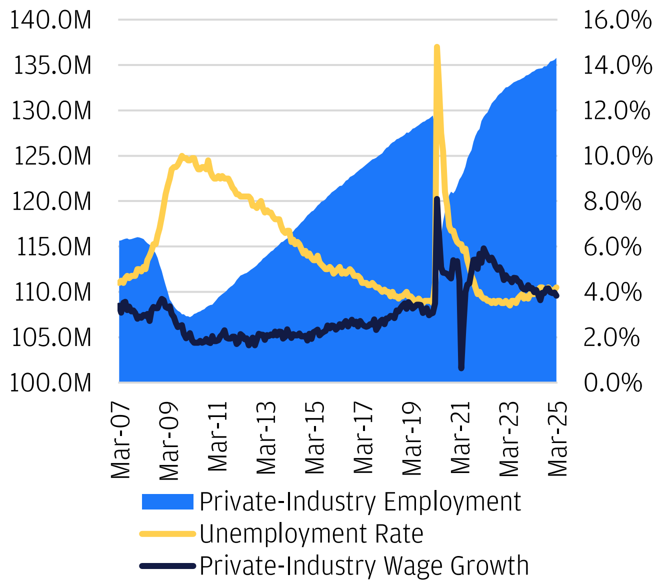
- Personal and corporate balance sheets in the U.S. are unprecedentedly strong, providing a buffer against a potential economic slowdown or a mild recession.
- Rapidly dwindling construction starts, triggered by high—and rising—construction costs and elevated costs of capital, should result in accelerated rent growth in 2026 and 2027.
- Benchmark CRE public and private indices have improved in recent quarters, suggesting that property values have troughed and are primed to continue to rise.
- Liquidity should improve based on still-elevated dry powder levels, improving fundraising environment and declining open-end fund redemptions.
- Debt markets are liquid with historically tight spreads - and are even improving for offices. This trend should help to reinvigorate CRE investment activity when capital markets volatilities subside.
- CRE historically serves as a hedge against inflation, which is widely expected to rise soon.

Why It Is An Attractive Entry Point for Commercial Real Estate

Strong footing of the U.S. economy positions it to remain resilient despite recent turbulence

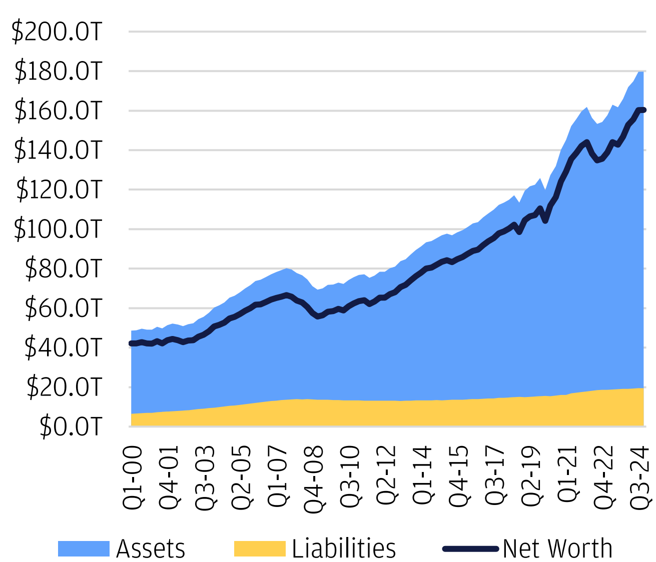
Lost in the recent financial market volatility and newsreels is the historically strong underlying health of the U.S. economy. Record levels of total jobs, sustained wage growth, significant accrued wealth and limited liabilities demonstrate that U.S. consumers and corporations should be able to withstand weaker or slightly negative growth.

Private Employment, Unemployment and Wage Growth[1]



The labor market has tightened considerably in recent years, highlighted by **record-setting employment** that increased 4.9% since the pandemic, **healthy annual wage growth** of 4.0% in the past year that was 90 bps above the long-term average and a **low unemployment rate** of 4.2% that was 148 bps below equilibrium. Private industry jobs would need to contract by 5.7%—or more acutely than the average job losses of the Global Financial Crisis and the Dot-Com Recession—to match pre-COVID levels when the economy was perceived to be healthy.

