

Markets

Office Rebound Expected in 2025 While Other Real Estate Stocks to See Trouble

- Once out-of-favor office REITs are rallying and can keep going
- High-flying homebuilding stocks will face challenges in 2025



There's growing optimism in one of the most beaten-down corners of the market: office real estate investment trusts. *Photographer: Amir Hamja/Bloomberg*

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It's been a challenging couple of years for real estate stocks since the Federal Reserve started raising interest rates in 2022, as borrowing costs soared and the property market collapsed. And despite a healthy rebound in the middle of 2024, the outlook for 2025 isn't particularly encouraging.

But that doesn't mean investors should expect a sea of red in real estate shares next year. Rather, it will likely be a stock-picker's market, where some rise, some fall, and the group doesn't move in unison, according to Adam White, senior equity analyst at Truist Advisory Services.

That isn't great news for the residential market, which is expected to face challenges from stubbornly high mortgage rates and limited supply in 2025, particularly after Fed Chair Jerome Powell's comments on Wednesday indicating fewer rate cuts are coming. Just this week, the average 30-year fixed mortgage rate rose for the first time in a month, Freddie Mac said in a statement Thursday.

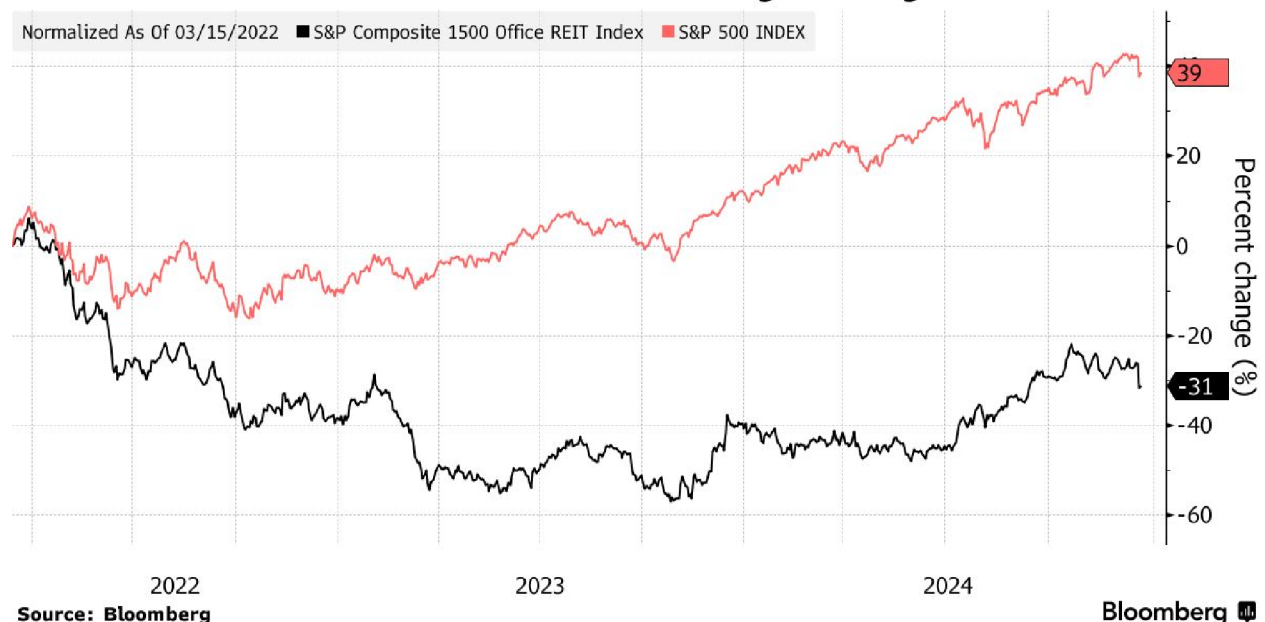
But there's growing optimism in one of the most beaten-down corners of the market: office real estate investment trusts.

"Where REITs can really compete is their cost and availability of capital, and that's probably truest for office," said Uma Moriarity, senior investment strategist at CenterSquare Investment Management. "When you think about a trophy asset in any given market, more likely than not, it is owned by one of the REITs."

The group has been hit hard since the start of 2022, with the S&P Composite 1500 Office REITs Index plunging more than 30% while the S&P 500 Index gained 24%.

