# Stewart Financial Advisory Services

## Commercial Economic Summary, 2Q25

By Jeff Lanier, Head of Commercial Finance

The great existential philosophers Calvin and his tiger Hobbes of the eponymously named comic series once said,

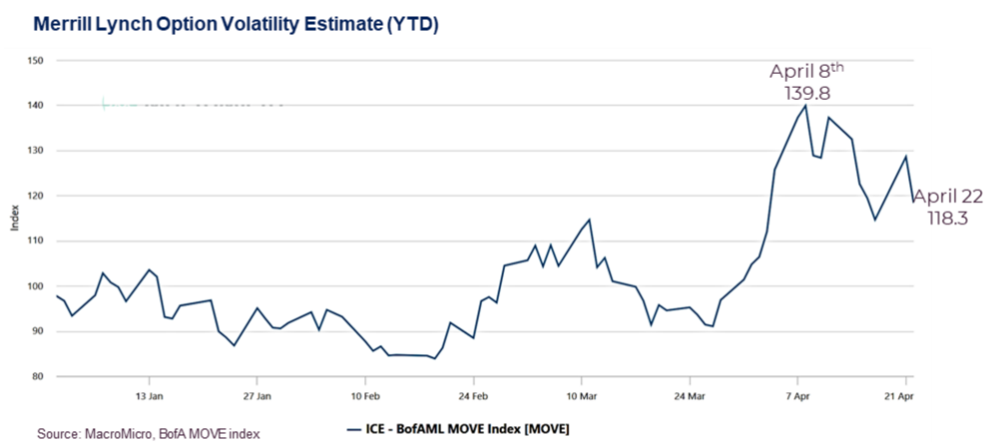
Calvin: "I thrive on uncertainty. Predictability is boring."
Hobbes: "You thrive on sugar and eat cereal for dinner three nights in a row."
Calvin: "That's called consistency."[i]

I think Wall Street would prefer consistency to uncertainty, but the latter is the environment in which we find ourselves. The last 12 weeks (and three in April) of macroeconomic development have been dynamic to say the least. Tariffs have been announced, implemented, pulled back, paused, and adjusted – all with a dizzying effect on the 10-year United States Treasury rate (not to mention the equities market). There has been a pop in the 10-year treasury rate each time a new tariff announcement is made, followed by a drop as markets hear of possible reversals or fear recession. The Federal Reserve's Beige book, which summarizes current economic conditions across the 12 Federal Reserve districts eight times a year, mentions "uncertainty" 80 times. That's a lot.

The current tariff war may prove to be a temporary 'Shakespearean sideshow' or a new longer-term approach to global trade. Either way, in the short term, it is disruptive – and interest rate risk is palpable.

The Bank of America MOVE Index — a gauge of Treasury market volatility (or said differently, a proxy for how uncertain banks are about future interest rates) — is now extremely elevated. Historically, a range of 50–70 is considered normal. As of April 16th 2025, the index stood at 132.5, reflecting how erratic policy signals have deeply unsettled rate expectations.

### Interest Rate Uncertainty Remains Elevated; Banks Continue to Build in a Buffer



This surge in volatility has direct implications for our commercial title businesses. Elevated interest rate uncertainty leads to wider lending spreads and a more cautious stance among commercial lenders—driving up borrowing costs, tightening access to capital across asset classes, and delaying transaction timelines as lenders and investors wait for greater clarity. We may see deals pushed out because of the interest rate uncertainty.

This elevated rate volatility has widened the spread. As of April 24th, the yield on the 10-year U.S. Treasury stood at 4.39%, while BBB- rated CMBS yielded 5.63%, resulting in a yield spread of 1.24 percentage points raising borrowing costs and cooling investor appetite across key commercial real estate sectors. While this spread is narrower than the risk-adjusted credit spreads often cited in trading markets, it provides a clear and consistent measure of how rate uncertainty is influencing borrowing costs in the commercial real estate sector.

