

Navigating the Shift

2024 Capital Markets Review and 2025 Outlook for Commercial Real Estate

BWE





Year-in-Review

Leading up to January 2024, the Federal Reserve embarked on the most aggressive rate hiking cycle in a generation when it raised the fed funds rate an unprecedented eleven times beginning in March 2022. Under a year and a half later, the Fed made its final rate hike of the cycle, bringing the benchmark overnight lending rate to 5.25 – 5.50%. This range marked the highest level of interest rates in over 20 years. Fed policymakers, charged with achieving both price stability and maximum employment, steered bond markets through uncharted territory in a rabid attempt to curtail elevated inflation. They maintained this resolve by holding the fed funds rate constant through the beginning of 2024. It is through this lens that, with the benefit of hindsight, investors can assess the journey to the present rate-cutting cycle and contemplate the direction in which markets could travel in 2025.

The following synopsis captures a **chronological review of 2024's pivotal capital market themes** and will also provide an assessment of where markets are positioned going into the new year.

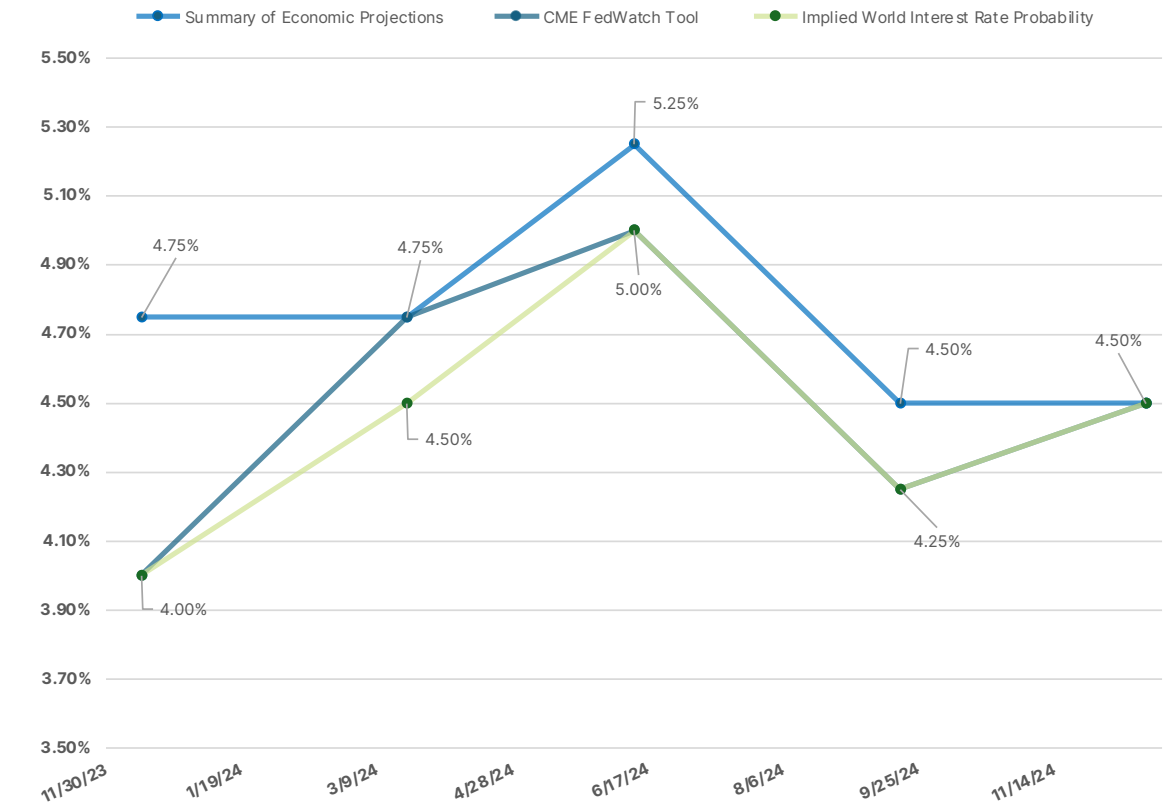
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Opening Projections fuel Market Dissonance

The beginning of 2024 embodied a stark divergence in economic expectations between the Federal Reserve and financial market participants. At the January 30-31 Federal Open Market Committee (FOMC) Meeting, policymakers voted to leave policy rates unchanged while acknowledging that monetary policy remains firmly in restrictive territory. Headline inflation, measured by the annualized change in the price index for Personal Consumption Expenditures (PCE), was then at 2.6%. Inflation had notably cooled from the post-COVID peaks, which reached as high as 7.2% on an annualized PCE basis in June 2022. However, Fed policymakers necessitated additional evidence to build confidence that inflation was truly moving down sustainably towards their 2.0% goal.

