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UNIVERSITY OF DENVER

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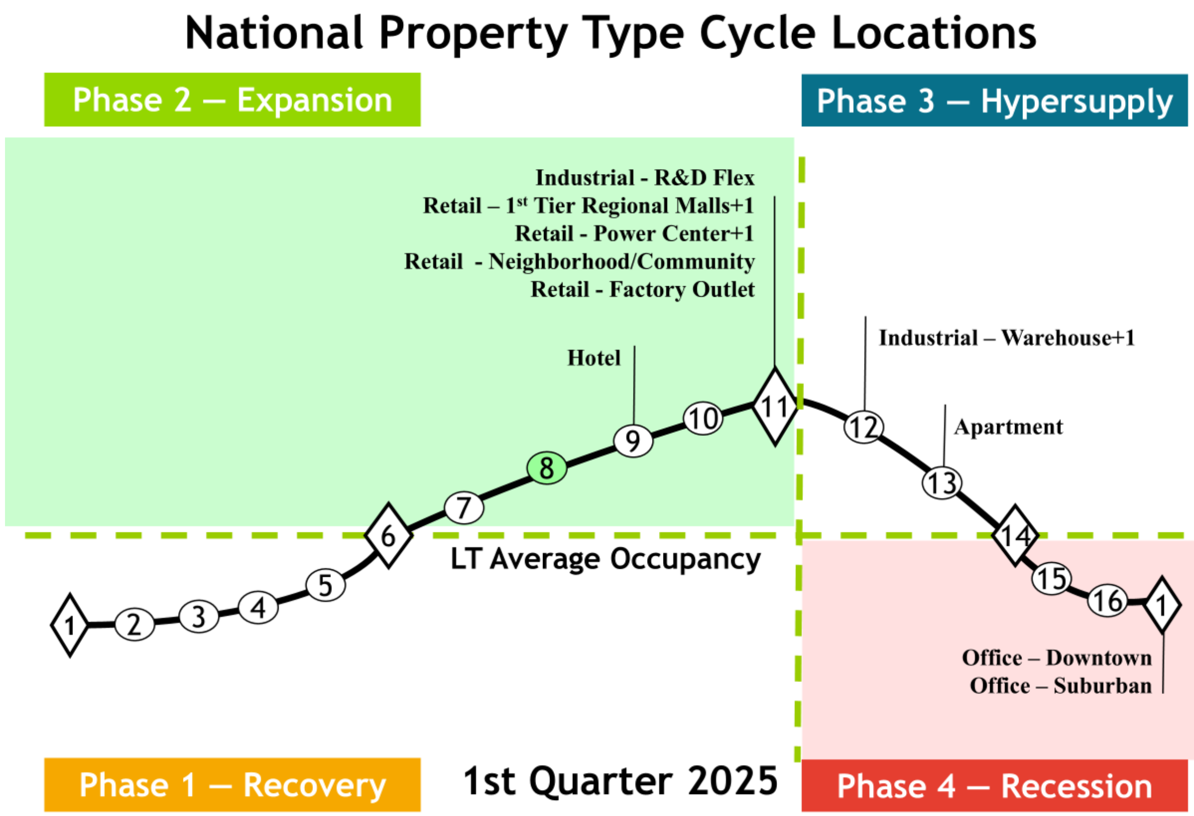
Mueller
Real Estate Market Cycle Monitor
First Quarter 2025 Analysis – May 2025

The Physical Market Cycle Analysis of 5 Property Types in 54 Metropolitan Statistical Areas (MSAs).

The economy moved forward moderately well in 1Q25 through the turmoil of expected changes with tariffs and government layoffs, decreased funding, new wars and other headline news issues. Enough employers did not pause their job hiring and the US saw 3 more months of employment growth. Consumer spending was motivated by buying ahead of tariffs being imposed. As interest rates stabilized and even dropped slightly, commercial real estate transaction volume had a minor improvement, but foreign buyers were less involved. It is anyone's guess as to the future direction of the economy.

Office occupancy **declined -0.1%** in 1Q25, while rents **were up 0.3%** for the quarter and **were up 1.1%** annually.
Industrial occupancy **declined -0.2%** in 1Q25, but rents **were up 0.6%** for the quarter and **were up 2.5%** annually.
Apartment occupancy **increased 0.1%** in 1Q25, and rents **were up 0.3%** for the quarter, and **up 1.2%** annually.
Retail occupancy **declined -0.1%** in 1Q25, and rents **were up 0.4%** for the quarter and **were up 1.9%** annually.
Hotel occupancy **was up 0.1%** in 1Q25, and Rev PAR **grew 0.6%** for the quarter and **was up 2.4%** annually.



Source: Mueller, 2025

The National Property Type Cycle Locations graph shows relative positions of the sub-property types.