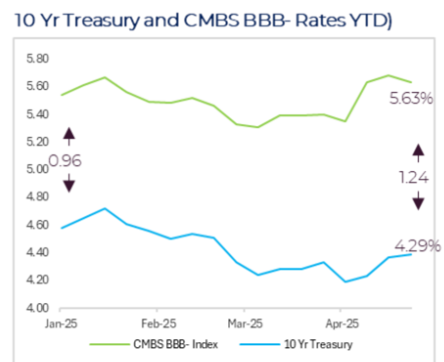




Chart by author
Source: Federal Reserve Economic Data (FRED)

In addition, CMBS (Commercial Mortgage-Backed Securities) issuance slowed considerably in Q1 2025 compared to the same period last year, down approximately 28% year-over-year. Investor appetite remains subdued amid widening spreads and persistent rate volatility. While AAA-rated tranches are still finding placement, mezzanine and non-investment grade paper has faced sharp pricing challenges, contributing to tighter deal flow. Lenders are increasing debt service coverage requirements, and many borrowers are now facing refinancing gaps, particularly in the office and hospitality sectors.

Across the broader capital markets, traditional lenders—banks and insurance companies—have grown more selective, preferring stabilized assets in core markets. Meanwhile, private capital and debt funds have stepped in to fill the void, albeit with higher return hurdles. Bridge lending remains active but is frequently tied to significant interest reserves and enhanced collateral requirements. Given this environment, underwriting timelines have lengthened, and title orders have shown episodic rather than sustained momentum. It's been a bumpy 1Q25 and likely the same in 2Q25.

**What we're seeing now may well be what we're stuck with.** With the first quarter now behind us, hopes for clarity and certainty from a macroeconomic and policy standpoint remain wanting. As a result, those of us in the title business might find ourselves back where we started at the beginning of the quarter: facing elevated rates, where any downward movement in rates triggers quick pops in activity, a pattern that may well define 2025.

It would be remiss of me not to point out that the scale and scope of the April 2nd tariff announcement and the rapid implementation through April 9th were more sweeping than expected and more than the market could bear. With fears of recession (and even depression) due to the twin threats of higher inflation and slower growth, the equities market dropped 12 percent before the reciprocal tariffs were officially paused.

At the same time, initially there was a flight to safety: the 10-year Treasury rate dropped to nearly 4.0%; however, by Friday there had been an unusual bond market selloff which sparked greater concern. The 10-year yield surged from 4.0% to 4.5% in just one week—a dramatic move by any bond market standard. While both markets have recovered somewhat, a sense lingers that some degree of reputational damage may have been done to the perceived trustworthiness of U.S. policy, and by extension, its currency. More than likely, this is a brief stumble and an anomalous week; the U.S. continues to be the deepest, most stable market worldwide. But the possible reputational damage appears to be on the global radar, nonetheless.

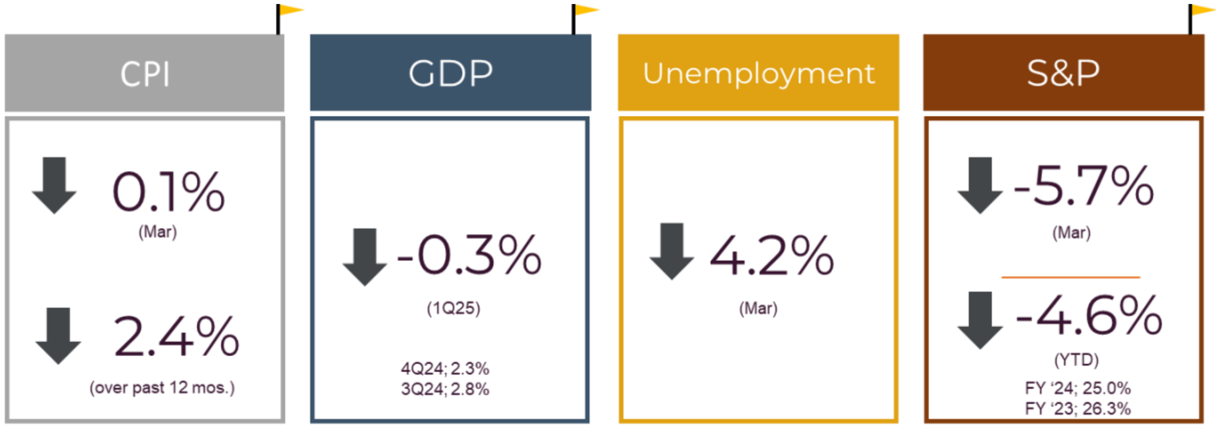
While flight-to-safety dynamics traditionally favor Treasuries, certain sectors of commercial real estate—particularly core industrial, multifamily, and well-leased retail—have increasingly become alternative safe havens for capital. For investors seeking capital preservation and durable cash flow, these sectors are increasingly viewed as defensive allocations amid policy-driven volatility. With that in mind, if the market does soften, signs of which are emerging but still seem avoidable, the commercial real estate could benefit to some extent.