While the first FOMC Meeting of the year did not include a Summary of Economic Projections (SEP), the prior SEP, published in December 2023, included a “dot plot” forecast for the path of economic growth, inflation, unemployment, and the federal funds rate. **While policymakers had implicitly guided between two and three quarter-point rate cuts through 2024, investors and market pundits envisioned significantly more easing.** Throughout the month of January 2024, futures trading data suggested that approximately six quarter-point cuts were on the horizon for 2024. The notable divergence between the Federal Reserve and market participants would shift several times over the coming months.

Year-end Fed Funds Rate Projections in 2024



Sources: CME FedWatch Tool, Federal Reserve, and Bloomberg

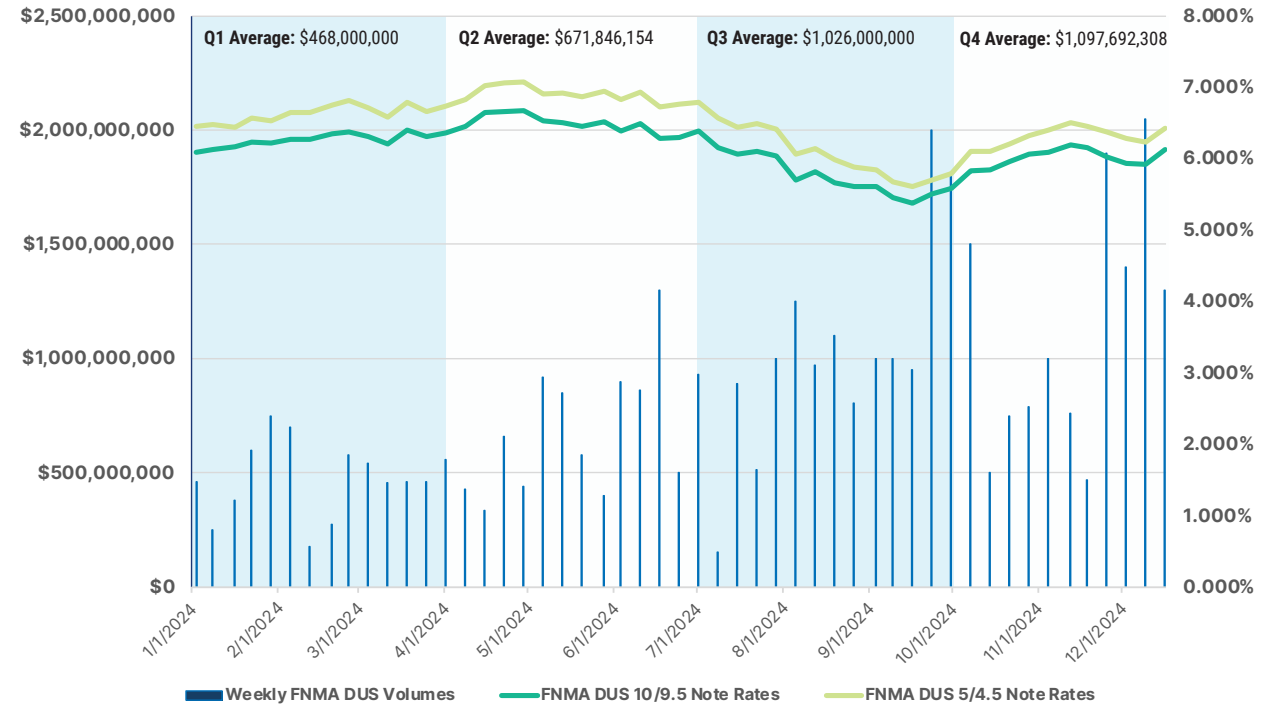
Early Market Woes

From a rate standpoint, the first quarter of 2024 was mired with challenging economic news for fixed-income markets. While economic growth remained resilient, inflationary pressures persisted. By mid-February, investors had already withdrawn their previous optimism for the amount and timing of Fed rate cuts and tempered their expectations to a more modest three to four quarter-point cuts by the end of the year. Policymakers addressed the shifting narrative in their FOMC Meeting Minutes, citing perceptions that disinflation was progressing more slowly than previously thought.

