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Living uncertain - “riding the waves of the never normal.” - by William Pastuszek

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William Pastuszek

Uncertainty is an everyday fact of life, business, nearly everything. How can we label today's environment that we are struggling to make sense for our one decision making? There's no good

answer. It seems like the new normal is that there isn't any normal! We can address that a bit last.

But first, let's examine some trends related to real estate and real estate valuation.

Economy, Inflation, Interest Rates.

By most metrics, economic growth is solid with low unemployment. It appears that getting a job is a bit harder than it once was and the disruptive influence of AI is a factor for both entry level and established workers.

Business owners, consumers, and analysts are all striving to understand the impact of tariffs. Rather to say, many struggle to understand the impact of constantly changing tariffs and negotiating positions.

Interestingly, Blackstone, a major real estate player, has taken a position. CEO Stephen Schwarzman notes that tariff-related uncertainty has "dramatically impacted investor sentiment", though it's still too early to gauge the full economic effects. The firm sees this as a "speed bump" rather than a roadblock, emphasizing that patience and staying power are key in navigating the volatility. Blackstone is leaning into the chaos, viewing tariff-induced market gyrations as a buying opportunity while others stay cautious.

Commercial Real Estate - Lending.

Maturing loans, lease renewals, lower appraisals are creating difficulties out there for owners and lenders. Lenders have abundant capital and are lending. Most sources indicate an uptick in activity. The uncertainty here is in terms of pricing and where the market is headed in any particular market and specific asset type. So, borrowers and lenders, while appearing to have adapted to higher rates, are wrestling with heightened uncertainty.

Many smaller, community oriented banks have gotten heavily involved in mid-market lending. Some concerns about appraisal quality are noted. Big banks appear to be doing just fine.

Commercial Real Estate – Investment.

Interest rates and the cost of money are not the only factor influencing investment behavior in commercial real estate. Sometimes overlooked factors that affect NOI and cash flow include rent growth, occupancy, and expenses.

Another factor that builds in risk when valuing income properties is the equity position. Uncertainty can bring on higher levels of risk in an uncertain environment. Investors may only be enticed to invest if their equity needs are satisfied. In the current environment, higher equity expectations may well influence the cap rate.

Market Segments.

Markets don't move in lockstep. Let's pick the apartment sector as an example. Multi-family has historically been a darling of investors. Traditionally strong and underserved markets such as those in the northeast exhibit strength based on strong fundamentals.

On the other hand, Real Page notes that “San Jose and Pittsburgh are the only two markets expected to see rent growth above 4%, while just over a quarter of regions are expected to see rent gains of between 3% and 3.9%.” About 40% of markets are expected to post rent growth in the 2% to 2.9% range. Two markets are expected to see modest rent declines over the next year.

Interest Rates.

The Fed moved on lowering interest rates in 2024 to much jubilation. There is a good deal of pressure to lower interest rates in 2025: the drama there is unfolding. Interestingly enough, when the Fed lowered short-term rates in 2024, capitalization rates didn’t really follow, underscoring that long-term rates are less influenced by short-term rates than by other factors.

As an author put it: The Uncertainty Principle is “riding the waves of the never normal.” That feels right. Time to go to the beach and ponder this some more.

William Pastuszek, Jr., MAI, ASA, MRA heads up Shepherd Valuation Services LLC, Needham, Mass.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540