Household Net Worth[2]



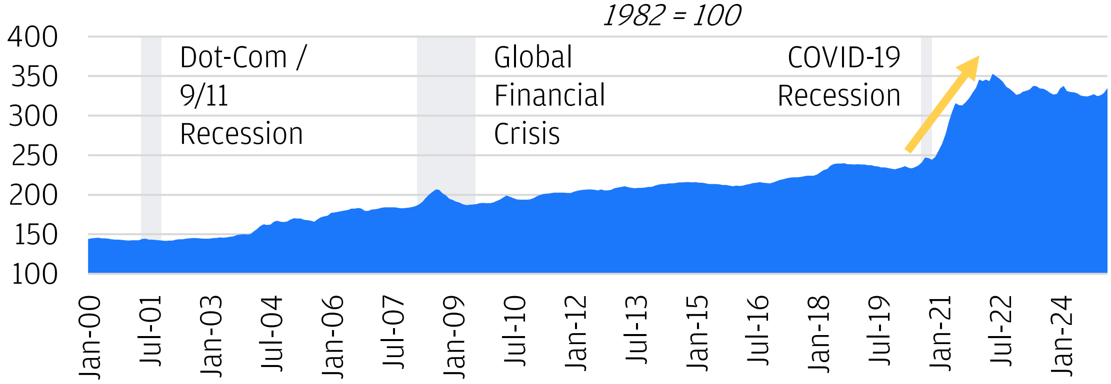
Consumers are sufficiently capitalized to withstand a correction, as indicated by **record-setting household net worth** reported in the past five quarters. Since Q4-19, assets increased by 42.7% whereas liabilities increased by just 25.6%, allowing net worth to rise by 45.1%. Recent financial market volatility may negatively affect accrued wealth; however, the comparatively modest rise in liabilities in recent years should provide buffers against significant changes to consumption habits.

New developments should capitalize on dwindling pipelines and robust demand for new product

Rapidly diminishing construction pipelines and continued absorption of new product should yield compelling development opportunities and rising rent growth in the coming quarters. Costs of capital and materials costs spiked from 2021 to 2022 due to COVID-related supply chain issues - and additional upward pressure is expected after the implementations of tariffs and more stringent immigration policies.

Construction Materials Cost Index[3]

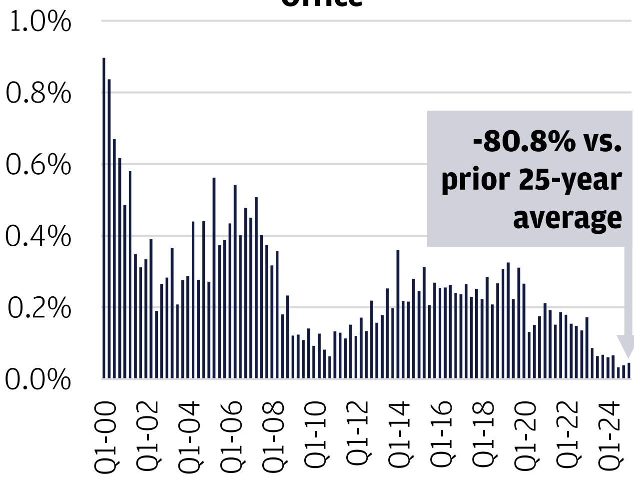
1982 = 100



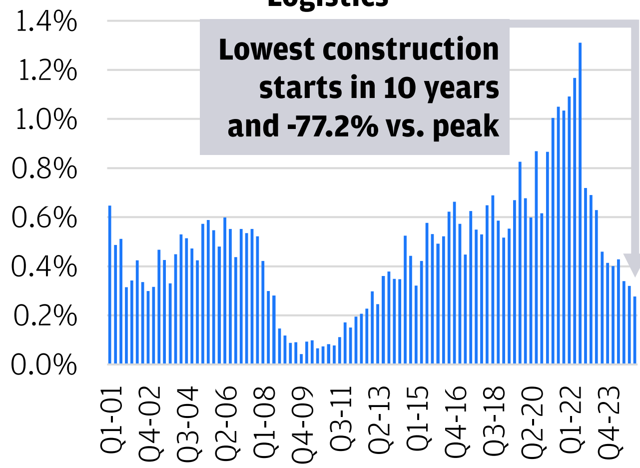
Construction materials costs are **+41.7% in the past five years** - and do not reflect the impacts of tariffs

Construction Starts as a Share of Existing SF/Units[4]

