

# What to watch in 2025: Look for cap rates to peak

Property market structure appears to be setting up for a topping process



Capitalization rates may be reaching a peak. (Getty Images)

By [Chad Littell](#)

CoStar Analytics

January 2, 2025 | 9:46 AM

Capitalization rates appear to be peaking, a situation that marks a critical turning point in the commercial real estate investment cycle. As a key metric for investors, cap rates measure the expected initial yield on a property before factoring in debt. Like bonds, cap rates move inversely with price: when yields rise, prices fall, and vice versa.

Historically, these inflection points have signaled the start of a new cycle, but they can be missed when pessimism clouds the property market's direction. The uncertainty associated with this environment can be uncomfortable, but if we look back at prior cycles, we can identify a set of conditions that came together the last time cap rates peaked.

Returning to the aftermath of the Great Recession, we find a repeating rhythm. Transaction volumes increased several quarters before rent growth hit its low point. This trough in rent growth often coincided with peak cap rates, which typically preceded peak vacancy rates by a few quarters. This sequencing played out consistently across most property types, with subtle differences in timing along the way.

## **Multifamily cap rates**

In the wake of the Great Recession, multifamily property sales bottomed in the first quarter of 2009 before vacancy and cap rates peaked concurrently a few quarters later. By late 2009, rent growth had also bottomed, and multifamily led all property types out of the downturn, marking the beginning of the next cycle.

Fast forward to the closing months of 2024, and a similar pattern is emerging. The year-over-year total of apartment sales turned positive in the second quarter, and we're now witnessing what looks to be the peak in vacancy between the end of 2024 and the first half of 2025. With cap rates expected to peak in the fourth quarter of 2024 alongside a trough in rent growth, multifamily once again seems to be the first property type to find its footing.

## **Industrial cap rates**

In the last cycle, industrial properties followed a similar trajectory as multifamily, with cap rates peaking in late 2009. Property sales bottomed out earlier that year, and rent growth hit its low point in the fourth quarter, the same as cap rates. As is the pattern for the industrial, office and retail property sectors, vacancy rates peaked about two quarters later.

Today, industrial properties appear to be retracing this path. Total industrial property sales turned positive in mid-2024, and cap rates are projected to peak in the first quarter of 2025. If the past is any guide, peak vacancy rates for industrial property may follow in the back half of 2025.

## **Office cap rates**

Office properties saw cap rates peak a quarter after total sales volume hit its low point in mid-2009, coinciding with the depths of rent growth. Peak vacancy rates followed, cresting in early 2010.

In 2024, office properties have surprised many by seeing increased sales volume in the third quarter compared to the prior year. This trend is expected to hold, and we anticipate peak cap rates and the trough in rent growth to occur by mid-2025, followed by peak vacancy rates in early 2026.

## **Retail cap rates**

Retail properties also mirrored the broader market trends, with retail property sales volume bottoming in early 2009 and cap rates, rent growth and vacancy rates all inflecting within a quarter or two of each other in late 2009 and early 2010.

Right on cue, retail property sales increased in the third quarter of 2024. If the pattern continues, cap rates are expected to peak in mid-2025, aligning with the trough in rent growth and peak vacancy rates in a similar timeframe.

## **Risks to the forecast**

As with any forecast, risks remain. One key factor to watch is the trajectory of Treasury bond yields. While the Federal Reserve began cutting policy rates in September 2024, longer-term borrowing costs tied to Treasury yields have continued to increase. Should yields move meaningfully higher — where the 10-year climbs between 4.5% and 5% and holds steady — the anticipated peak in cap rates could be delayed.

That said, there has been a notable shift among investors toward short-term, floating-rate debt since the third quarter. This financing strategy offers lower borrowing costs, prepayment flexibility, and downside security by purchasing interest rate protection, which could help mitigate some pressure from higher long-term yields.

## **More reason for optimism**

There are encouraging signs in the broader economy. As measured by the NFIB Business Optimism Index, small business optimism is at its highest since mid-2021. Hiring plans are also on the rise, with over 55% of small businesses reporting active hiring in November 2024. These signals suggest potential growth in future demand for commercial space, which could help stabilize vacancy rates and establish a floor for rent growth.

Cap rate peaks are a process, not a moment in time. Investors can start to stack layers of confidence about the market's direction by recognizing the environment most conducive to supporting this progression: first, transaction volumes improve; second, rent growth troughs at the same time cap rates peak; and third, we get confirmation of this new trend several quarters later as vacancy rates touch their peak. Multifamily is the only major property type where vacancy rates peak with cap rates instead of year-over-year rent growth, as seen in the other property types.

Remember, look for the condition set that fosters peak cap rates. It's never just one thing that moves markets.