As for the data, the annual inflation rate for the U. S. is now **2.4% (as of the April 10th report)**, a welcome decrease of 0.1% after rising 0.2% in February, moving us back towards the target 2% territory. However, in his recent remarks, Fed Chairman Jerome Powell indicated the Fed remains in wait-and-see mode to understand how tariffs and other economic policies of the administration play out, with concern inflation will pick up once again.

As mentioned, the **10-year Treasury rate** is **4.41%** as of April 22nd 2025. The rate continues to remain high based on a five-year historical average of 2.63%, (although, the 10-year Treasury rate's historical average since 1962 is 5.85%). The AAA US Corporate Index Effective Yield is 4.79 and the BBB- is 5.44. From a residential perspective, the 30-year mortgage stands at 6.81% as of Freddie Mac's April 24th release (MBA's weekly report was 7.09%), creating a ~2.4% spread to mortgage rates, a spread that is typically 1.5% to 1.7%. The rate had dropped somewhat since the beginning of January, from a weekly average of 6.93% to 6.62%; however, since April 2nd 2025, the volatility in the market has returned to heightened levels.

In addition to interest rate uncertainty, the national debt level at 121% as of 1Q 2025 is elevating the 10-year Treasury rate, particularly in light of potential tax cuts with undefined revenue-generating countermeasures. Remember, the 10-year Treasury rate reflects inflation risk and future growth, both of which are impacted by tariffs and potentially increasing national debt.

From a macroeconomic perspective, there are a few 'yellow flags' on the horizon. GDP growth shrank 0.3% in 1Q 2025 compared to the 4Q 2024 annual growth rate increase of 2.4%. Unemployment increased in March to 4.2% from the prior month's 4.1%, which, although an increase, is still a labor market in solid condition, described by Powell as near maximum employment[ii]. However, the Fed will likely continue to monitor unemployment levels in hopes of not being caught between rising inflation (from price increases, not consumer spending) and a rising unemployment rate as the economy potentially slows.[iii] The financial markets are expecting two quarter-point rate cuts by the end of the year, starting in June, which, true to form, may be overly optimistic, unless the unemployment level creates greater concern than potential inflation. The S&P has declined (4.6%) year-to-date after posting two years of strong returns; 25% in 2024 and 28.3% in 2023.



Arrow represents trend from prior period/report

With this economic backdrop, it appears the economy has decent fundamentals but is faltering given broader global market concerns. Powell said, "Despite heightened uncertainty and downside risks, the U.S. economy is still in a solid position [but] the data in hand so far suggest that growth has slowed in the first quarter from last year's solid pace."[iv] The question whether the Fed will pause a moment and monitor the data for a possible uptick in inflation or continue with rate cuts has been answered. It is clearly in a 'wait and see' mode with all eyes on the impact of tariffs and on how long it takes for the impact to pass through to consumer prices.