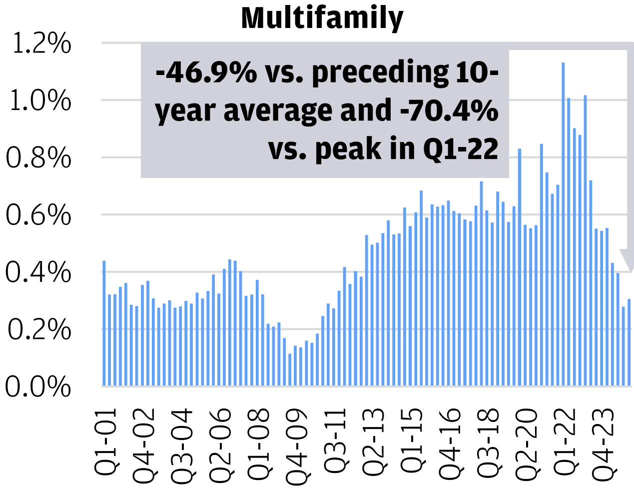
Office



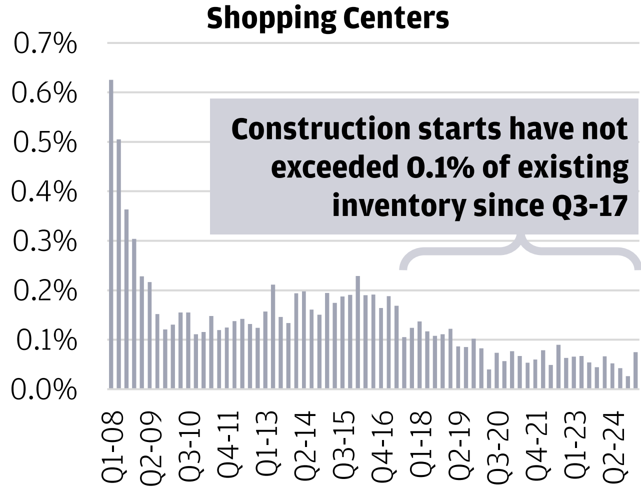
Logistics



Multifamily



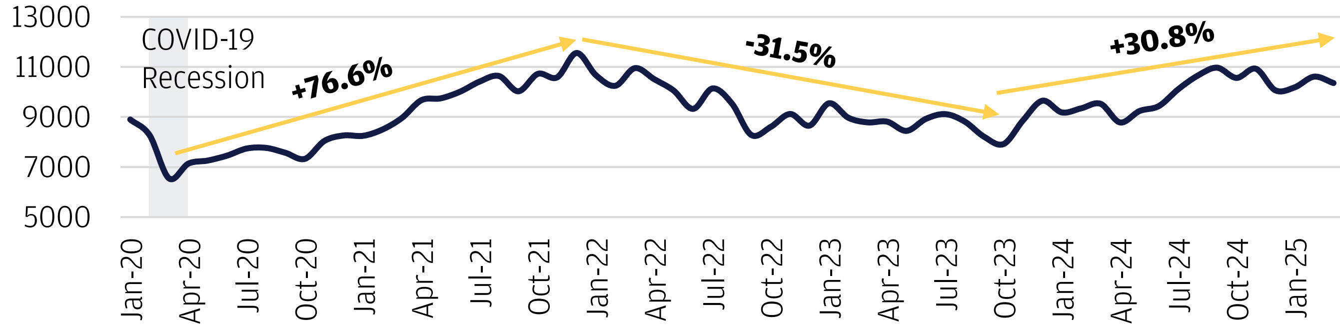
Shopping Centers



Key benchmarks indicate that CRE values are recovering

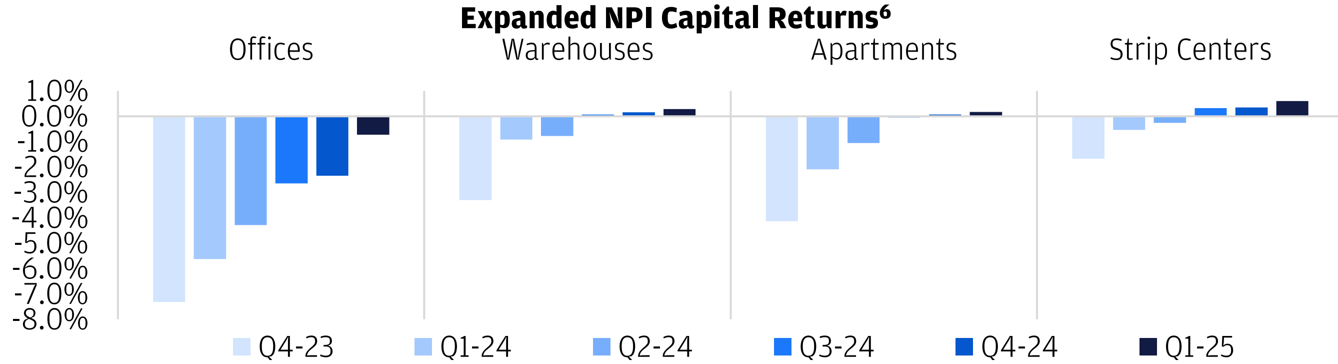
CRE values were negatively impacted by heightened interest rates despite strong economic conditions after the pandemic. Slowed inflation and improved operating fundamentals promoted stronger returns since mid-2024 – and public and private indices suggest that CRE values troughed in 2024 and are primed to improve, absent a recession.

