LEE & ASSOCIATES
COMMERCIAL REAL ESTATE SERVICES

THE LEE LENS

STICKY BUT SHIFTING: INSIDE THE CAP RATE RECALIBRATION

After nearly two years of elevated interest rates and shifting market conditions, commercial real estate investors find themselves at an unusual juncture. Despite clear increases in borrowing costs and economic uncertainty, cap rates remain surprisingly sticky. At the heart of this dynamic is a fundamental disconnect between sellers holding tight to earlier valuation benchmarks and buyers recalibrating for heightened risk. The result is a cautious, fragmented market—one defined less by distress than by recalibration.

Nationwide, pricing dislocation is now less about distress and more about perspective. Sellers remain anchored to past comps. Buyers are focused on forward-looking yields and risk-adjusted returns. And while capital is returning, particularly for smaller, well-leased deals, many transactions still stall due to valuation gaps neither side is willing to close. In many cases, it's not that buyers and sellers are far apart on value—it's that they're speaking different pricing languages shaped by past cycles versus current risks.

STICKY, NOT STATIC

Lee & Associates' Q2 2025 data shows average national cap rates holding steady around 5.4% to 5.7% for multifamily, 6.2% to 6.5% for industrial, 6.8% for retail, and approximately 7.3% for office. Yet these broad averages obscure growing dispersion. Davidson Kempner reports that cap rate spreads across sectors are near 25-year highs, particularly in office, hospitality, and non-credit retail—a sign of increasing investor caution.

Even within asset types and regions, variability is notable. According to CoStar's Q3 2025 data, industrial cap rates have expanded roughly 150 basis points since 2021, typically hovering around 6%. Specialized industrial assets such as cold storage or flex often trade closer to 6.6%, while logistics hubs can reach 6.9%.

Class A industrial in Southern California still trades near historically low 5% cap rates, while transitional suburban office in the Midwest may require yields of 8.5% or more. Many deals obscure cap rate movements through concessions such as tenant improvements or credits, complicating true valuation clarity. These adjustments often mask a steeper underlying repricing trend.

SELLERS HOLD THE LINE—BUT FOR HOW LONG?

Seller resistance isn't always irrational. In coastal markets with strong leasing fundamentals and limited new supply—particularly for assets like small-bay industrial and grocery-anchored retail—sellers are maintaining pricing power, supported by tenant demand and stable cash flows.

But market realities diverge in overbuilt multifamily markets and larger-format office properties. Trepp's TPPI data highlights that institutional-grade assets have experienced sharper value declines, particularly for complex or aging properties. CREXi shows office sales averaging cap rates of 7.44%, even as sellers continue listing closer to 7.02%—a meaningful gap, with DOM now averaging 239 days.

Many long-term owners remain anchored to peak valuations from two to three years ago, anticipating rate cuts and holding out hope for a return to 2021-era pricing. But the reality of aging assets, deferred capital improvements, regulatory pressures, and maturing debt is driving a gradual increase in transactional activity. In Seattle, for instance, multifamily sales volumes rose 92% in the first half of 2025 over the prior year, as private owners began adjusting expectations. For some, capitulation is no longer optional—it's a matter of survival or balance sheet cleanup.

THE NEW BUYER RISK PREMIUM

Buyers are recalibrating underwriting assumptions to reflect forward-looking risks: lease rollover exposure, tenant credit, refinancing hurdles, operational cost escalation, and tariff-related inflationary pressures. CoStar's Office Report points to transactions at $68/SF in Philadelphia and $104/SF in Charlotte, illustrating steep discounts driven by risk aversion.

Buyers are more focused than ever on refinancing timelines, insurance premiums, and lender-imposed reserves. Operational expenses are a major focus, with insurance, life safety upgrades, and deferred maintenance under scrutiny. Electrical panel replacements, elevator systems, and HVAC units are frequent sticking points in negotiations, often resulting in seller-funded repairs or pricing adjustments. Assumptions around future rents and renewal probability now play a central role in underwriting, with downside scenarios baked into pricing models.

The LightBox CRE Activity Index (August 2025) shows listings down 12% month-over-month, with appraisal volume also declining, signaling cautious buyer and lender posture.

CREXi's data on retail and multifamily confirms this discipline. Even where asking prices have adjusted, actual sale cap rates remain tighter, indicating continued valuation friction and buyer selectivity. The result is not a freeze, but a filtration. In other words, deals are happening, but only when risks are fully understood and reflected in pricing.