Regional banks, such as New York Community Bank, captured headlines on rising delinquency concerns within their commercial real estate portfolio, which had a chilling effect on investment activity across fixed-income asset classes. Agency CMBS trading activity, already facing the customary Q1 seasonal slowdown, was challenged as interest rates gradually rose. Fannie Mae DUS weekly rate lock volumes drugged along at a crawling pace as borrowers decidedly “held pat” with the prospect that lower rates were on the horizon. **The first quarter of 2024 averaged approximately \$468 million in Fannie Mae DUS rate lock volume per week, which was the lowest weekly average in a quarter since at least 2020.** While new issue volumes waned, investor spreads tightened as the marginal pool of end investors consumed the limited supply of Agency assets.

FNMA DUS Weekly Volumes vs. 5/4.5 & 10/9.5 Note Rates (2024)

2024 Average = \$825,038,462



Source: BWE and Active Agency CMBS Broker Dealers

Bond-Bearishness Rises, Don't Fight the Fed

An unexpectedly strong Nonfarm Payrolls report released in early April 2024 spooked the market and firmly changed sentiment for the number of Fed rate cuts to expect in 2024. Nonfarm Payrolls in March were the strongest of the year at 310,000 and reached the largest job gains since January 2023. The robust labor print caused investors to pay heed towards inflationary risks as hefty job gains indicated that the economy showed no signs of slowing. This was accompanied over the coming weeks by reports of the hottest annualized headline Consumer Price Index (CPI) inflation of the year at 3.5%, along with stronger-than-expected Retail Sales data.



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By the end of April, the market consensus had shifted towards only anticipating one to two quarter-point cuts for the remainder of the year. This sentiment was largely carried through May, though credit spreads continued to narrow largely due to a drought of new issuance Agency CMBS rate lock supply as Treasury yields lingered around their YTD peaks.