REIT Index[5]



As of March 2025: **+45.1% vs. post-COVID trough** **+8.7% year-over-year** **-10.1% vs. peak**

Expanded NPI Capital Returns[6]

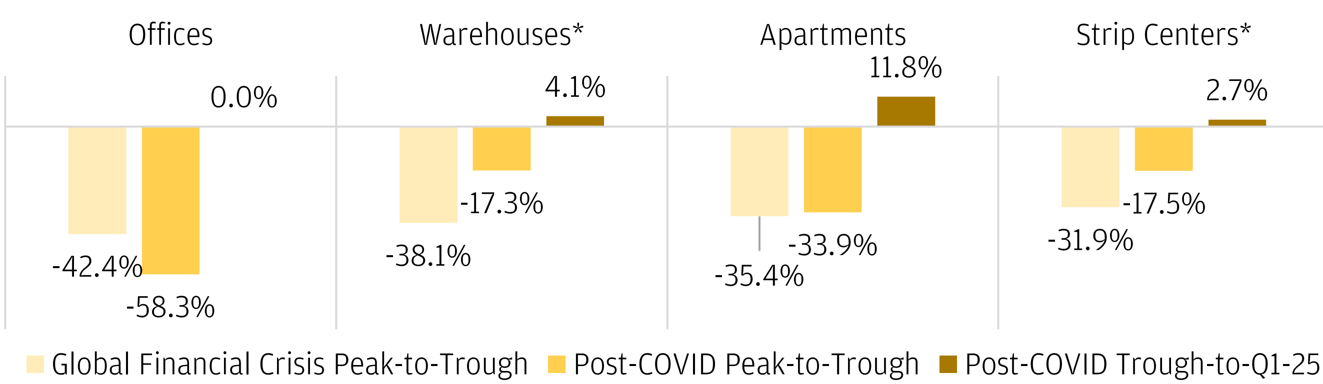


Highest quarterly returns reported since 2022

Three out of four sectors posted positive returns in Q1-25

Each sector reported five consecutive quarters of rising returns

Cyclical Peak-to-Trough CRE Property Values[7]



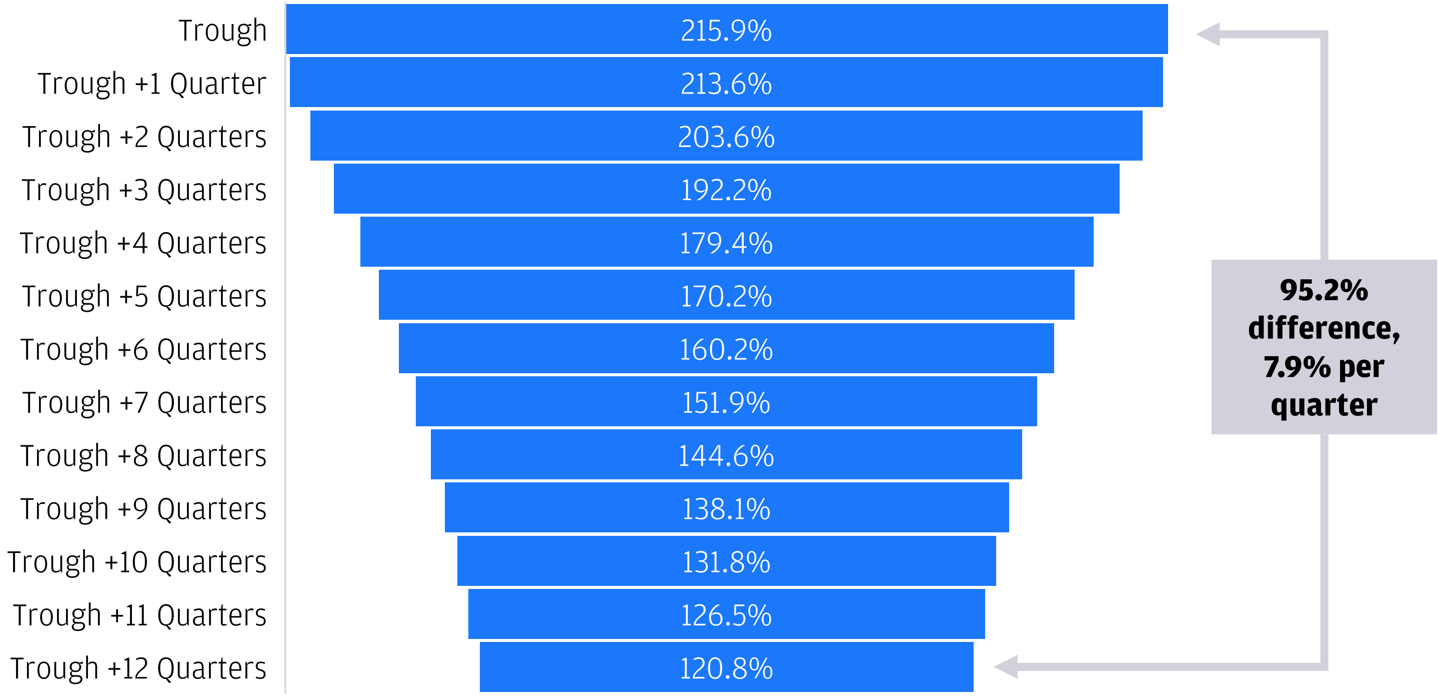
Three of the four sectors posted rising values since the COVID market bottom

Office values are stabilizing after significant deterioration

Value declines comparable with the Global Financial Crisis but absent a recession

CRE is a cyclical business and timing matters. Investors that deploy capital at the market bottom have historically reaped superior returns relative to investors that deployed capital when markets improved. This can be measured through cumulative value-weighted returns since the Global Financial Crisis trough and internal rates of return (IRRs) of funds with first closings during different economic cycles.

