VILLAGE PROPERTIES

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2026–2027 Commercial Real Estate Investment Strategy

"The McKnight Outlook" Prepared and authored by **Eugene H. McKnight**

A Private Investor's Guide to Sectors, Markets, Cap Rates and Timing.

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Executive Summary

The 2026–2027 commercial real estate market is best understood as a sorting cycle. Transaction liquidity is improving, but higher capital costs, uneven refinancing conditions and wide differences in property quality are preventing a broad-based rebound. The strongest opportunities are likely to come from durable income, constrained new supply, favorable basis and motivated sellers—not from assuming that falling interest rates will rescue weak real estate.

Our base case is modest cap-rate compression for high-quality assets, broadly stable pricing for average assets and continued decompression or price discovery for obsolete properties. Income should drive most returns. Investors should emphasize tenant durability, replacement cost, rent-to-market, lease rollover, local supply and the property's residual value if the current tenant leaves.

1. Strategic Market View

Commercial real estate is moving from a period of frozen transactions into a more active but highly selective market. CBRE forecasts U.S. investment volume to rise approximately 16% in 2026 to about $562 billion. At the same time, the Federal Reserve's June 2026 projections and current interest-rate environment argue against underwriting aggressive near-term rate relief. The result is a market in which well-capitalized buyers can transact, but debt remains expensive enough to expose weak assumptions.

The central strategy for 2026–2027 is simple: buy cash flow that can survive higher-for-longer financing costs, and buy real estate whose value is not dependent on one optimistic exit assumption.

2. Sector Allocation: Where to Buy

OVERWEIGHT — Medical Outpatient. Favor properties near hospitals and affluent population centers, strong parking, expensive tenant improvements, diversified medical tenancy and 7–12 year weighted lease terms. Demographics, tenant stickiness and limited supply support the sector.

OVERWEIGHT — Necessity and Service Retail. Grocery-anchored centers, restaurants with strong unit economics, auto service, dental, fitness, personal services and irreplaceable infill retail benefit from limited new construction. Focus on occupancy cost and tenant sales—not merely brand recognition.

OVERWEIGHT — Small-Bay and Infill Industrial. Favor shallow-bay warehouses, contractor buildings, service industrial and last-mile locations with multiple replacement tenants. Avoid paying premium pricing for large speculative distribution assets in overbuilt submarkets.

SELECTIVE BUY — High-Quality Single-Tenant NNN. Credit matters, but residual real estate value matters more than it did in the low-rate era. Prioritize below-market or sustainable rents, strong unit-level performance, good demographics, fungible buildings and locations that can be re-leased.

SELECTIVE BUY — Multifamily. The best opportunities may come from capital-structure distress: floating-rate debt, expiring caps and refinancing pressure. Favor Class B/B+ properties in supply-disciplined markets. Be cautious with newly delivered Class A product in high-construction Sun Belt submarkets.

SPECIALIST BUY — Senior Housing and Data-Center-Related Real Estate. Both have powerful structural demand, but execution risk is high. Senior housing requires operating expertise. In data centers, access to power is often more valuable than the building itself.

3. Sectors to Underweight or Avoid

UNDERWEIGHT — Commodity Office. Large, undifferentiated office buildings with near-term rollover, major capital needs and weak tenant demand remain the clearest value-trap risk. Buy only when basis, location and a credible repositioning plan are compelling.

CAUTION — Large Speculative Industrial. Industrial remains healthy overall, but the market is no longer a one-way trade. Large-box assets in supply-heavy corridors require careful analysis of absorption, concessions and replacement rent.

CAUTION — Self-Storage and Hotels. Both can work, but performance is highly local and operational. Hotels require an operator thesis, not merely a real estate thesis. Storage markets can suffer quickly when new supply and weak housing turnover converge.

4. Geographic Strategy

PREFERRED — Dallas–Fort Worth and selected Texas growth corridors. Economic depth, logistics and population growth remain attractive, but avoid submarkets where supply has outrun demand.

PREFERRED — Midwest cash-flow markets. Indianapolis, Columbus, Kansas City and selected secondary cities can offer stronger going-in yields, less construction and more conservative pricing than highly promoted coastal or Sun Belt markets.