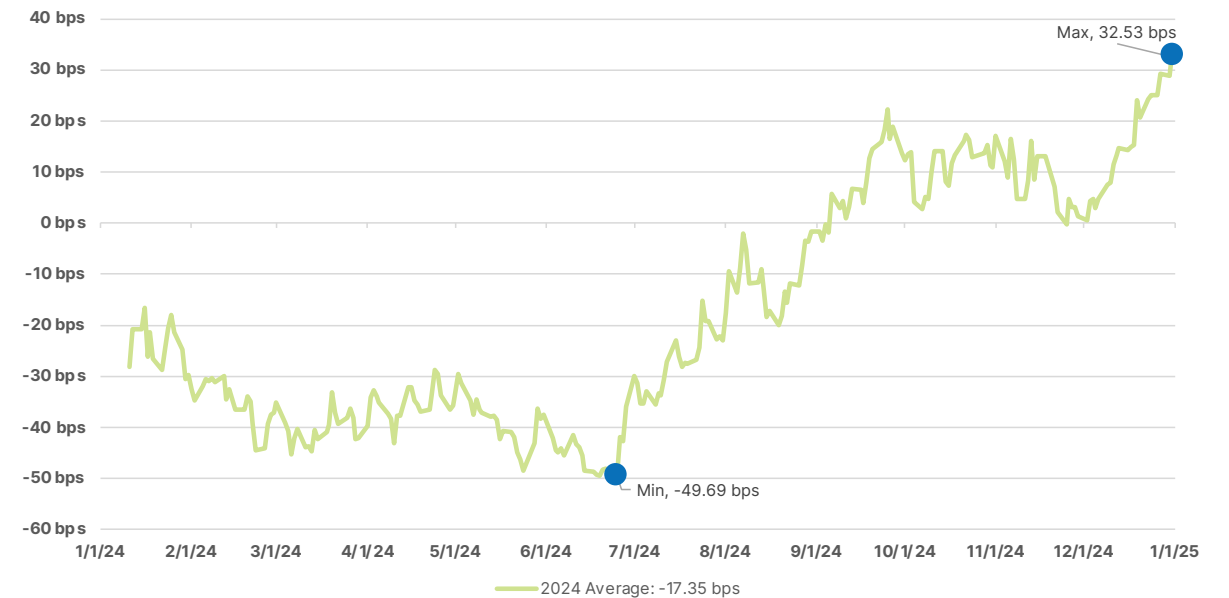
Political Tensions Stir Markets

Policymakers again voted to leave the fed funds rate unchanged at the June 11-12 FOMC Meeting. The accompanying SEP and “dot plot” projections for the fed funds rate arrived at a year-end median value of 5.125%, acknowledging that inflation had eased substantially from its peak, yet it remained obstinately too high as consumer spending remained resilient. The July 30-31 FOMC Meeting along with Fed Chair Jerome Powell’s commentary produced dovish undertones which hinted that a rate cut could be in sight, though proof of inflationary progress was still being established.

Inflationary angst had been a recurring theme in capital markets, and the stubborn pricing pressures were destined to be voiced in the year’s election cycle. The first presidential debate between President Joe Biden and challenger Donald Trump aired on June 27, and a throng of market pundits opined that the performance jeopardized the odds of a Biden victory. On July 13, Donald Trump survived an assassination attempt while speaking at a campaign rally in Pennsylvania, further rallying attention to the Presidential race. Facing increasing scrutiny from Democratic party leadership, Biden withdrew from the 2024 presidential race shortly thereafter and endorsed Vice President Kamala Harris. Campaign issues swirled around inflation, immigration, taxes, and trade policy, leading markets to speculate on possible shifts in fiscal policy and the direction of interest rates.

While competitive polling data prevented markets from drawing premature conclusions, one point was becoming clear: **U.S. fiscal policy was on the path of expansion, leading to the return of the “term premium” that investors long sought. This concept, which captures the difference in yields between short-term and long-term fixed-income securities, rebounded from a year-to-date low just before the debate and steadily marched in an upward trajectory as the election race continued.**

2-to-10 Yr - Treasury Yield Curve (2024 Closing Levels)



Source: BWE and Bloomberg

Jackson Hole and the First Cut

By early August 2024, the imminence of a rate cut at the September 17-18 FOMC Meeting was emerging. Although the decision was over a month away, investors anticipated that the Jackson Hole Economic Symposium in late August would provide a clearer indication of the Fed's next move. Chair Powell's keynote address provided this clarity, sharing the decisive signal that policymakers were prepared to pivot. "The time has come for policy to adjust...The direction of travel is clear, and the timing and pace of rate cuts will depend on incoming data, the evolving outlook, and the balance of risks," stated Powell.

At the time, Powell viewed that the upside risks to inflation were diminishing while the downside risks to employment were growing. The concerns were amplified by July labor data which revealed that the unemployment rate had reached 4.3%. While still low by historical standards, this print nevertheless touched its highest level since 2021, urging Powell to emphasize that "we do not seek or welcome further cooling in labor market conditions."

"The time has come for policy to adjust... The direction of travel is clear, and the timing and pace of rate cuts will depend on incoming data, the evolving outlook, and the balance of risks."

- Federal Reserve Chair Jerome Powell

This shift in the balance of risks cleared the path for the Fed to implement its long-awaited rate cut, though markets were divided on the magnitude of the initial decrease. While the Fed has traditionally opted to shift the fed funds rate in quarter-point increments, a series of influential financial editorials in mid-September quickly garnished market sentiment for considering a potential 50 basis point move.

The flurry of dovish support drew the 10-year Treasury to reach a year-to-date low of 3.595% on the day before the September FOMC Meeting. From the policymakers' perspective, the steady creep in unemployment was enough to warrant an aggressive policy response, which ultimately led the Fed to execute its first rate cut of the cycle in a dramatic 50-basis point fashion. However, the decision was not unanimous. Michelle Bowman cast the first dissenting vote by a Fed Governor since 2005, citing lingering inflationary risks.