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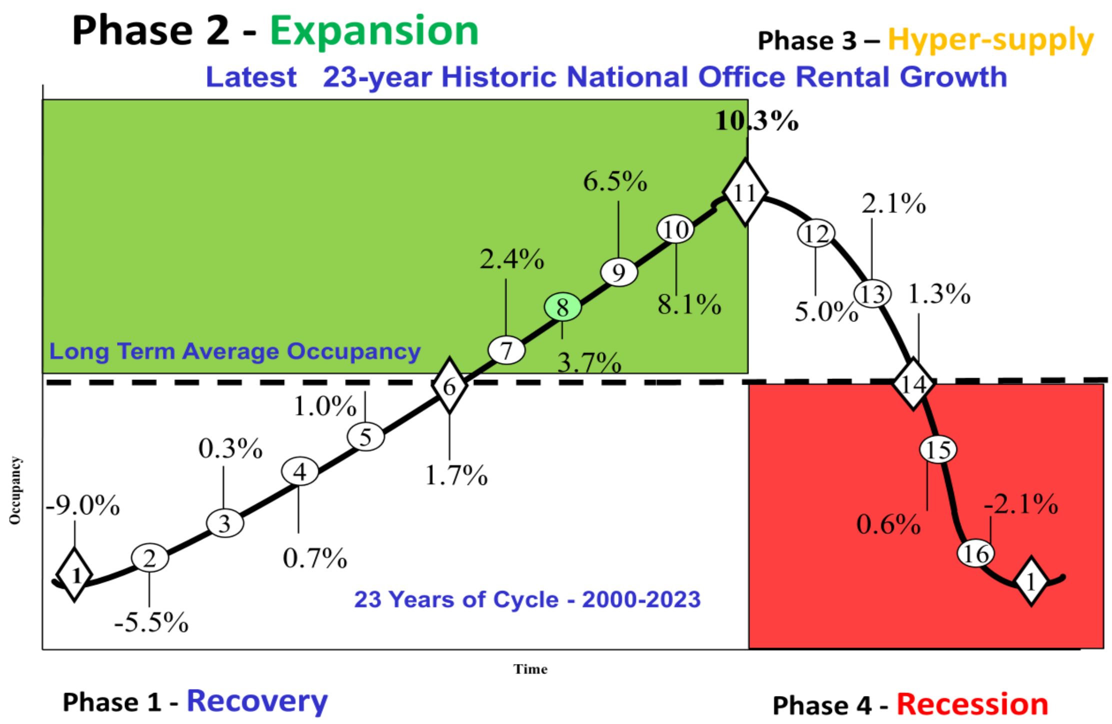
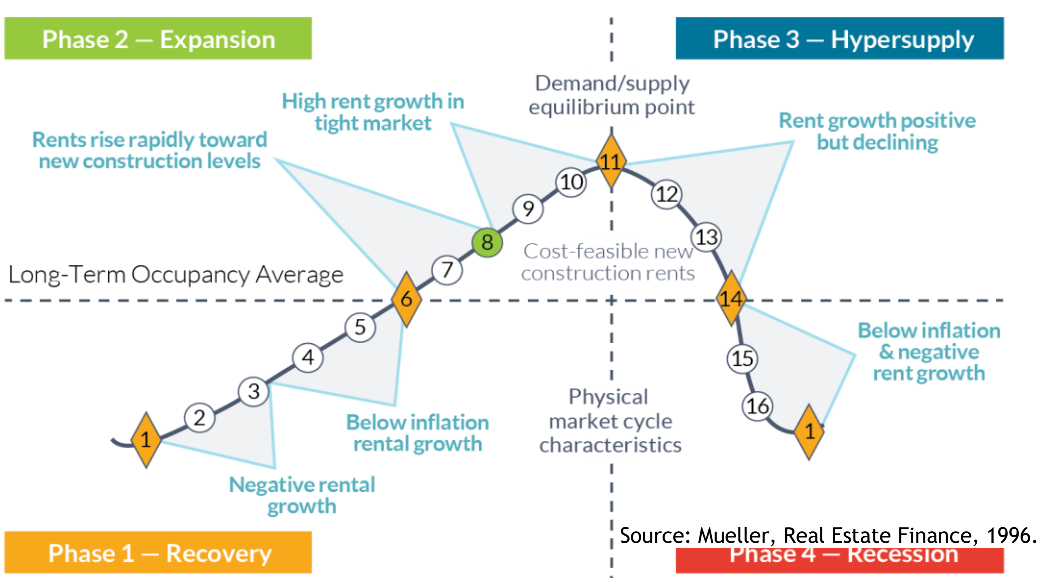
The cycle monitor analyzes occupancy movements in five property types in 54 MSAs. Market cycle analysis should enhance investment-decision capabilities for investors and operators. The five property type cycle charts summarize almost 300 individual models that analyze occupancy levels and rental growth rates to provide the foundation for long-term investment success. Commercial real estate markets are cyclical due to the lagged relationship between demand and supply for physical space. The long-term occupancy average is different for each market and each property type. ***Long-term occupancy average*** is a key factor in determining rental growth rates — a key factor that affects commercial real estate income and thus returns.

