

SUMMER
2025

THE GROWING DISCONNECT:
Buyers and Sellers Must Agree
On Prices to Get Deals Done

It takes two to tango. Buyers and sellers faced growing disagreement in the second quarter, with deal volume falling in April and May and early indicators of trouble for June. How long the disconnect lasts and how much further deal volume has to fall is likely to vary by property sector.



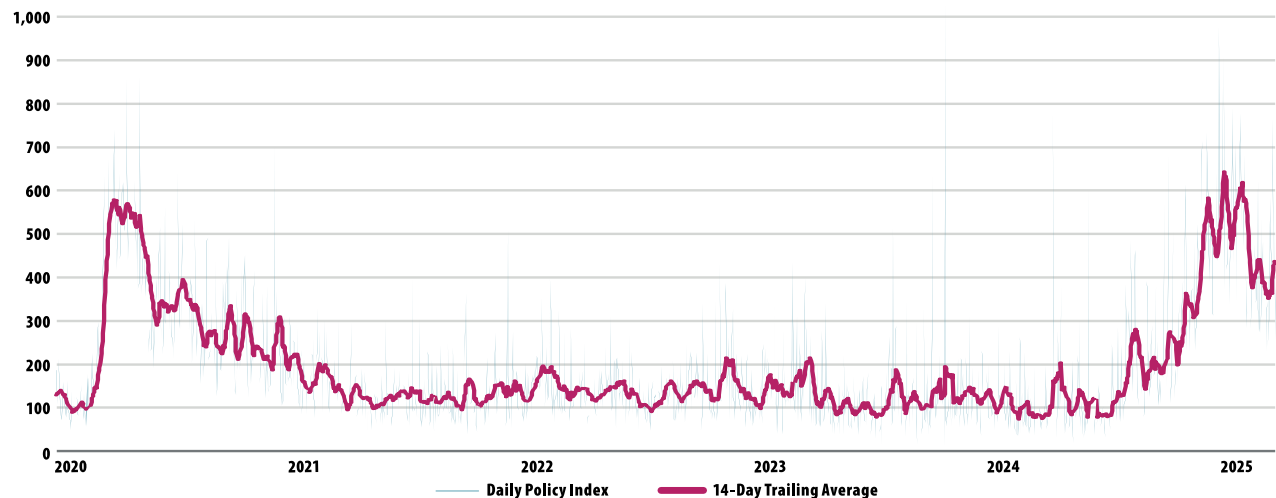
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Everything was looking up in late 2024. Interest rates were stabilizing as inflation moderated, and declines in commercial real estate prices looked to be running the course that started in 2022 when cap rates increased. The mantra “stay alive until 2025” that echoed across every commercial real estate conference over the past three years seemed to be playing out, with growing optimism around commercial real estate returns.

And then tariffs happened. The overall impact of tariffs is open to debate, and the politics around them is tricky. If you think I am going to jump into that briar patch, you have another thing coming. An impact that is easier to identify, however, is that the lack of clarity around future policy trends has introduced new risks to the economic landscape. New and growing risks should change how players in the market underwrite deals.

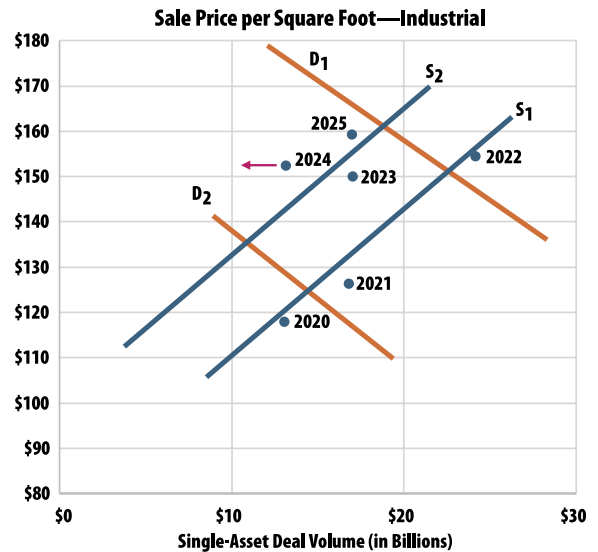
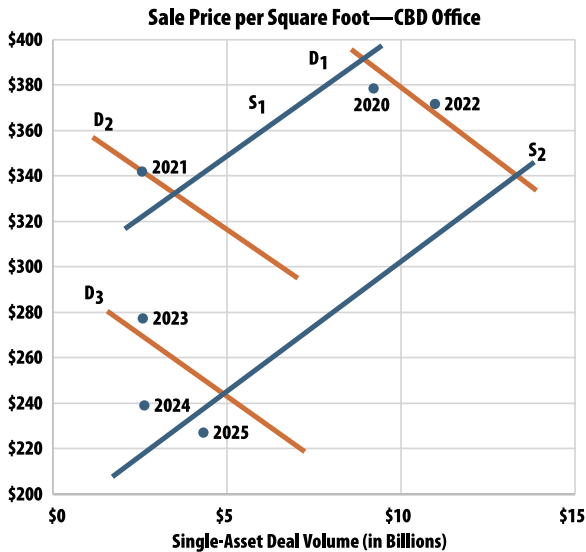
Policyuncertainty.com generates an index highlighting the uncertainty that surrounds economic policy. It is created from a language model that reads articles in the business press and ranks each for certain key words indicative of the uncertainty ahead. In 2021, this index retreated to a range bouncing between 100 and 200, a level similar to that seen before the COVID-19 pandemic. As discussions about tariffs started early in 2025, the index surged, with the 14-day trailing average climbing above the level seen at the height of the pandemic (Exhibit 1).