Economic Indicators							
	1/1/2022*	7/1/2022*	1/1/2023*	7/1/2023*	1/1/2024*	7/1/2024*	12/31/24*
Consumer Price Index (CPI)	7.04%	9.06%	6.45%	2.97%	3.35%	2.90%	2.75%
Consumer Price Index - Core	5.45%	5.92%	5.71%	4.83%	3.93%	3.17%	3.32%
Consumer Price Index - Supercore	3.67%	5.44%	6.23%	4.00%	3.91%	4.47%	4.25%
Personal Consumption Expenditures (PCE) Deflator	6.18%	7.12%	5.44%	3.20%	2.62%	2.47%	2.44%
Personal Consumption Expenditures - Core Deflator	5.04%	5.04%	4.62%	4.28%	2.94%	2.58%	2.82%
Personal Consumption Expenditures - Supercore	5.25%	4.87%	4.85%	4.43%	3.34%	3.34%	3.51%
JOLTs**	11,511	11,204	11,000	9,125	8,889	7,910	7,744
Nonfarm Payrolls**	566	420	136	240	290	118	227
Unemployment Rate	3.90%	3.60%	3.50%	3.60%	3.70%	4.10%	4.20%

*Data reported as of

**Data reported in thousands

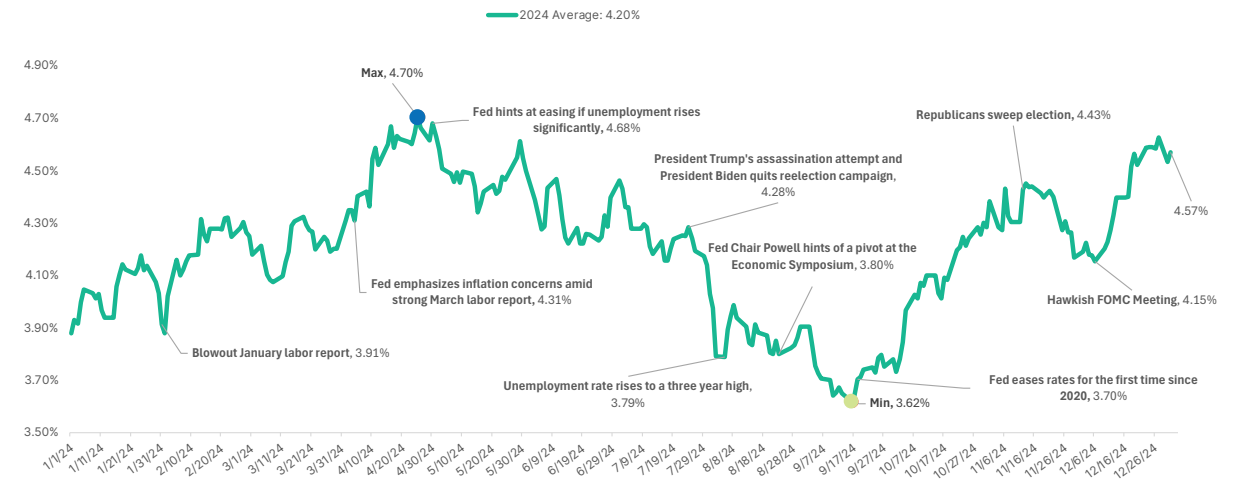
Source: BWE and Bloomberg

Red Sweep and the Fed's Objectivity

October 2024 was a nebulous month for clean economic data, yet Treasury yields steadily marched upward following the September rate decision. Labor markets saw the smallest monthly gain in Nonfarm Payrolls since December 2020 as two damaging hurricanes and labor strikes fogged the reports, while inflationary progress appeared to have stalled. Entering the fourth quarter of 2024, the market focus remained on the election with many investors awaiting clarity on how the political landscape might influence future fiscal policy. As a result of this uncertainty, yields stayed elevated through October despite broader economic concerns, reflecting the anticipation of fiscal expansion under a new Presidential administration.