Market Cycle Quadrants



Source: Mueller, Real Estate Finance 1998 Source: Mueller, 2024

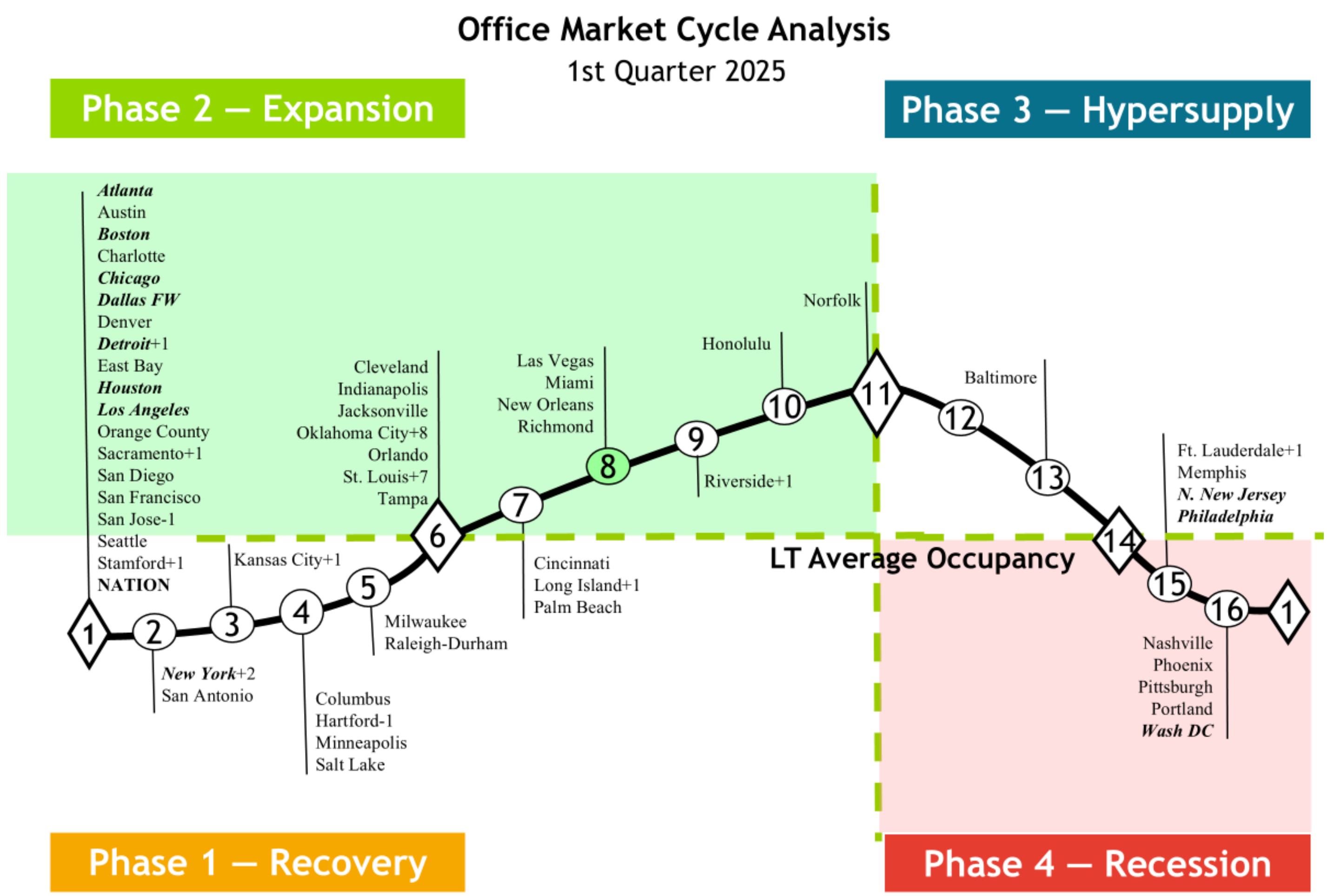
Rental growth rates can be characterized in different parts of the market cycle, as shown below.



Source: Mueller, Real Estate Finance, 1996.

Office

The national office market occupancy level **was down -0.1%** in 1Q25 and **was down -0.2%** year-over-year. Office demand continued to be positive in 1Q25 with New York premium class A space leading the way. Unfortunately, new supply coming online continued to be higher than demand, causing occupancies to have a slight decline. While 17 markets are shown in the expansion phase, with demand higher than supply, the rest of the markets are still in the recession or recovery phase. Asking rental rates **were up 0.3%** in 1Q25 and **were up 1.1%** year-over-year.

