

Commercial Real Estate Investors Balance Rate Relief With Cost Pressures

CPI edges higher, Fed poised to ease. Inflation picked up in August, led by higher food and energy costs, while tariffs continued to gradually raise prices across other categories. Headline CPI advanced 0.4 percent month over month — the sharpest rise since January — lifting the annual rate to 2.9 percent. Core CPI increased 0.3 percent on the month and 3.1 percent year over year, underscoring the persistence of underlying cost pressures. At the same time, recent downward payroll revisions point to a softer labor market. With inflation still relatively contained, the Federal Reserve is expected to cut rates at its Sept. 17 meeting. More accommodative monetary policy is expected to provide tailwinds for commercial real estate investment activity, though elevated prices and weaker job growth could strain household budgets and affect the performance of some property sectors.

Rising costs, slower spending test retailers. Hiring over the past three months has slowed to its weakest pace since the pandemic, raising the risk of softer consumer spending. Lower-income households pulling back on big-ticket discretionary items may limit retailers' ability to raise prices to match higher import costs. In the latest CPI report, categories such as consumer electronics and sporting equipment showed stable pricing, while other tariff-affected goods such as household furnishings and apparel recorded modest increases, indicating limited pass-through so far. Large retailers with strong balance sheets and established supplier relationships are likely to be better positioned to absorb higher tariff costs than independent operators with limited financial resources, potentially putting greater strain on inline tenants at neighborhood and strip centers.

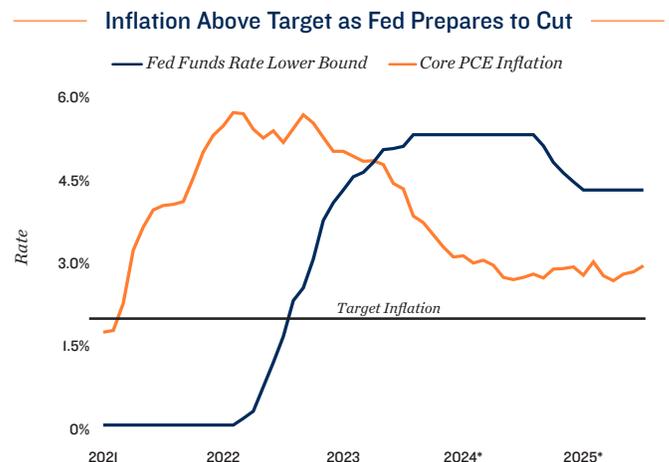
E-Commerce growth sustains last-mile demand. Online spending increased 8.0 percent year over year in July, underscoring resilient e-commerce growth that should continue to uphold tenant demand for last-mile delivery facilities. Warehouses under 20,000 square feet reported vacancy near 3 percent in June, with second-quarter leasing volume reaching its highest level since 2021. For investors focused on small-bay industrial assets, triple-net leases will be critical in managing expenses, particularly as utility costs rose 6 percent year over year in August. Meanwhile, larger warehouses recorded vacancy above 7 percent. Firms have grown more cautious about big-box commitments, underscoring investor emphasis on high-credit tenants.

Increasing car prices reinforce repair needs. New and used vehicle prices each rose in August, straining affordability as the labor market loses momentum. The average vehicle on the road is now 14.5 years old — the highest on record — which means more households are holding onto cars longer, reinforcing demand for auto repair and parts providers. This is expected to help sector fundamentals, with vacancy among auto repair shops holding below 2 percent as of August. Leasing activity has also stayed steady, totaling more than 4 million square feet over the 12 months ended in June, driven by expanding tenants. These include O'Reilly Auto Parts, which plans to open 200 new stores in 2025, and Advance Auto Parts, which is adding 30 locations.

Rate cuts boosts CRE investment outlook. Still-moderate inflation and weakening job growth is expected to push the Federal Reserve to lower the overnight rate at its next meeting, potentially easing pressure on long-term yields and spurring CRE investment. Reduced funding costs for banks could encourage more lending, particularly for high-quality, stabilized multifamily, retail and industrial assets. Further cuts will likely depend on continued labor market softness, however, as rising inflation could still push long-term rates higher.

2.9% Increase in Headline CPI Year Over Year

3.1% Increase in Core CPI Year Over Year



* Through July

Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CME Group; CoStar Group, Inc.; Federal Reserve; National Travel and Tourism Office; RealPage, Inc.