Despite published polling data, November delivered the somewhat unexpected outcome of a “Red Sweep,” wherein Republicans won control of the presidency and both chambers of Congress. The term premium resurged as markets considered the path of fiscal policy in a presidency that would presumably be less fettered by Congressional approval to execute new policy initiatives. The penultimate FOMC Meeting of the year in November commenced with Fed officials voting for another quarter-point rate cut, and an abundance of questions surrounded the Fed’s views on future interest rates, economic growth, and monetary policy under the new presidential administration. On the reactive rise in Treasury yields, Fed Chair Powell attributed the movement to stronger growth expectations instead of looming economic risks.

10 Yr - Treasury Yield (2024 Closing Levels)



Source: BWE and Bloomberg

As the new administration takes shape, Fed officials (specifically Powell) stated they would be unable to provide foresight on hypothetical future Fed policies that may or may not be implemented until future fiscal policies materialize. While asserting the Fed’s political independence, Powell was transparent in how the Fed approaches an indeterminate legislative outlook stating, **“We don’t guess. We don’t speculate. We don’t assume.”**

A Hawkish Transition into a New Phase

Labor market concerns that led to the initial September fed funds rate cut appeared to have stabilized with an encouraging November Nonfarm Payrolls report and an unemployment rate that has steadied (i.e. not continuing to trend upward). This has shifted the pendulum for the balance of risks back to constraining inflation to the Fed's 2% target. This reasoning was emphasized in the last FOMC Meeting of the year in December, which struck a hawkish finale despite implementing an additional quarter-point cut. The decision again saw one dissenting vote, and Powell clarified that *"Today was a close call... From here, it's a new phase, and we're going to be cautious about further cuts."*



The newest SEP revealed that the majority of policymakers expect just two quarter-point cuts in 2025 (revised down from its four cuts in 2025 projected in September), which was more hawkish than the market consensus anticipated. This "slower-to-lower" strategy was a tone-setting reality that undercut previous market optimism toward aggressive rate cuts continuing through the new year. The Fed increased 2025 projections for PCE inflation to 2.5% compared to 2.1% in the last SEP, and Powell stated "It might take another year or two from here" for the Fed to reach its inflation goal.

The yield curve renewed its steepening trend, further emphasized by the spread between the 2-year and 10-year Treasury yields ending 2024 at a year-to-date high. Meanwhile, *10-year Treasury yields have blitzed past technical moving averages to yield 4.57% at the year's close, the highest level since May 2024.* Despite Treasury headwinds, Agency CMBS rate lock volumes surged in the fourth quarter as investors took advantage of tightening credit spreads in the backdrop of a seasonal pickup in new issue supply. Notably, the influx of supply has not untethered credit spreads, which remain near historical tights.



Looking Ahead

Slower-to-Lower

Although the last FOMC Meeting concluded 2024 on a hawkish “slower-to-lower” tone, the market remains primed for additional cuts in 2025 to extend the runway for lowering financing costs for consumers, corporations, and commercial real estate borrowers.

The consensus at this writing has momentarily aligned between market participants and the Federal Reserve concerning projections for the federal funds rate to fall to approximately 3.75% by the end of 2025, facilitating the potential for more favorable conditions for fixed-income products, specifically in the commercial mortgage-backed securities (CMBS) financing market. From a financing rate perspective, CMBS borrowers will advisably monitor key trends anticipated in the year ahead.

Fed's Dual Mandate

The Fed will continue to balance the need to support U.S. economic growth through maximum employment while jointly holding inflation in check. Expectations are that the labor market will see fewer job creations given the “slower-to-lower” pace of interest rate cuts, though unemployment rates are projected to remain near the lower end of historic norms, approximately 4.3%. While the second half of 2024 saw a stagnation of progress towards disinflation, further progress is expected for the “last mile” to get inflation closer to the Fed’s preferred 2.0% inflation target. Aggregated economic forecasts from leading institutional investors project core Personal Consumption Expenditures to end 2025 near 2.2%. With this backdrop, the expectation today is for the Fed to make just two quarter-point interest rate cuts in 2025.