Exhibit 1: Policy Uncertainty



Source: Policyuncertainty.com

Exhibit 2: Supply-and-Demand Dynamics for CBD Offices and Industrial Properties



Source: MSCI Real Capital Analytics Platform

It is challenging for investors to decide on an investment when the landscape ahead is not clear. How an investor reacts to an uncertain environment depends in part on the role of the investor. Buyers and sellers react differently to new information that throws assumptions about the future into question. To show this difference in reactions, simple concepts you were likely introduced to in Microeconomics 101 highlight the disconnect.

Supply and Demand

Microeconomics classes might have been traumatizing, but I am just going to go through some simple aspects of human behavior that should not lead to nightmares about being unprepared for the final Microeconomics exam.

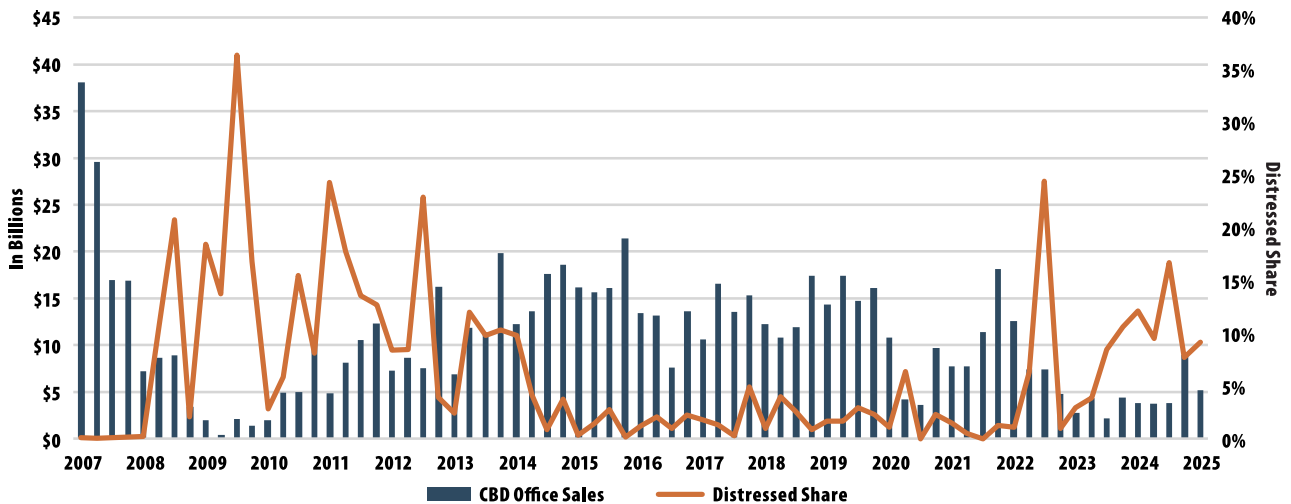
The current owner of an asset sets expectations on pricing using a backward-looking process. An owner who paid \$800 per square foot for an asset is going to be hesitant to sell if current market comparables suggest a \$600-per-square-foot price. For an owner, embedded prices and expectations for the future matter. It is better to hold on and wait for a recovery in the market and sell then to potentially realize a gain rather than locking in a loss today. An owner who expects some sort of price recovery may hang on—unless some issue forces a sale.

