CBRE Investment Management

2025 offers an attractive entry point in the property markets

Chase McWhorter, Institutional Real Estate, Inc.'s managing director, Americas, spoke in early April with **Shane Taylor,** Americas head of research with CBRE Investment Management. Following is an excerpt of that conversation.

CBRE Investment Management has highlighted 2025 as an attractive investment window. What factors contribute to this assessment, considering the current economic uncertainty and higher-for-longer interest rates?

For one, values have been falling across the property sectors for much of the past three years. The entry point we see ahead is a fairly rare point in time. We've only had two other occasions since the late 1970s when values have fallen by more than 20 percent across "all property."

Second, supply pipelines – construction commencements and properties under construction – have fallen dramatically during the past year or two. Finance is expensive, material costs are moving up and now there are shortages of labor, as well. That series of events means comparatively few new developments are getting out of the ground these days, which bodes well for the supply/demand balance going forward. Vacancies had been moving higher for the past couple of years, but we believe they are at or past peak in many markets, or very close to peak in other cases, indicating fundamentals will improve in the next couple of years. That bodes well for rent growth.

A third point involves capital that has been sitting on the sidelines. Many institutional investors had been watching the spike in the Federal Reserve interest rates from the sidelines, until last September when the Fed commenced cautiously cutting rates. We've already seen a larger number of investors bringing a higher quantity of capital to investments since then. There will still be uncertainty, of course, particularly around tariffs. But those investors who have a medium- to long-term perspective will see this as an opportunity to move back into the market, if they haven't already.

Expand on what has been happening on the supply-side of U.S. real estate?

When interest rates were low in 2021 and early 2022, two of our preferred sectors – multifamily and logistics – had a significant uptick in construction commencements. Those projects have been delivering during the past year or two, given the lag between when a project is conceived, financed, commenced and then finally delivered. We have seen patches of oversupply in certain sectors and markets. That window of opportunity for cheap financing has closed, which has meant construction commencements have plummeted, particularly in the past year, as those higher financing costs kicked in. That bodes well for vacancy rates to move down, even assuming quite modest amounts of demand that should absorb the new space. Modern logistics is one of our preferred sectors, and although the delivery of new stock is quite significant, we do see that ongoing rotation out of legacy stock and into modern stock, which should help that segment of the market. It's the older, more commodified legacy logistics stock that is most threatened by this new construction.

What is your current outlook for the modern logistics sector, and what, specifically, are the key factors driving its performance?

The properties in the modern logistics sector are far more efficient and much more amenable to automation and robotics than traditional logistics assets. There has been a shortage of warehouse workers in many key U.S. markets. For efficiency gains, particularly the larger, more sophisticated occupiers are looking at stock with higher racking and stacking, with thicker floor plates to support those higher stacks and with seamless floor plates to allow the robotics to glide seamlessly over the floors. They seek roof loads that are strong enough to support solar, because a lot of these same occupiers will be using EV fleets, so the ability to generate electricity and to have charging capacity in these logistics facilities is critical. There will still be workers at these facilities, but often they will be in charge of technical and IT operations, for example – they're not your classic warehouse worker. Making sure there are high-level amenities at those facilities will definitely attract the right occupiers and workers to those spaces, which makes them much more resilient.

Retail appears to be making a comeback. What are your thoughts on the retail sector, particularly neighborhood and community centers?

When it comes to the retail environment, our house view is that enclosed malls will continue to struggle. We remain quite cautious about the vacancy rates and uncertainty with that format. It seems to have fallen out of favor with many of the best tenants. But fundamentals for neighborhood community center retail, or NCC, have been improving. Not much new supply has been built for the past decade, despite good population growth in a number of American cities and submarkets.

Yes, Americans are still increasingly using ecommerce, but some retail can be seen as part of the supply chain. The retailers that have survived the structural challenges of ecommerce, the pandemic and various other disruptions have figured out a way to adapt, to transform their retailing models and, in some cases, really thrive. We would still be very cautious about the types of assets we would select, but particularly those assets in very strong catchments, good school districts, infill-type locations in the cities with the best demographic and economic growth prospects could be very good retail opportunities.

Which property types do you think will be most severely impacted by policies of the new administration?

Life sciences is the one we are most concerned about. Even before this new administration came to power, there had been quite a spike in the vacancy rate nationally with 2024 ending with a national vacancy rate just over 20 percent. There was just too much new supply delivering that had been commenced during the pandemic era, when financing costs were low and there was strong emphasis on research and development in medical and other sciences. Life sciences development made a lot of sense at that time, but it all delivered in the past year or two, right when demand was already starting to diminish, particularly in terms of demand supported by venture capital. The NIH's government funding was still an important support for much of that research, and occupiers were still quite optimistic about funding for their future research. Unfortunately, the new administration has targeted that funding in its cuts. There are challenges in the courts about whether these funds can be cut in this manner, but they've at least been stopped for now. It certainly does not give a great deal of confidence to some of those life science occupiers, whether the bigger established firms or the smaller startups, which are critical to that ecosystem.

How does CBRE Investment Management recommend constructing a well-diversified real estate portfolio in the current market environment, and what are the key considerations for risk management?

We forecast approximately 360 U.S. city-sector combinations every six months. These are five-year, forward-looking total return forecasts, which go into a portfolio optimizer. Our quantitative team has a model portfolio, which we've published going back for many years, so we can back test it. It is a tool that helps us have a conversation with clients about how to construct a new portfolio going forward, but also how to balance a current portfolio more optimally — what markets need to be sold, what markets need to be bought, what should be held in order to outperform the benchmark.

We aim for diversification across different U.S. sectors to mitigate sector risk. We have a series of overweights and underweights in our model portfolio vis-a-vis the NCREIF NPI index. In those sectors where we think the risk-adjusted returns will be higher and stronger, we'll be overweight. Meanwhile, where we think there will be underperformance ahead, we will sometimes even have a zero weighting in our model portfolio. For example, we currently have a zero weighting in our model portfolio for enclosed malls. Legacy office, which is still a sizable portion of the benchmark, is another sector about which we are still very cautious going forward and which has a zero weighting, as well. In contrast, we are well overweight in modern logistics, which we define as stock built since 2011. We are underweight in legacy logistics. A number of investors are pursuing logistics right now, but we still think there are some inherent risks in having old stock, which while it might be performing today, may well become obsolete four or five years from now.

With residential, we have been overweight for some time. Within residential, though, we are now market weight in multifamily apartments. We are considerably overweight, however, for some of the other residential subsectors. Manufactured housing, single-family rental and student accommodation are good examples of subsectors that are still a fraction of the current benchmark. They have not yet gone through that institutionalization process that other sectors, such as self-storage, have gone through. Those residential segments are still a tiny fraction of the universe, and they can be difficult to access. You have to build them and aggregate them, but we do have an overweight for each of those other residential property types.

That combination of being overweight in modern logistics, overweight in residential and overweight in NCC retail is likely going to be the main driver that pushes us ahead of where the benchmark performance is likely to be in the next five years.

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COMPANY OVERVIEW

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