Cumulative Expanded NPI Total Returns From Global Financial Crisis Trough to Q4-24[8]

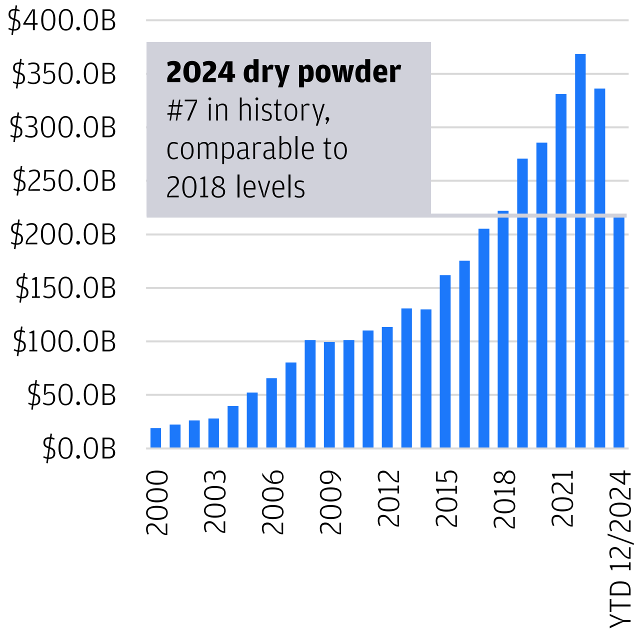


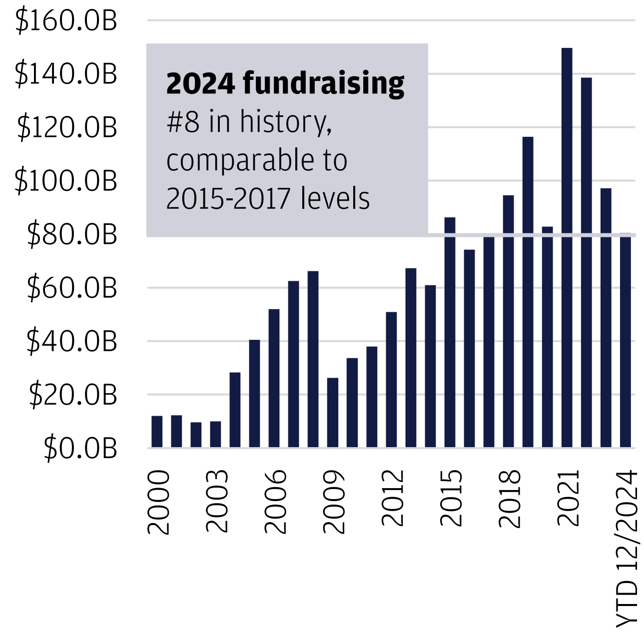
IRRs of U.S. CRE Funds by Year of First Closing Through Q3-24[9]

Liquidity should improve due to heightened dry powder levels, lower redemption queues and tightened bid/ask spreads

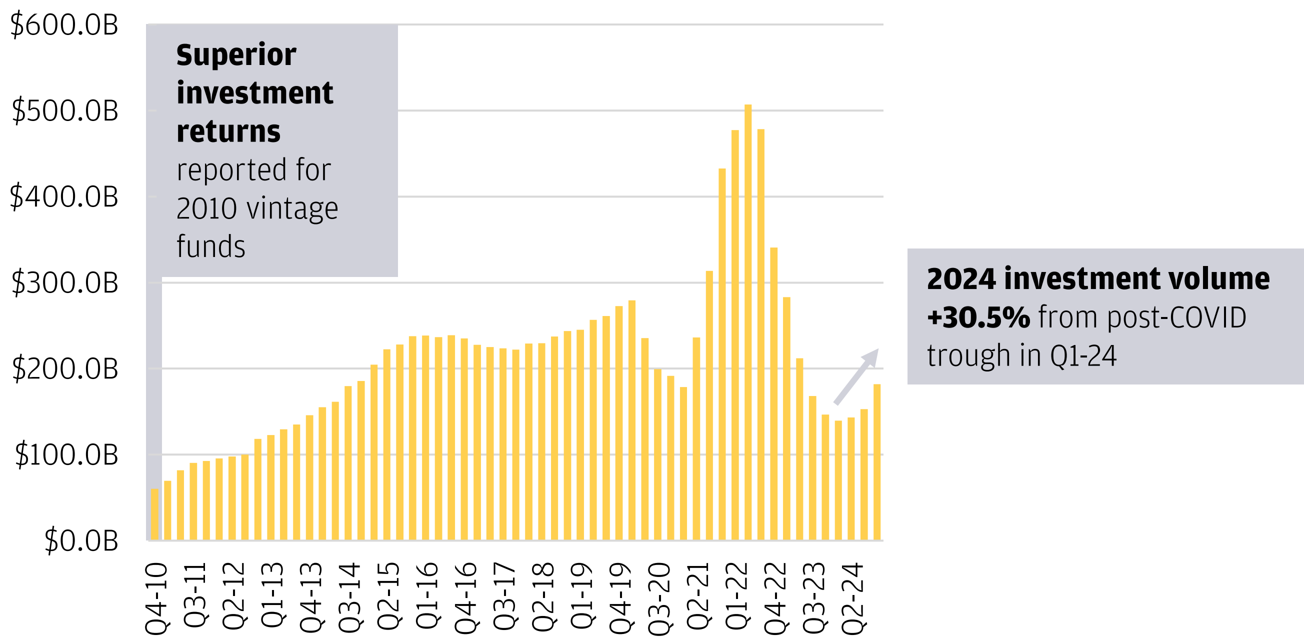
CRE investment sales activity is poised to rebound in the coming quarters, especially when financial market volatility moderates, partly due to elevated levels of dry powder and lower Open End Diversified Core Equity (ODCE) redemption queues. ODCE redemption queues diminished since the beginning of 2024 as interest rates stabilized and investment returns recovered, declining from the peak of 19.3% of NAV in Q1-24 to 15.0% of NAV in Q4-24, indicating that core funds could become more active.[10] Spot values have approximated valuations in recent quarters, so rising prices should lead to stronger investment demand.