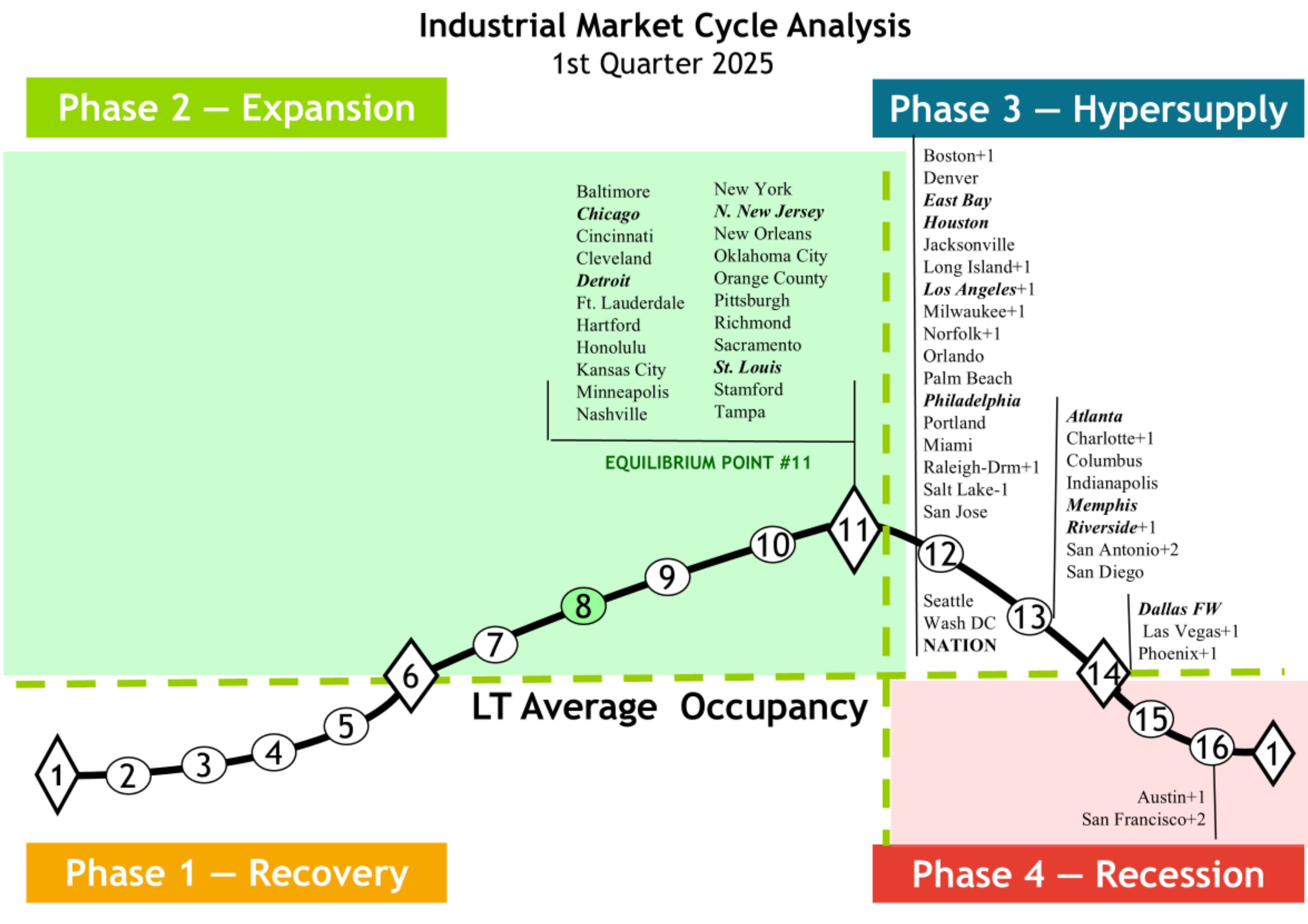


Source: Mueller, 2025

Note: The 11-largest office markets make up 50% of the total square footage of office space we monitor. Thus, the 11-largest office markets are in ***bold italic*** type to help distinguish how the weighted national average is affected.
Markets that have moved since the previous quarter are now shown with a + or - symbol next to the market name and the number of positions the market has moved is also shown, i.e., +1, +2 or -1, -2. Markets do not always go through smooth forward-cycle movements and can regress or move backward in their cycle position when occupancy levels reverse their usual direction. This can happen when the marginal rate of change in demand increases (or declines) faster than originally estimated or if supply growth is stronger (or weaker) than originally estimated.

Industrial

Industrial occupancies **decreased -0.2%** in 1Q25 and **decreased -0.9%** year-over-year (keeping the national average in the hyper-supply phase of the cycle). Low demand growth could not meet the 312 million square feet of new supply that came online over the last year. While there were some additional leases made to store goods purchased before the tariffs went into effect, it was not enough to make a significant difference. 12 markets saw occupancy declines that moved them further down in the hyper-supply and recession phases of their cycles More available space puts most tenants in the driver's seat when negotiating rents, but higher construction costs have landlords trying hard to move rents up enough to get a positive return. Asking rent growth **was up 0.6%** and annual rent growth **was up 2.5%** year-over-year, a substantial slowing from the previous quarter.



Source: Mueller, 2025

Note: The 12-largest industrial markets make up 50% of the total square footage of industrial space we monitor. Thus, the 12-largest industrial markets are in ***bold italic*** type to help distinguish how the weighted national average is affected.