U.S. Economic Growth

With fewer interest rate cuts currently projected for 2025, elevated interest rates are expected to levy a moderating drag on a resilient consumer and labor market over the upcoming quarters. The consumer is the main engine powering economic growth and showed marginal signs of slowing last year as real disposable income and spending rose at a 2.6% annualized pace. With a softening labor market in tandem with a likely decelerating of income, consumer spending may slow to 1.75% - 2.00%. Expectations are for real GDP to land at approximately 2% for each quarter through 2025.

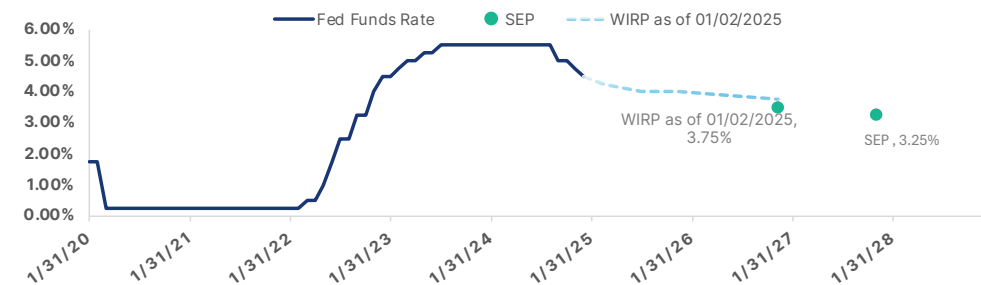
Fiscal Policy

Shifting fiscal priorities (including tax, tariffs, and regulatory policy changes) may introduce episodic volatility as these policies take shape. Upcoming speculated fiscal policy changes under a “Red Sweep” with Republican control of the executive and legislative branches will more vividly formulate and likely allow the Fed to more accurately predict economic outcomes as such fiscal policies materialize in relation to tax implications, immigration, and the federal budget deficit. **Both the certainty and timing mechanisms surrounding potential implications of evolving fiscal policy remain a variable to Fed officials and market participants currently.**

CMBS Investor Appetite

Since the Fed’s “pivot” began last September and the ensuing steepening of the yield curve, end investor appetites have steadily improved for investment-grade products. Bank appetite, one of the primary historical buyers of Agency CMBS, has started to reemerge from the pandemic-induced coma and convulsion of deposit runs faced. Equally, bank capital requirements from a less restrictive than expected Basel III Endgame and subsequent portfolio repositioning has enabled more capital to be deployed into higher-yielding investment-grade securities. **According to S&P Global Market Intelligence’s analysis of nationwide property records, approximately \$1 trillion of U.S. commercial real estate mortgages are estimated to mature in 2025.**

Fed expects 50 bps of cuts in 2025



Source: Federal Reserve and Bloomberg

Rate outlooks for the year will continue to evolve as additional macroeconomic data prints arrive involving inflationary progress and labor market resilience. Bloomberg’s survey of forecasts (dated 12/17/24) across leading institutional investors reveals that the market consensus is for Treasury yields to gradually grind lower throughout the year. Through 49 responding economists, **the median 10-year Treasury yield forecast for the first quarter of 2025 is at 4.25%, and this figure drops to 4.15% by the end of the year.** Fed policymakers will be tested in their ability to maintain strong economic momentum as lagging impacts from their previous hiking cycle continue to work through the economic system. Importantly, when faced with decades-high levels of inflation, the fed funds rate peaked at only 5.50% - merely a quarter-point higher than the rates realized in 2006/2007. As inflation has more than halved from its peak in June 2022, it seems unlikely that policymakers should feel compelled to revisit this level of monetary policy restrictiveness in the foreseeable future. This provides a psychological upper bound to the interest rate environment barring a global calamity, pandemic, or otherwise economic-related surprise. In this vein, although the Fed will be keen to have inflation drift lower to their 2% target, the worst of inflationary pressures has decidedly passed. Although the path towards the Fed’s inflation target has been characterized as “sometimes bumpy,” markets today anticipate that the FOMC will be justified in normalizing policy rates lower as economic data gradually vindicates the Fed’s decision-making. Additionally, the digestion of future fiscal policy actions will help refine future implications to the macroeconomic backdrop as it materializes. As we look ahead, many uncertainties remain, including fiscal policy changes, economic updates, and geopolitical risks, which will continue to shape the market.

