Will Real Estate Thrive in 2025? A Look at What's Ahead

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2024 was a challenging year in real estate, particularly for investors, owners, and developers who were handcuffed as high interest rates led to fewer overall transactions. Conditions have finally started to shift with the Federal Reserve's cycle of rate cuts which began in September, potentially alleviating some of the pressure on borrowers and lenders. But is the industry poised to flourish in the new year that lies ahead, or is "the fix" coming after 2025?

INTEREST RATES ARE STILL AFFECTING PROPERTY DEMAND AND PRICING

In a non-spec ground-up development, the interest rate environment is not as big of an issue. Debt is often still cheaper than equity, so if a developer has tenants lined up, can get entitlements quickly (which is a big "if"), and can build at a reasonable cost, then short-term debt can be profitable. On the valuation side, with cap rates higher due to the interest rates, sellers have been hesitant to sell at lower prices unless they have no other alternative due to loans maturing that can't be refinanced profitably or various other reasons. Even with interest rates trending downward, commercial real estate transactions are slow-moving, and it may take some time before we see transaction frequency catch up.

PORTFOLIO ADJUSTMENTS ARE PAYING OFF

Investors need to deploy capital, and they've been targeting sectors where the risk-reward ratio makes sense. Multifamily developers and investors are increasingly shifting to self-storage properties, a trend we expect to see continue in 2025. Industrial real estate remains strong and requires less hands-on management than retail, multifamily, or office properties.

Despite years of talk about the death of brick-and-mortar stores, the strength of retail is another bright spot in commercial real estate. While it's true that retail was overbuilt, and many underperforming malls with large anchor stores had to adjust, we're now seeing neighborhood and community shopping centers getting stronger. In Los Angeles, retail vacancy rates are about 5.5% lower than the national average. And though some might say that office space was also overbuilt, and will never fully recover due to generational shifts, we could see a positive trend similar to what has happened with retail as many office building owners are focusing on amenities to make a return to the office more appealing.

ALTERNATIVE FINANCING CONTINUES TO GAIN TRACTION

We're seeing a lot of short-term, high-interest construction and bridge financing from non-traditional lenders like hedge funds. With interest rates where they are, non-traditional lenders are stepping into the real estate market, often through debt funds that provide more flexibility to borrowers. This will likely continue until interest rates have dropped more significantly. These loans usually come with hefty fees, both origination and exit, but with higher loan-to-value (LTV) ratios, there are benefits to having more flexible financing options.

SOME RISKS AREN'T GOING AWAY

As sales of real estate properties in Los Angeles continue to bear the negative impact of high interest rates and the Measure ULA tax on real property sales over $5M in Los Angeles, it's safe to say that in California, regulations and laws don't always lead to the intended outcomes. Ballot propositions can be long and hard for the average voter to understand, and since legislators aren't typically real estate professionals, decisions can be made without proper facts or context. Unfortunately, the "one size fits none" approach often results from these new initiatives and laws, and there will be no escaping their impact in 2025.

Keeping successful companies in California is also top of mind for the real estate industry. The state's strong economy attracts top talent. While we need to create affordable housing for younger generations and those priced out of the market, overregulation and excessive taxation could drive companies out. It's a delicate balance, but companies must prioritize their shareholders. Many operators doing business in California feel it is becoming too difficult, and if that sentiment becomes widespread, it could create a bigger problem.

Regardless of how swiftly or dramatically conditions are improving, there is renewed optimism about the overall market in 2025. Real estate is resilient and responsive, and opportunities will always be there for those who are quick to embrace change when necessary. By remaining vigilant and flexible, investors and professionals alike can position themselves to not just survive, but thrive, in the new year ahead.

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