Markets that have moved since the previous quarter are now shown with a + or - symbol next to the market name and the number of positions the market has moved is also shown, i.e., +1, +2 or -1, -2. Markets do not always go through smooth forward-cycle movements and can regress or move backward in their cycle position when occupancy levels reverse their usual direction. This can happen when the marginal rate of change in demand increases (or declines) faster than originally estimated or if supply growth is stronger (or weaker) than originally estimated.

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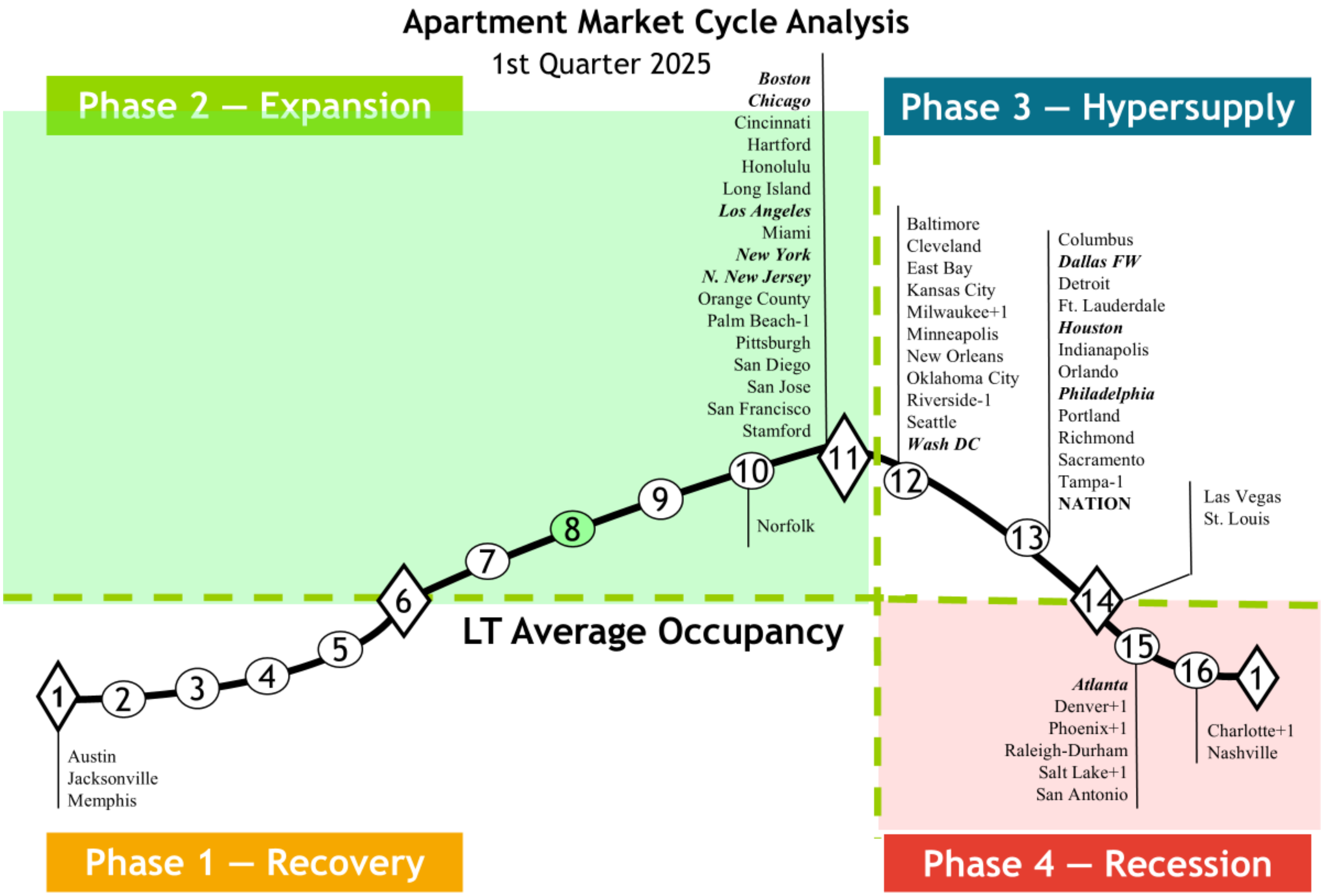
Apartment

The national apartment occupancy average **increased 0.1%** in 1Q25, but was **up 0.1%** year-over-year. This is the first improvement in occupancy in three years! Demand is strengthening from moderate job growth with over 500,000 units absorbed in the last year. New supply growth has declined by 30% over the last 3 quarters to a moderate 125,000 units in 1Q25. The small occupancy increase allowed landlords to ask for moderately higher rents. National average apartment rent growth **was up 0.3%** in 1Q25 and **up 1.2%** year-over-year.



Source: Mueller, 2025

Note: The <u>10-largest apartment markets make up 50%</u> of the total square footage of multifamily space we monitor. Thus, the 10-largest apartment markets are in ***bold italic*** type to help distinguish how the weighted national average is affected.