PREFERRED — Southeast markets with economic depth. Charlotte and Raleigh remain attractive when basis is disciplined. Nashville is more selective because popularity and pricing can outrun fundamentals.

PREFERRED — Wealthy, supply-constrained coastal markets. Santa Barbara and similar markets can preserve value because replacement supply is extremely difficult. Favor irreplaceable neighborhood retail, medical, small office and industrial; avoid accepting a low yield without genuine scarcity value.

CAUTION — High-supply multifamily submarkets. Parts of Austin, Phoenix and other fast-growth metros require submarket-level supply analysis.

CAUTION — High-insurance-risk markets. Coastal Florida and other catastrophe-exposed markets can suffer from insurance costs that materially alter cash flow.

AVOID — One-employer towns, weak downtown office districts and markets where the thesis is based only on population growth.

5. Cap-Rate Outlook

Base case: modest compression for the best assets, stability for average assets and continued decompression for impaired or obsolete assets. CBRE expects cap rates for most property types to decline approximately 5–15 basis points, with better-quality assets seeing greater compression. Investors should not underwrite 50–100 basis points of compression as a core return assumption.

Expected direction:

- Medical outpatient: modest compression.
- Prime necessity/service retail: modest compression.
- Quality industrial: modest compression.
- Strong long-term NNN: stable to slight compression.
- Multifamily: broadly stable, then gradual compression if supply moderates.
- Hotels: stable and operator-dependent.
- Commodity office: flat to decompression.
- Distressed assets: pricing driven more by debt and capital needs than headline cap rates.

6. Who Should Buy Now

Cash-rich private investors can negotiate without allowing debt markets to dictate the transaction. Family offices and long-hold investors can compete where highly leveraged buyers cannot. Owner-users remain compelling buyers when occupancy control and long holding periods justify the economics. 1031 buyers should remain disciplined and avoid overpaying simply because the exchange clock is running.

The ideal 2026–2027 buyer has liquidity, a 7–10+ year horizon, conservative leverage and the ability to improve or re-lease the property. Investors able to assume favorable existing debt may have a meaningful advantage.

7. Who Should Sell Now

Owners facing refinancing or major loan maturities within 12–24 months should evaluate a sale before time removes negotiating leverage. Owners of obsolete office assets without repositioning capital should consider exiting. Owners with major lease rollover may benefit from selling while current income is still in place.

Long-time private owners with concentrated wealth in one management-intensive property may use improving liquidity to diversify into passive or lower-management assets. Owners of exceptional assets should also test the market: liquidity typically returns first to the best properties.

8. 2026–2027 Action Matrix

BUY NOW: medical outpatient, necessity/service retail, small-bay industrial, selected NNN with strong residual value, owner-user properties.

WAIT FOR BETTER BASIS: over-supplied multifamily, large-box industrial in high-supply markets, popular markets priced for perfection.

SELL OR REPOSITION: commodity office, properties with large near-term rollover, assets requiring refinancing without sufficient debt yield, management-intensive properties held by owners seeking income simplification.

HOLD: irreplaceable infill real estate with durable tenants, below-market rents and manageable leverage.

9. Key Risks

Interest rates may remain elevated or rise if inflation reaccelerates. Economic growth and hiring may slow. Insurance, taxes and operating expenses can overwhelm nominal rent growth. Geopolitical events can change capital-market assumptions quickly. AI-related investment may create extraordinary demand in some markets while also increasing power and construction constraints.

For these reasons, every acquisition should be stress-tested for: no cap-rate compression, higher refinancing costs, tenant rollover, slower rent growth and realistic capital expenditures.

10. Property Tax Risk by State

Property taxes can materially alter a commercial real estate acquisition's true NOI and effective cap rate. Investors should distinguish between two different risks: (1) a sale or change in ownership that triggers reassessment, removes an assessment cap or "uncaps" taxable value; and (2) a state or locality with a high ongoing property-tax burden even when no formal sale-triggered reset occurs.

GREEN — **GENERALLY FAVORABLE FOR UNDERWRITING**: Nevada, Utah, Arizona, Idaho, Colorado, North Carolina, Tennessee, Alabama and Wyoming. These states generally offer comparatively manageable or predictable commercial property-tax environments, although local assessment practices and special districts still require review.