As the price of an office building increases, the owner is more disposed to selling. The owner who paid \$800 per square foot for an asset is likely to be a seller if the comparables suggest \$1,000 per square foot. This behavioral issue leads to what is known as an upward-sloping supply curve, as highlighted in Exhibit 2. Each dot in the charts represents an intersection of the supply preference of current owners as well as the demand preference of potential buyers. We see only the intersection, not actual lines, so the supply-and-demand representations are only illustrative examples.

Supply-and-Demand Dynamics for CBD Offices and Industrial Properties

For central business district (CBD) offices, prices nationally stood at \$378 per square foot in the first quarter of 2000, a price level that saw individual asset deal volume of \$9.2 billion for the quarter. This analysis focuses on individual asset sales to strip out the one-off impact of big merger and acquisition types of transactions. The \$4.3 billion in such sales that was posted in the first quarter of 2005 came through at a much lower price level—\$227 per square foot—and reflects a downward shift in that idealized supply curve from position S1 to S2.

Exhibit 3: CBD Office Sales and Share Tied Up in Distressed Activity



Source: MSCI Real Capital Analytics Platform

Buyers prefer a different relationship between price and quantity sold than sellers. An office property listed for sale at \$300 per square foot will get fewer interested buyers than a listing at \$200, assuming no quality differences in the assets or expectations for the market. The demand curve is downward sloping, with more demand as prices fall. Thinking about how each of these curves moved to generate the unique intersection tells us something about shifting investor preferences for each subtype.

All these descriptions of moves in supply and demand for investment assets focused on first-quarter activity because that is the data available relative to the deadline for the *PREA Quarterly*. The shifts in uncertainty in 2025 have moved faster than commercial property markets can respond.

The industrial sector saw deal volume and pricing fall in both April and May, with early data for June suggesting three strikes for the quarter. Prices have started to fall in the industrial sector as well, though only at a minimal pace. The move relative to 2024 will look something like the red arrow in the industrial plot in Exhibit 2. This kind of move back on quantity trends with relatively flat pricing suggests a shift in both the demand side and the supply side of the market. In other

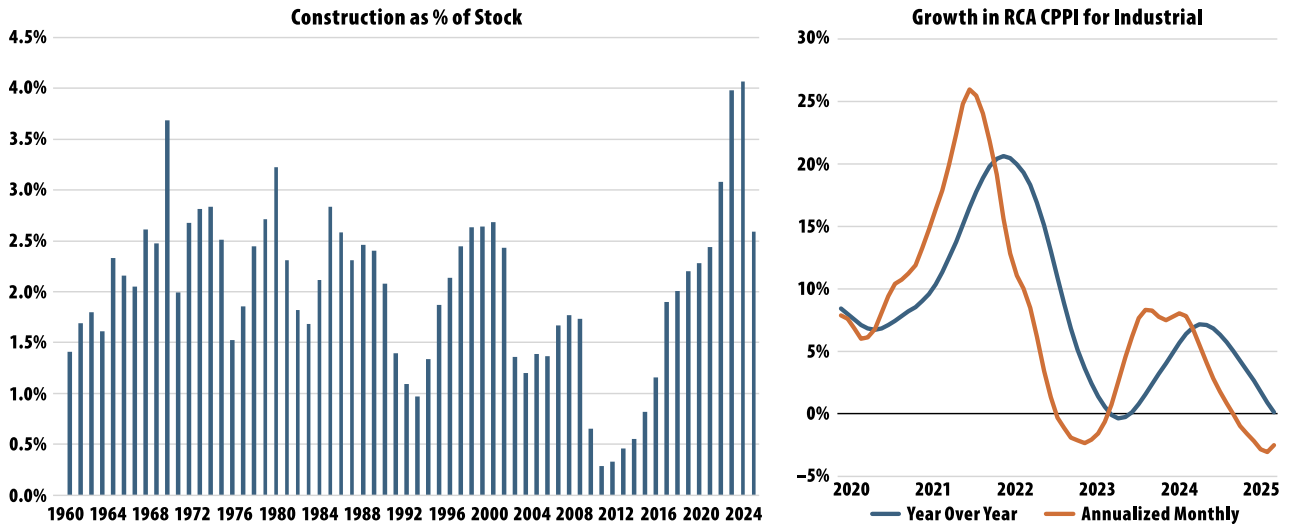
words, both buyers and sellers are pulling back from the market. Sellers are waiting to see if the current turmoil fades, and buyers are waiting to see more blood in the water.