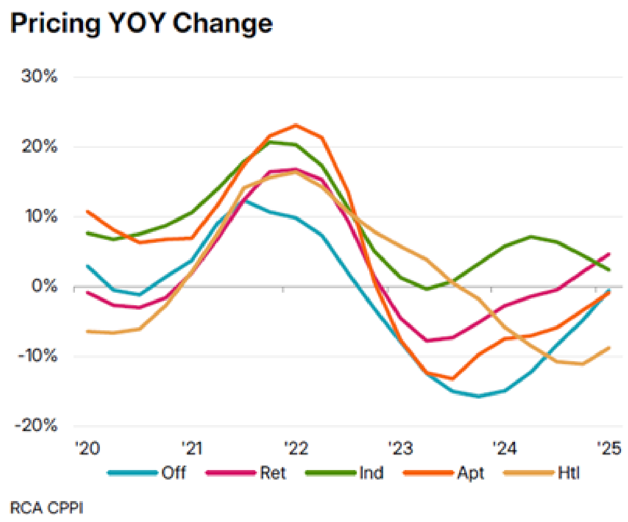
We might expect the Q2 2025 to materialize like the first, with a continued back-and-forth on tariff policy and negotiations, creating a level of uncertainty and a choppy but opportunistic commercial market.

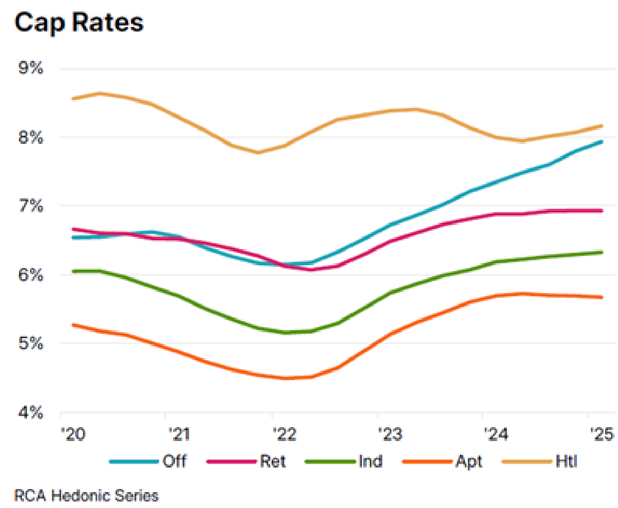
## Cap Rates and Valuation Compression

Against this economic backdrop, cap rates have remained relatively stable—though sector-specific dynamics are starting to create notable divergence. Cap rates remained relatively flat in Q1, though directional pressure varies by asset class. Industrial and data center assets continue to command premium pricing, with cap rates averaging 4.9%–5.2%, while office assets have seen significant expansion, now averaging 6.8%–7.4% in many secondary markets. Retail cap rates are stabilizing around 6.1%, with strong demand for well-located strip centers and single-tenant net lease deals in high-income submarkets.

Valuations remain difficult to pinpoint in asset classes like office, where leasing fundamentals are challenged, and long-term use-case assumptions are in flux. Appraisal variance continues to affect deal flow and title production timelines, particularly for repositioning or redevelopment projects. The rebound into 2025 might have provided a boost to sentiment for the year were it not for the current turmoil on tariffs and trade.

### Pricing Pressure and Investment Uncertainty Is Impacting CRE deals




Source: MSCI Capital Trends Report, U.S. Big Picture. 1Q25

## Asset Class Performance Snapshot

**Office:** Remains the sector under the most pressure. Vacancy rates are climbing in major metros (e.g., San Francisco at 27%, Houston at 23%), with limited leasing activity outside of Class A properties. Title activity in office has slowed, and distressed assets are beginning to reprice.

**Industrial:** Still a bright spot. Although absorption has slowed from pandemic-era highs, demand for logistics and warehouse space remains elevated, especially in Sunbelt markets. Construction continues, albeit more cautiously, with developers focusing on tenant pre-commitments.

**Retail:** Holding steady. Consumer strength in Q1 helped maintain foot traffic and rent collections. Investors continue to pursue grocery-anchored and lifestyle centers. Cap rates have stabilized, and title volume has modestly improved YoY.

**Multifamily:** Moderate rent growth persists, though new supply in markets like Austin, Phoenix, and Nashville is beginning to weigh on fundamentals. Capital for new projects is limited, but demand remains stable.