We urge you to stay connected with your BWE team for expert guidance and timely insights as these developments unfold.

2025 Outlook - Year-end Forecast							
	Fed's Dec. 24 SEP	Bloomberg Consensus	Fannie Mae	J.P. Morgan	Morgan Stanley	Wells Fargo	Santander
Consumer Price Index (CPI)		2.50%	2.10%	2.40%	2.50%	2.70%	
Consumer Price Index - Core			2.40%	2.70%	2.80%	3.00%	
Personal Consumption Expenditures (PCE) Deflator	2.50%	2.30%	2.00%	2.20%	2.30%	2.50%	1.70%
Personal Consumption Expenditures - Core Deflator	2.50%	2.50%	2.10%	2.30%	2.50%	2.70%	2.30%
Unemployment Rate	4.30%	4.30%	4.40%	4.40%	4.10%	4.30%	4.30%
Gross Domestic Product (GDP)	2.10%	2.10%	2.10%	2.00%	1.90%	2.00%	1.90%
Fed Funds Rate	3.90%	3.46% - 3.75%	3.90%	3.75%	3.625%	3.94%	3.50% - 3.75%
10-Yr Treasury Yield		4.12%	4.20%	4.25%	3.55%	4.04%	

Source: Federal Reserve, Bloomberg, and Various Other Broker/Dealers

Events	Key Economic Release Dates 2025 Calendar											
	Q1 2025			Q2 2025			Q3 2025			Q4 2025		
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Consumer Inflation	1/15/2025 (Dec '24)	2/12/2025 (Jan '25)	3/12/2025 (Feb '25)	4/10/2025 (Mar '25)	5/13/2025 (Apr '25)	6/11/2025 (May '25)	7/15/2025 (Jun '25)	8/12/2025 (Jul '25)	9/11/2025 (Aug '25)	10/15/2025 (Sep '25)	11/13/2025 (Oct '25)	12/10/2025 (Nov '25)
FOMC Meeting	1/29/25	—	3/19/25*	—	5/7/25	6/18/25*	7/30/25	—	9/17/25*	10/29/25	—	12/10/25*
GDP	1/30/2025 (4Q A '24)	2/27/2025 (4Q S '24)	3/27/2025 (4Q T '24)	4/30/2025 (1Q A '25)	5/29/2025 (1Q S '25)	6/26/2025 (1Q T '25)	7/30/2025 (2Q A '25)	8/28/2025 (2Q S '25)	9/25/2025 (2Q T '25)	10/30/2025 (3Q A '25)	11/26/2025 (3Q S '25)	12/19/2025 (3Q T '25)
Labor Data	1/10/2025 (Dec '24)	2/7/2025 (Jan '25)	3/7/2025 (Feb '25)	4/4/2025 (Mar '25)	5/2/2025 (Apr '25)	6/6/2025 (May '25)	7/3/2025 (Jun '25)	8/1/2025 (Jul '25)	9/5/2025 (Aug '25)	10/3/2025 (Sep '25)	11/7/2025 (Oct '25)	12/5/2025 (Nov '25)
PCE	1/31/2025 (Dec '24)	2/28/2025 (Jan '25)	3/28/2025 (Feb '25)	4/30/2025 (Mar '25)	5/30/2025 (Apr '25)	6/27/2025 (May '25)	7/31/2025 (Jun '25)	8/29/2025 (Jul '25)	9/26/2025 (Aug '25)	10/31/2025 (Sep '25)	11/26/2025 (Oct '25)	12/19/2025 (Nov '25)
Retail Sales	1/16/2025 (Dec '24)	2/14/2025 (Jan '25)	3/17/2025 (Feb '25)	4/16/2025 (Mar '25)	5/15/2025 (Apr '25)	6/17/2025 (May '25)	7/17/2025 (Jun '25)	8/15/2025 (Jul '25)	9/16/2025 (Aug '25)	10/16/2025 (Sep '25)	11/14/2025 (Oct '25)	12/17/2025 (Nov '25)

* SEP release

Source: BWE and Bloomberg

Our capital markets team delivers timely market intelligence to guide informed business decisions.



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