Dry Powder (L) and Fundraising (R) for U.S. CRE Core, Core-Plus, Value-Add, Opportunistic, Distressed and Debt Funds[11]



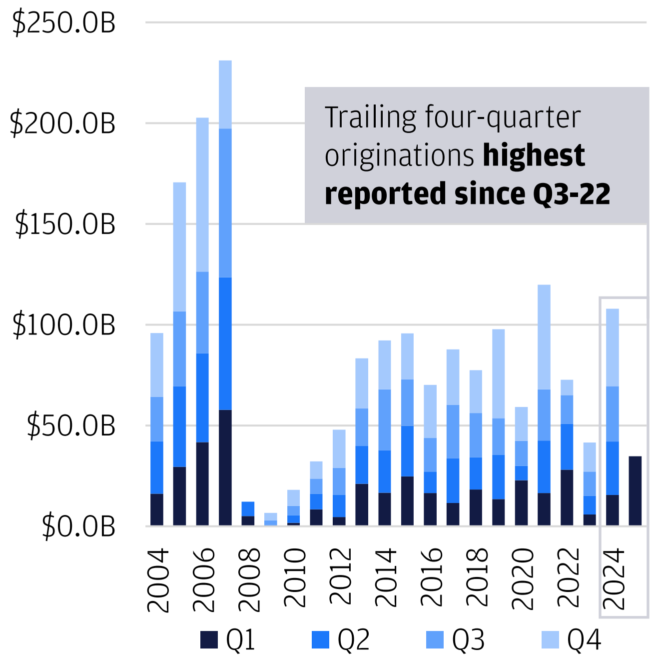


Investment Sales, Office, Industrial, Multifamily and Strip Center, Trailing Four Quarters[12]

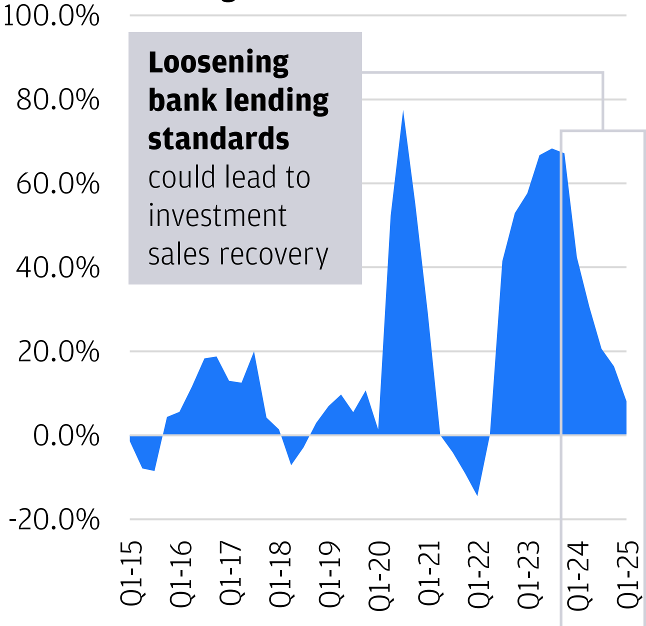


Debt liquidity is expected to continue to improve—promoting greater CRE investment sales volumes—assuming volatilities subside and the economy continues to expand. CRE debt yields trended higher than alternative corporate debt yields for life companies and other capital sources[13] and tightened relative to cap rates in recent months, bolstering stronger levered investment returns.