Markets that have moved since the previous quarter are now shown with a + or - symbol next to the market name and the number of positions the market has moved is also shown, i.e., +1, +2 or -1, -2. Markets do not always go through smooth forward-cycle movements and can regress or move backward in their cycle position when occupancy levels reverse their usual direction. This can happen when the marginal rate of change in demand increases (or declines) faster than originally estimated or if supply growth is stronger (or weaker) than originally estimated.

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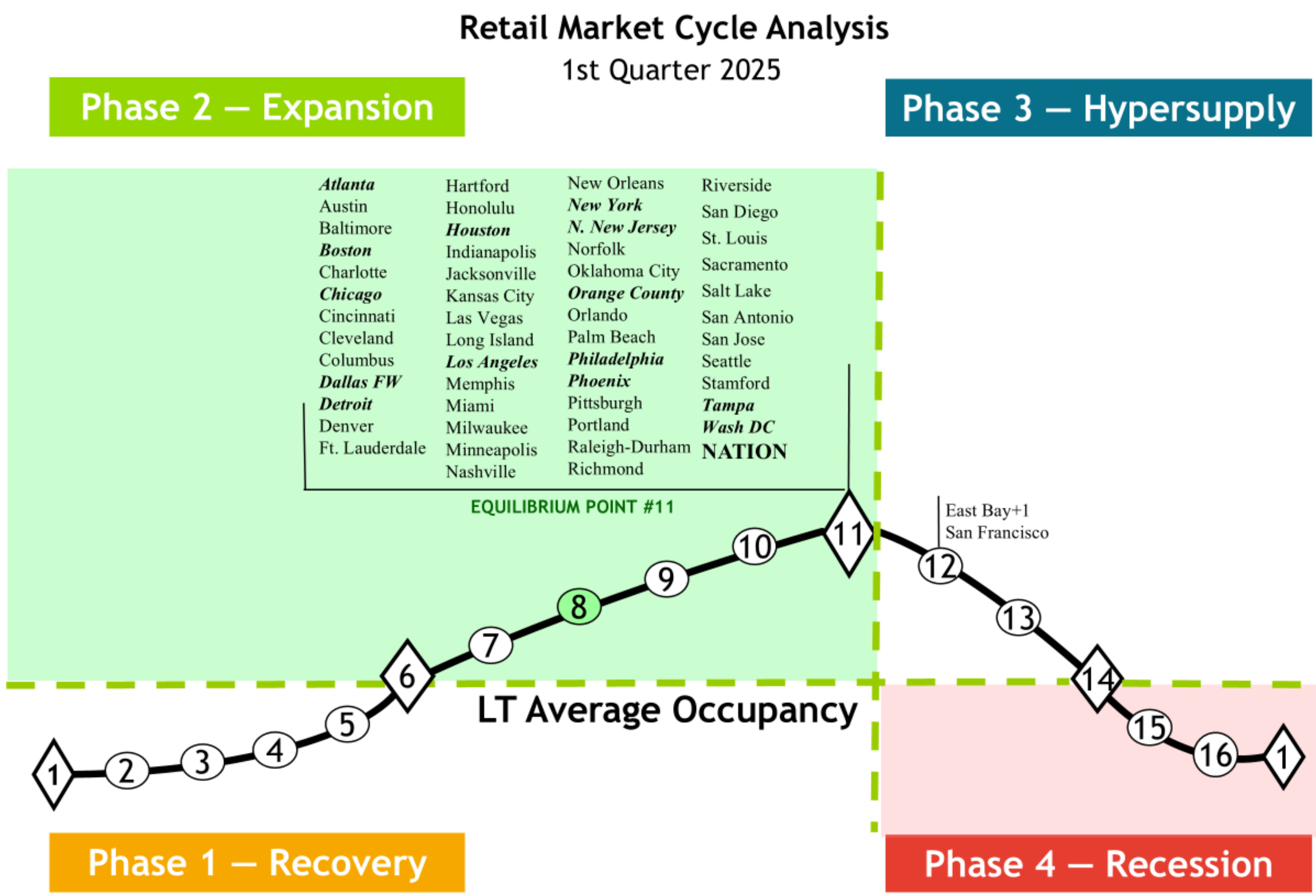
Retail

Retail occupancies were **down 0.1%** nationally in 1Q25 but **up 0.3%** year-over-year, hovering near the highest peak-occupancy level in retail's history. Most of the demand decline came from retail bankruptcies of major chains and move-outs from poor performing stores whose leases had expired. However, demand for quality retail space is still strong from tenants who are doing well and expanding. This demand continues to be good for high quality / well located space. Supply continues to be constrained at 80% of previous growth rates with only 40 million+ square feet delivered in the last year. 80% of new space delivered continues to be pre-leased. The national average retail asking rents **were up 0.4%** for the quarter and **were up 1.9%** year-over-year.



Source: Mueller, 2025

Note: The 14-largest retail markets make up 50% of the total square footage of retail space we monitor. Thus, the 14-largest retail markets are in ***bold italic*** type to help distinguish how the weighted national average is affected.