YELLOW — **UNDERWRITE CAREFULLY**: Georgia, South Carolina, New Mexico, Indiana, Missouri, Kansas, Kentucky, Minnesota and Oregon. These states can offer attractive investment opportunities, but county-level assessments, local millage, reassessment cycles and special taxing districts can materially affect the actual burden.

RED — **MAJOR TAX UNDERWRITING REQUIRED**: *California,* Florida, Michigan, Texas, Illinois, New Jersey, New York, Connecticut, Ohio, Pennsylvania and Nebraska. The risk varies by state. California can reassess qualifying transfers to current fair market value; Michigan can uncap taxable value after transfer; Florida requires careful analysis of non-homestead assessment treatment and local millage; Texas is primarily a high ongoing tax and appraisal-risk state rather than a classic sale-reset state; and several Northeastern and Midwestern states carry high effective property-tax burdens or complex local systems.

California deserves particular attention. A long-held property may have a taxable basis far below market value under Proposition 13. Following a qualifying change in ownership, the buyer's assessed value can reset to current fair market value. Accordingly, the seller's historical tax bill may be largely irrelevant to the buyer's stabilized NOI.

For every acquisition, the underwriting should compare: seller's current taxes; estimated buyer taxes after reassessment or un-capping; realistic annual tax growth; special assessments and district charges; lease reimbursement provisions; and the effect of stabilized taxes on NOI, debt coverage and the effective cap rate.

Property Tax Disclaimer

The state classifications above are general screening guidelines only and should not be interpreted as a ranking of overall investment attractiveness or as tax, legal or investment advice. Commercial property-tax rules are frequently determined at the county, municipality, school-district and special-district level and can vary materially within the same state. Assessment methods, transfer rules, equalization factors, millage rates, exemptions, appeal rights and reassessment cycles can change. Before acquiring or selling property, investors should obtain a property-specific estimate of post-closing taxes from the applicable assessor or tax authority and consult qualified tax and legal advisers. A state shown as "green" can still contain high-tax jurisdictions, while a property in a "red" state may be attractive when the purchase price, lease structure and yield adequately compensate for the tax burden.

McKnight Commercial Investor Strategy

The strongest private-client opportunity is the $1.5 million to $10 million investor who owns appreciated California real estate, has substantial equity and wants stronger income with less management.

Recommended acquisition buckets:

1. Long-term NNN assets with strong residual real estate value—not merely strong tenant credit.
2. Medical outpatient and service-retail properties with durable demand.
3. Higher-yield Midwest and secondary-market assets where the income premium genuinely compensates for location risk.
4. Select owner-user acquisitions where control and long-term occupancy create value.

Recommended advisory message: move from "finding a cap rate" to evaluating durable income, replacement value, rent sustainability, financing risk and exit liquidity.

Conclusion

2026–2027 should favor disciplined private investors. The market is becoming more liquid, but it is not returning to the easy-money conditions of the last cycle. The best returns are likely to come from buying durable income at a defensible basis from sellers who have a reason to transact. The winning question is not "What property type is hot?" It is: "Does this specific property produce durable income, at a sustainable rent, in a location with constrained competition, at a basis that can survive a less favorable exit?"

For more information pertaining to this report, or to discuss these and other commercial real estate investment opportunities, contact Gene McKnight at 805-689-6500 or mcknight@villagesite.com. Visit web site at Commercial | Village Properties | Santa Barbara

Research Sources

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Important Notice: This report is for general informational purposes only and is not legal, tax, securities or investment advice. Property-level due diligence, financing terms, tenant credit, market conditions and investor objectives can materially change the appropriate strategy.

About This Strategy

This 2026–2027 Commercial Real Estate Investment Strategy was prepared and authored by Eugene H. McKnight and reflects his independent analysis, professional judgment and forecast of commercial real estate market conditions. The conclusions, sector preferences, geographic recommendations and forward-looking views expressed herein are those of the author.

The strategy incorporates economic and commercial real estate data from third-party sources believed to be reliable; however, the interpretation of that information and the resulting investment outlook and forecasts are those of Eugene H. McKnight. Forecasts are inherently uncertain, actual market conditions may differ materially, and the strategy is subject to change as economic, capital market and property-level conditions evolve.

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