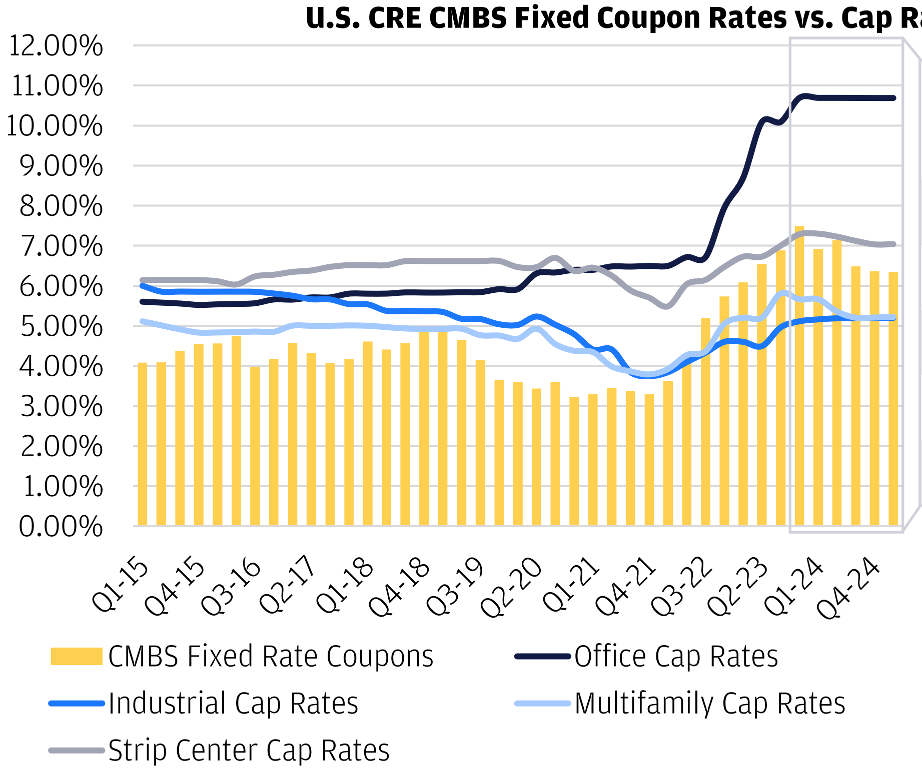
U.S. CRE CMBS Loan Origination Volumes[14]



Net Percentage of U.S. Banks Tightening Lending Standards for CRE[15]



U.S. CRE CMBS Fixed Coupon Rates vs. Cap Rates[14]



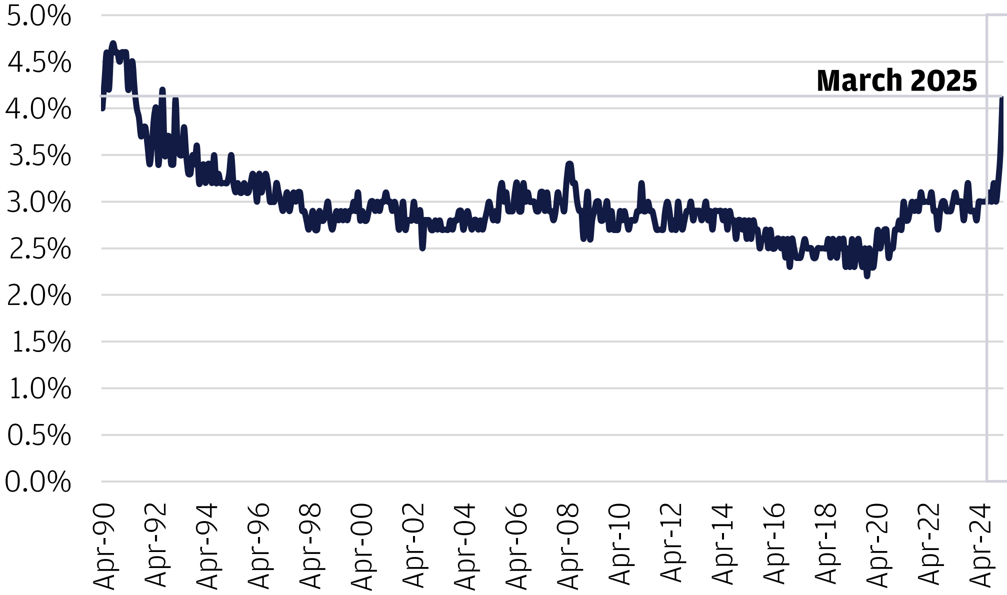
Loan spreads tightened more than cap rates from Q4-23 to Q1-25, lifting levered investment returns

CMBS Fixed-Rate Coupons	-115 bps
Office Cap Rates	0 bps
Industrial Cap Rates	+9 bps
Multifamily Cap Rates	-44 bps
Strip Center Cap Rates	-25 bps

Prices are expected to rise – and CRE historically serves as a hedge against inflation

Trade wars, immigration restrictions and other protectionist policies that are being implemented by the Trump administration are widely expected to stoke higher inflation rates. CRE serves as a hedge against higher prices because landlords pass off higher costs to tenants in the form of rents and operating expenses. High historical correlations between CRE asset values and inflation rates reinforce this concept.