Markets that have moved since the previous quarter are now shown with a + or - symbol next to the market name and the number of positions the market has moved is also shown, i.e., +1, +2 or -1, -2. Markets do not always go through smooth forward-cycle movements and can regress or move backward in their cycle position when occupancy levels reverse their usual direction. This can happen when the marginal rate of change in demand increases (or declines) faster than originally estimated or if supply growth is stronger (or weaker) than originally estimated.

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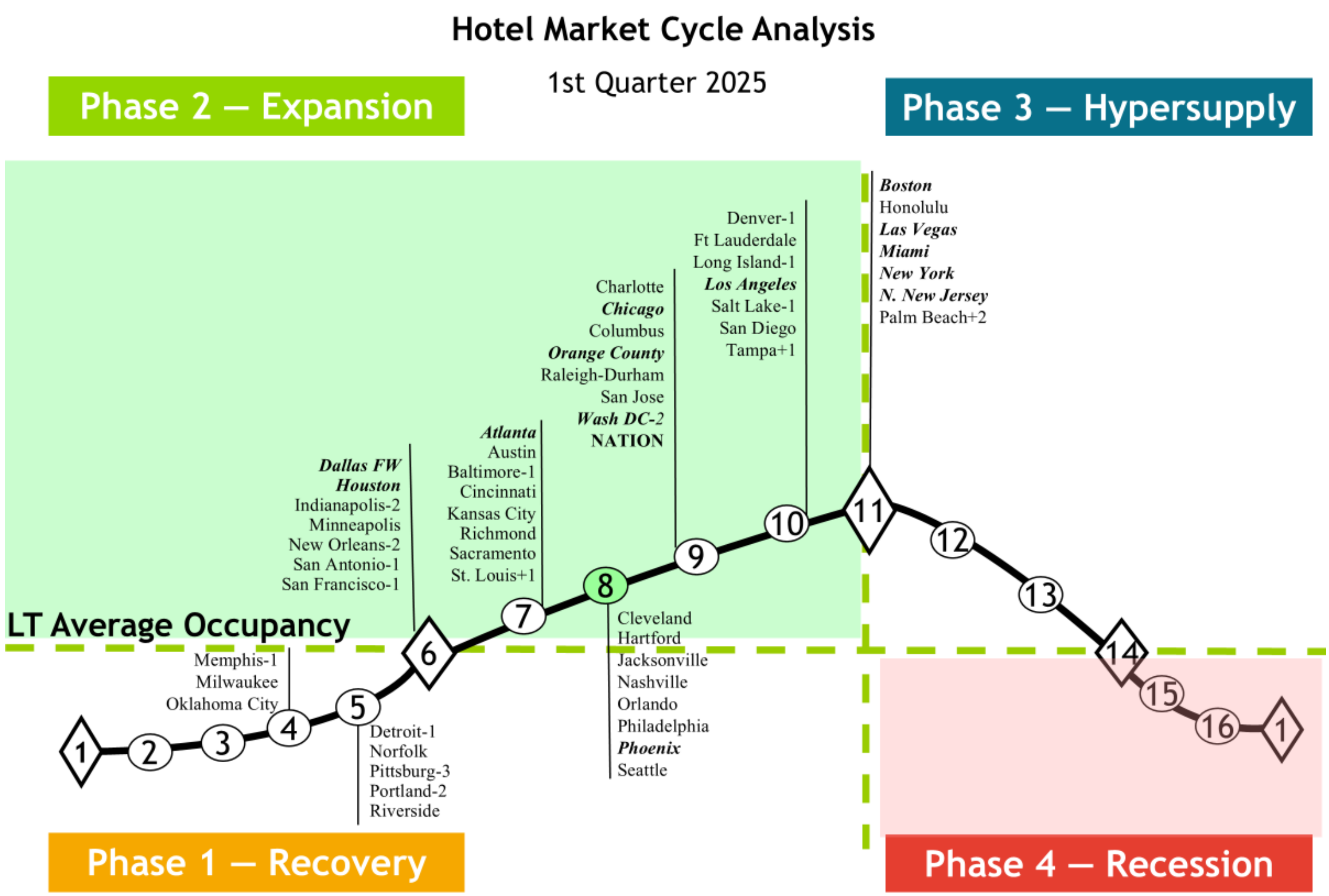
Hotel

Hotel occupancies were **up 0.1%** in 1Q25 and **up 0.4%** year-over-year. The demand continues to be bifurcated with luxury doing well and business and economy travel growth stagnant. In addition, tariff talks slowed international travel to the US, especially from Canada (a country whose people love to get away from the cold winters). Fortunately, new supply remained low as higher costs, higher interest rates and more cautious lenders did not allow for much speculative new construction. National average Revenue Per Available Room – (RevPAR) was **up 0.6%** for the quarter and **up 2.4%** year-over-year.



Source: Mueller, 2025

Note: The 14-largest hotel markets make up 50% of the total square footage of retail space we monitor. Thus, the 14-largest hotel markets are in ***bold italic*** type to help distinguish how the weighted national average is affected.