**Energy/Infrastructure:** Although data centers posted a large double-digit decline in volume for the first quarter of 2025, in select regions (e.g., Texas, New Mexico, Colorado), energy-related real estate will continued to be a quiet outperformer as it has been. Increased federal infrastructure spending and strong private equity interest in logistics-related energy assets are creating title opportunities tied to land assembly and mineral rights.

Energy-related real estate and data centers continue to outperform traditional asset classes, driven by long-term policy tailwinds and surging infrastructure demand. Federal legislation such as the Inflation Reduction Act and Infrastructure Investment and Jobs Act is catalyzing investment in utility-scale renewables, battery storage, and transmission networks—particularly in energy-abundant regions like Texas and New Mexico. Simultaneously, hyperscale data center expansion, fueled by AI and cloud computing, is creating sustained demand for power-adjacent land in both core and emerging markets. These sectors offer durable, income-generating opportunities and are increasingly viewed as recession-resilient. For commercial title professionals, these transactions present complex entitlements, utility easements, and mineral rights considerations—highlighting the need for agile, specialized support in a rapidly evolving landscape.

### Brief Comment on Residential Activity

We know to some extent rooftops drive commercial and residential overall performance is a leading indicator for Self-Storage, all Multifamily, Affordable, Senior and Student Housing, BFR/BTR, homebuilding and retail. Residential real estate remains constrained by elevated mortgage rates, limited inventory, and persistent macroeconomic uncertainty. Fannie Mae and MBA continue to see the 30-year mortgage interest rates above 6 percent in 2025 with slight relief at the back end of the year, while MBA suggests a 7% rate in 2Q25.

March inventory levels remained low but improved at a 4.2-month supply from last month's 3.8 months but better than last year's March level of 3.5 months. However, single-family home sales have hit a new, historic low, to a seasonally adjusted annual rate of **4.02 million in March, down 5.9 percent from 4.27 million in February and down 2.4 percent from 2024.** The median existing single-family home price continues to increase, to **$403,700 in March 2025**, up 2.7% from March 2023 (and a 1.7% increase from February 2025).

As for sales volume, Fannie Mae and MBA residential real estate forecasts for 2025 have come down from their fall forecast of 9.0% but remain a slight improvement from 2024 with an average 3.8% year-over-year growth. If the 10-year Treasury rate moves downward and approaches the low 4% range in the second and third quarters, we could see lower 30-year mortgage rates and regain some year-over-year growth greater than 3.8% percent, especially if the ReFi market gets relief. How the next 90 days play out from a macroeconomic and policy standpoint will be important.

## Summary View

We entered the first quarter expecting uncertainty —but also expecting it would be tempered by greater clarity around tariff policy and its impact on the economy. That clarity, however, has yet to materialize. As a result, the broader market continues to operate under a heightened level of uncertainty. This uncertainty is keeping the spreads wide.

Clients in commercial title—developers, institutional investors, private equity, and insurers—should continue to expect a choppy but opportunistic market. Volatility in interest rates, inconsistent lending appetite, and ongoing policy ambiguity around trade and tax treatment are keeping the market cautious. However, asset repricing may create acquisition opportunities for well-capitalized buyers, particularly in distressed or transitional assets.

Cap rates are expected to remain elevated in most sectors through the end of the year, with little relief unless the 10-year Treasury yield retreats below 4%. Transaction volumes are likely to remain lumpy, driven more by financing windows and opportunistic buyers than broad-based recovery. In this environment, title professionals must remain agile, aligning closely with lenders and deal teams to ensure readiness when opportunities emerge.

What remains clear is that demand hasn't disappeared—it's simply waiting, ready to move the moment the opportunity presents itself.

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[i] Paraphrased from cartoonist Bill Watterson

ii Reuters, "Powell says Fed remains in wait-and-see mode; markets processing policy shifts". April 16, 2025.

iii Reuters, "Powell says Fed remains in wait-and-see mode; markets processing policy shifts". April 16, 2025.

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