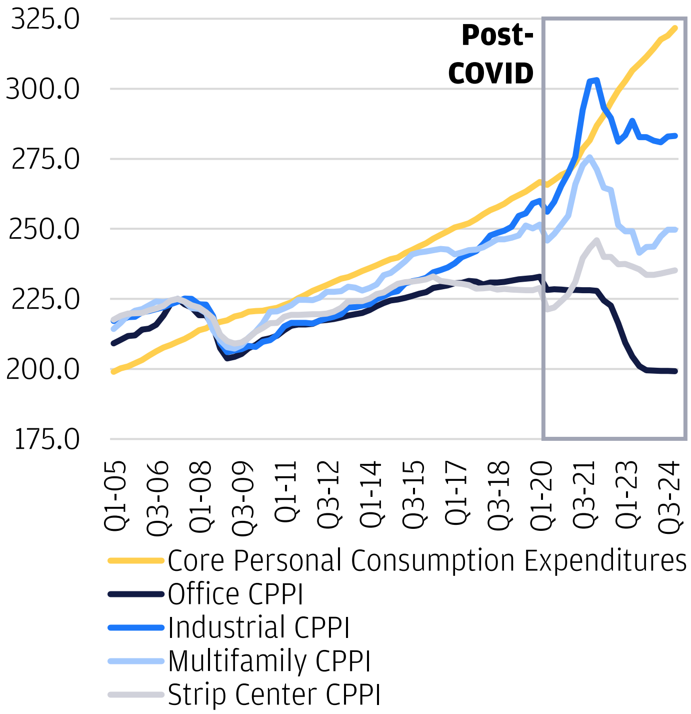
Consumers' Expected Change in Prices, Next Five Years[16]



March 2025 inflation expectations were the **highest reported since February 1993** and the two-month increase of 0.9 pp was the **highest escalation reported in the index's history** (since April 1990)

Inflation (L) vs. CRE Property Value (R) Indices[17]

(Referencing the Federal Reserve's Preferred Inflation Measure and Green Street's Commercial Property Price Index (CPPI))



Strong pre-COVID correlations between CRE values and inflation suggest that there **should be reversions to historical trends** when market conditions normalize, **especially for the industrial, multifamily and office sectors**

CRE value and inflation correlations (-1.00 to 1.00)	2005 to 2024	2005 to COVID	Post-COVID
Industrial	0.92	**0.82**	0.39
Multifamily	0.81	**0.89**	-0.43
Strip Center	0.78	**0.69**	0.42
Office	-0.03	**0.81**	-0.94

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ENDNOTES

1. U.S. Bureau of Labor Statistics. Data as of 3/2024. Accessed 4/11/2025.
2. Board of Governors of the Federal Reserve System via FRED. Data as of Q4-24. Accessed 4/15/2025.
3. U.S. Bureau of Labor Statistics via FRED. Data as of Q1-25. Accessed 4/24/2025.
4. CoStar. Data as of Q1-25. Office data accessed 4/23/2025. Industrial data accessed 4/21/2025. Multifamily data accessed 4/21/2025. Shopping center data accessed 4/24/2025.
5. Nareit. Data as of Q1-25. Accessed 4/15/2025.
6. Note: Expanded NPI for Office: Central Business District, Secondary Business District, Suburban and Urban; Industrial: Warehouse; Residential: Apartment; Retail: Strip property types. NCREIF. Data as of Q1-25. Accessed 4/25/2025.
7. Note: Warehouse and Strip Center post-COVID troughs in 2023 instead of 2020-2021 to demonstrate appropriate valuation trends. Green Street CPPI. Data as of Q1-25. Accessed 4/15/2025.
8. NCREIF. Data as of Q1-25. Accessed 4/25/2025.
9. NCREIF. Data as of Q3-24. Accessed 4/15/2025.
10. "Private Real Estate Valuations May Have Bottomed; REITs Fall." Callan. 2/20/2025.
11. Preqin. Data as of 12/13/2024. Accessed 12/13/2024.
12. Note: $25M+ transactions only. Green Street. Data as of Q4-24. Accessed 4/16/2025.
13. "State of the U.S. Capital Markets." Newmark. 4Q24.
14. Green Street. Data as of Q1-25. Accessed 4/16/2025.
15. Board of Governors of the Federal Reserve System via FRED. Data as of 2/3/2025. Accessed 3/18/2025.
16. Surveys of Consumers: Inflation Expectation. University of Michigan. Data as of 3/2025. Accessed 4/17/2025.
17. U.S. Bureau of Labor Statistics via FRED. Data as of Q4-24. Accessed 4/17/2025. Green Street. Data as of Q4-24. Accessed 4/17/2025.

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