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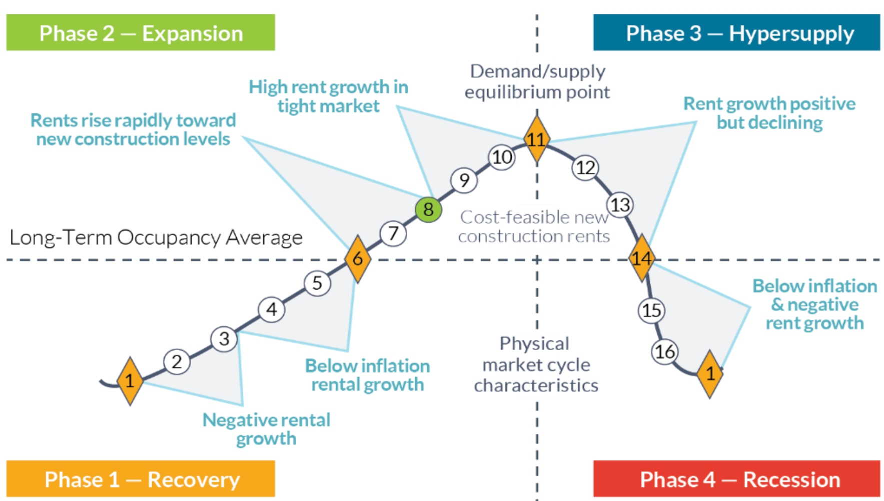
Market Cycle Analysis — Explanation

Supply and demand interaction is important to understand. Starting in Recovery Phase I at the bottom of a cycle (see chart below), the marketplace is in a state of oversupply from either previous new construction or negative demand growth. At this bottom point, occupancy is at its trough. Typically, the market bottom occurs when the excess construction from the previous cycle stops. As the cycle bottom is passed, demand growth begins to slowly absorb the existing oversupply and supply growth is nonexistent or very low. As excess space is absorbed, vacancy rates fall, allowing rental rates in the market to stabilize and even begin to increase. As this recovery phase continues, positive expectations about the market allow landlords to increase rents at a slow pace (typically at or below inflation). Eventually, each local market reaches its ***long-term occupancy average,*** whereby rental ***growth is equal to inflation***.

In Expansion Phase II, demand growth continues at increasing levels, creating a need for additional space. As vacancy rates fall below the ***long-term occupancy average***, signaling that supply is tightening in the marketplace, rents begin to rise rapidly until they reach a cost-feasible level that allows new construction to commence. In this period of tight supply, rapid rental growth can be experienced, which some observers call "rent spikes." (Some developers may also begin speculative construction in anticipation of cost-feasible rents if they are able to obtain financing). Once cost-feasible rents are achieved in the marketplace, demand growth is still ahead of supply growth — a lag in providing new space due to the time to construct. Long expansionary periods are possible and many historical real estate cycles show that the overall up-cycle is a slow, long-term uphill climb. As long as demand growth rates are higher than supply growth rates, vacancy rates should continue to fall. The cycle peak point is where demand and supply are growing at the same rate ***or equilibrium.*** Before equilibrium, demand grows faster than supply; after equilibrium, supply grows faster than demand.

Hypersupply Phase III of the real estate cycle commences after the peak / equilibrium point #11 — where demand growth equals supply growth. Most real estate participants do not recognize this peak / equilibrium's passing, as occupancy rates are at their highest and well above long-term averages, a strong and tight market. During Phase III, supply growth is higher than demand growth (hypersupply), causing vacancy rates to rise back toward the long-term occupancy average. While there is no painful oversupply during this period, new supply completions compete for tenants in the marketplace. As more space is delivered to the market, rental growth slows. Eventually, market participants realize that the market has turned down and commitments to new construction should slow or stop. If new supply grows faster than demand once the long-term occupancy average is passed, the market falls into Phase IV.

Recession Phase IV begins as the market moves past the long-term occupancy average with high supply growth and low or negative demand growth. The extent of the market down-cycle is determined by the difference (excess) between the market supply growth and demand growth. Massive oversupply, coupled with negative demand growth (that started when the market passed through long-term occupancy average in 1984), sent most U.S. office markets into the largest down-cycle ever experienced. During Phase IV, landlords realize that they could quickly lose market share if their rental rates are not competitive. As a result, they then lower rents to capture tenants, even if only to cover their buildings' fixed expenses. Market liquidity is also low or nonexistent in this phase, as the bid–ask spread in property prices is too wide. The cycle eventually reaches bottom as new construction and completions cease, or as demand growth turns up and begins to grow at rates higher than that of new supply added to the marketplace.



Source: Mueller, Real Estate Finance, 1996

This research currently monitors five property types in 54 major markets. We gather data from numerous sources to evaluate and forecast market movements. The market cycle model we developed looks at the interaction of supply and demand to estimate future vacancy and rental rates. Our individual market models are combined to create a national average model for all U.S. markets. This model examines the current cycle locations for each property type and can be used for asset allocation and acquisition decisions.

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