By contrast, preliminary office data for the second quarter suggests little difference from the first quarter trends shown in Exhibit 2. The sale of individual CBD offices climbed in both April and May, with price declines moderating along the way. The preliminary data for June already shows a climb, and these figures typically revise upward in the course of information gathering. Sellers have started to capitulate, with the revealed supply preferences moving down from the S1 to the S2 position on the chart. This capitulation on the part of sellers is driven in part by the information coming through on distressed assets.

The Composition of the Deal Market for CBD Offices

The products selling in the CBD office market are changing, with a higher share of distressed assets, suggesting capitulation on the part of current owners (Exhibit 3). The sale of distressed CBD office assets trended at a minimal share of the market in the five years before the pandemic, with such sales accounting for an average of only 1.8% of all sales activity each quarter.

Exhibit 4: Industrial Pricing Was Already Slipping on the Heels of Record High Supply Growth



Source: MSCI Real Capital Analytics Platform

Over the four quarters to the first quarter of 2025, however, distressed CBD office sales accounted for 9.9% of all sale activity.

The high share of distressed CBD office sales relative to the past decade was not the only driver of growth in asset sales in recent quarters. Stripping out the distressed sales, even transactions involving stabilized assets have been growing. The information on the distressed sales, though, does help inform the market about what is possible.

CBD Office Sales and Share Tied up in Distressed Activity

The increase in distressed CBD office sales was a long time coming. The initial shock from the pandemic in 2020 led to only intermittent spikes in distressed asset sales. Timing issues were at play for specific assets facing loan maturities. Liquidity for CBD office sales was falling generally in this time frame, however, as both buyers and sellers reevaluated conditions. Everything started to move into 2023 as the interest rate shock piled on top of the pandemic demand shock, pushing more distress into the market and also pushing current owners to finally capitulate. The reevaluation of the industrial market is happening faster.

Tariffs Are Not the Only Thing Impacting Industrial

It is a mistake to lay all the changes underway in the industrial market at the feet of tariffs. Yes, the added uncertainty in the sector is impacting deal volume as both buyers and sellers wait to see what happens next. The industrial deal market moves faster than the CBD office market, however.

The structure of every commercial property market varies a bit in terms of customs and practices. Over the past couple of years, industrial sales brokers would have told buyers that if they could not commit to closing within 30 days, they would not be at the top of the bidding pool.

This short timeline is not just a story of the recent frenzy for investment in industrial property. Each industrial property is unique, but the market is more homogeneous than, say, the CBD office market. With more homogeneity across buildings, fewer unique conditions exist to underwrite for every transaction. With faster underwriting, changes in the market can be incorporated into the bidding process faster than in sectors such as the CBD office market. Industrial property prices have been reacting to recent shocks since late last year.



Price growth for industrial in May, as measured by the RCA CPPI, climbed only 0.1% from a year ago, well below the rate of inflation. The downward momentum for industrial prices started late in 2024, even before tariffs were announced. Annualizing the monthly change, the industrial market moved into a death cross situation in November of 2024, when the high frequency measure of price growth was falling below the year-over-year trend (Exhibit 4).

Why the change ahead of the tariff announcements? Part of the issue is that as investors became excited about the sector and drove prices to record highs, developers were inspired to produce more space. Development of industrial space as a percentage of the current stock of space in the market hit an average of 4% in 2022 and 2023.

Looking back to the 1960s, the supply of industrial space had never grown that quickly. To put these figures into context: if all this industrial space had come to the market empty, it would have pushed industrial availability rates up a total of 800 basis points in 2022 and 2023. Availability rates did not grow that quickly, however, because tenant demand was also rising at a robust pace. Broker reports started showing increasing availability rates for industrial properties, and development started to pull back in 2024.

Expectations Are Changing

Optimism in the investment market for commercial real estate was growing in 2024 but has faded into 2025 as growing policy uncertainty has forced investors to reevaluate how they underwrite investments. The recent changes in the investment markets for CBD office and industrial properties highlight the impermanent nature of “hot” markets. CBD office markets were hot a decade ago but slipped in the aftermath of the COVID-19 pandemic. Evidence suggests that buyers and sellers are finally starting to see eye to eye on underwriting assumptions for the sector, and deal volume is growing. The industrial sector is just at the start of this process. ■

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