LIQUIDITY FINDS ITS LANE

Despite caution, liquidity is returning in selective pockets. Cohen & Steers notes improved transaction volumes, lending conditions, and investor sentiment, suggesting the market may have bottomed in mid-2024. That has supported seller confidence in well-stabilized asset classes and mid-market properties where debt and equity execution are more predictable.

Green Street reports nearly $6 billion in Q2 2025 transaction volume for industrial properties priced between $5M and $25M. That marks a clear vote of confidence in small-format industrial—a segment seen as lower risk with durable fundamentals.

Family offices, HNWIs, and experienced private operators are driving this trend, especially in discounted office deals in Manhattan, Tri-State suburbs, and South Florida. Many are long-term holders capitalizing on historically low entry points. In markets like Seattle, tech executives and syndicators are re-entering the market as pricing resets offer clearer upside.

THE PATH TO PRICE DISCOVERY

multifamily, small-bay industrial, and necessity retail are slowly resetting benchmarks and shaping seller expectations. Each transaction is a new datapoint.

LightBox's August data showing slight declines in listings and appraisals supports this narrative of cautious, steady price discovery. Brokers are seeing sellers begin to accept valuations that reflect current borrowing costs rather than peak-era momentum.

Davidson Kempner notes a growing "complexity premium," with buyers willing to navigate entitlements, deferred maintenance, or tenancy issues can command higher returns. These types of buyers are redefining the value proposition—they're not just buying income; they're solving problems for margin.

Newer multifamily (post-1990) is drawing more investor interest due to lower capex risk. In Seattle and other core markets, experienced investors are leveraging 1031 exchanges to upgrade portfolio quality. Meanwhile, rent-stabilized assets in markets like NYC are trading as basis plays, weighed down by expiring abatements, strict rent regulations, political uncertainty, and diminished NOI. Many are now nearly unfinanceable, forcing a rethinking of exit strategy and hold periods.

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FROM MOMENTUM TO DISCIPLINE

This higher-for-longer cycle is forcing CRE to grow up. For many investors, this is the first truly rate-sensitive environment—rendering old playbooks obsolete. Momentum isn't a strategy. Core doesn't guarantee safety. Capital isn't cheap enough to cover mistakes. The Fed's recent rate cut offers modest relief, improving short-term borrowing conditions and providing a psychological lift. But internal divisions and policy uncertainty temper expectations. Forward guidance remains muddled, and rate volatility could persist well into 2026.

Fixed-rate permanent debt remains expensive without deeper yield declines or tighter lender spreads. Floating-rate loans like construction and bridge debt have benefited slightly, but not enough to drive meaningful valuation shifts. The market is thawing—but slowly. Borrowers are watching closely, but most are still penciling in tighter margins and longer exit timelines.

THE LEE LENS: REPRICING BY NEGOTIATION, NOT CAPITULATION

Cap rate stability can be misleading. On the surface, it suggests equilibrium. In reality, it reflects a slow, uneven repricing process happening behind closed doors, clause by clause, spreadsheet by spreadsheet. The so-called "stickiness" of cap rates isn't a sign that the market is frozen—it's a signal that we're still in translation mode, working to reconcile two very different views of value: yesterday's trailing comps and today's forward-looking risk.

What makes this moment different is that both sides of the table are adjusting in real time. Sellers aren't slashing prices indiscriminately, but they are more willing to entertain nuance—factoring in lease roll, aging infrastructure, and buyer-required capex. Buyers aren't demanding fire-sale discounts across the board, but they are underwriting with sharper pencils, adding back complexity and downside risk with surgical precision.

There is no single formula for value discovery right now. Cap rates don't rise or fall uniformly. They warp, bend, and blur—masked by concessions, credits, and creative structuring. This cycle won't be defined by dramatic blowouts. It will be shaped by incremental trades, tighter underwriting, and a growing premium on execution.

If higher-for-longer forced investors to rethink strategy, sticky cap rates are now forcing them to rethink expectations. That's not a bad thing. In fact, this may be one of the most important corrections the market has seen in a decade—not because pricing has collapsed, but because discipline is being rebuilt, deal by deal.

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This article is part of Lee & Associates' ongoing thought leadership series, offering market intelligence and expert perspectives from across the platform. The insights shared here reflect contributions from the following Lee professionals:

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