Office REITs Underperform S&P 500

Sector has trailed the broader market since Fed began raising rates in 2022

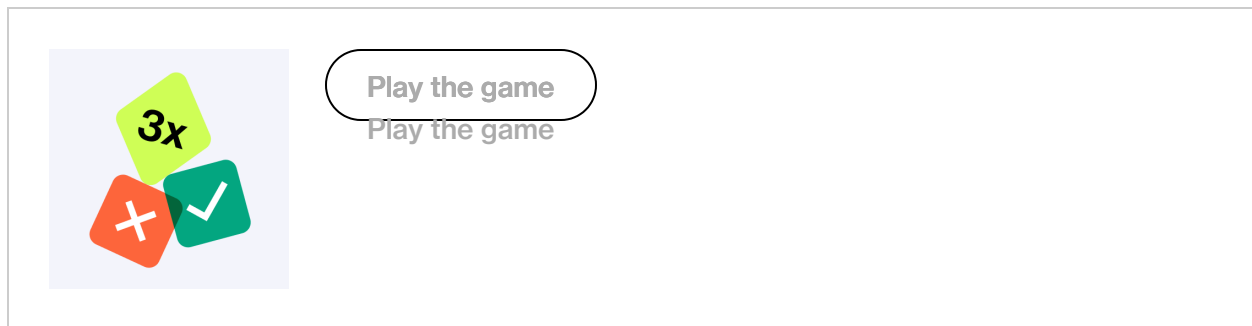


The divergence isn't entirely shocking considering the headwinds facing the real estate industry over that stretch. The cost of borrowing soared as the Fed raised interest rates 11 times between March 2022 and July 2023, the

regional banking crisis in March 2023 crippled local lenders, and employers struggled to get workers to return to offices after the Covid lockdowns.

Office Rebound

Those pressures have driven down real estate stocks across the board. US REITs have only been this cheap or cheaper relative to the S&P 500 11% of the time over the past 20 years, according to Todd Kellenberger, REIT client portfolio manager at Principal Asset Management. And office REITs are still down roughly 60% from pre-Covid levels compared to the rest of the REIT market, making them a decent target for growth, according to Moriarity.



In many ways, the rebound in workplace real estate is already beginning. Office REITs have posted a total return, which includes dividends and share price increases, of more than 28% in 2024, according to data from the trade association Nareit, putting them among the best performers in the group after data centers and niche specialty REITs. That's a substantial turnaround from 2023, when office REITs posted a total return of 2%, and 2022, when they dropped 38%, Nareit figures show.

The focus on prestige office properties Moriarity referred to is also happening now, as seen in the divergence between high-quality and lower-quality names.

Read more: [Wall Street Drives Office Revival on Manhattan's Ritziest Street](#)

Companies like [SL Green Realty Corp.](#), which is exclusively focused on office buildings in Manhattan, as well as [Vornado Realty Trust](#) and [Highwoods Properties Inc.](#), which operate in high-end markets across the US, have seen year-to-date gains of 30% to more than 50%. Meanwhile companies like

Office Properties Income Trust, which has the federal government as its largest tenant, has plunged some 85% in 2024.

“For the portfolios of the strongest assets, I wouldn’t be surprised to see another strong year,” Moriarity said.

Trouble in Paradise

The outlook isn’t nearly as optimistic for residential real estate.

Homebuilders were unique beneficiaries of elevated mortgage rates as builders capitalized on a tight resale market and surging demand. But after a blistering 74% runup since the Fed started raising rates, the sector is cooling off.

The US central bank’s intention to go slower on rate cuts will likely keep mortgage rates higher than had been anticipated. And that’s spilling over into dwindling supply as more homeowners are reluctant to move when they’re locked into an existing mortgage at a significantly lower rate than they can get now.

Homebuilder stocks are on pace to end the year with a loss of 1.6%, compared to their 80% leap in 2023. The SPDR S&P Homebuilders ETF is currently seeing its largest quarterly outflow in two years. And the S&P Composite 1500 Homebuilding index is down 25% since Oct. 18, putting it in bear market territory.

Homebuilders Enter Bear Market Territory



Even ultra-luxury homes, the part of the residential real estate market that seemed impervious to outside forces as deep-pocketed buyers avoided rising borrowing costs by using cash, could be hitting a wall, according to Cole Smead, chief executive officer and portfolio manager at Smead Capital Management in Phoenix.

Read more: [Real Estate Market Is Broken for Everyone Except the Ultra Rich](#)

“The thing I’m most negative on is high-end luxury real estate,” he said. “It’s going to do terribly.”

Smead expects the shares to reflect the performance of the broader stock market, which he’s bearish on for 2025. Luxury homebuilder [Toll Brothers Inc.](#), until recently the best-performing homebuilding stock this year, has lost 27% since Nov. 25 and just forecast weaker-than-expected gross margins, underscoring industry concerns about pricing pressure.

Read more: [Homebuilders Drop as Toll Brothers Flashes Weakness Ahead](#)



The all-cash deals that have kept the market thriving are at risk of higher borrowing costs too. Many of those deals aren’t done using physical cash, but rather through “money-like” collateralized lines of credit, Smead said.

“That’s what’s been feeding the luxury home market,” he said. “So, what if those assets struggle? What will that owner do? Will they sell the securities, or will they sell the second or third home? They’re going to sell one of the two, and it’s going to hurt either side.”

As investors consider how to play the real estate market heading into 2025, Truist’s White warns against simply buying a sector fund. Instead, he urges taking a stock picker’s approach. Data center REITs, real estate services companies and senior housing REITs are some areas where he sees opportunities.

“You’re going to want to be more selective,” White said. “It’s going to be harder to make the same returns in 2025.”

(Adds details on rising mortgage rates in third paragraph)

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