MetLife Investment Management



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What Rate Moves Really Mean for Commercial Real Estate Cap Rates

Key takeaways

- **The 10-year Treasury approached its highest level since 2002**, following a September Fed rate hike and a renewed bout of energy-driven inflation. Private real estate investors are once again asking what this means for values they cannot yet observe.
- **Our "Public Market Signals" framework from May 2025 still applies:** Baa corporate bond yields and two-year Treasuries explain roughly 80% of the variation in NCREIF transaction cap rates, with public markets leading private pricing by about two quarters.
- **If rates stay where they are, the model implies transaction cap rates should be 30 basis points (bps) above July 2026 levels.** That is roughly half the 70-bp move in the 10-year Treasury and is quantitative evidence of real estate's imbedded inflation resilience.

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Where are cap rates headed?

In May 2025, with tariff announcements whipsawing public markets, we published "Public Market Signals for Private CRE Investors," arguing that investors in an opaque, slow-moving asset class should watch corporate bond yields and short-term Treasuries as a real-time proxy for what return hurdle private real estate should command. At the time, the signals said the tariff shock had barely moved real estate pricing. The private real estate world had a very different view: With transactions stalled, markets assumed values had fallen precipitously. In hindsight, however, our view proved to be correct: NCREIF transaction cap rates in mid-2026 were essentially the same as they were in mid-2025.

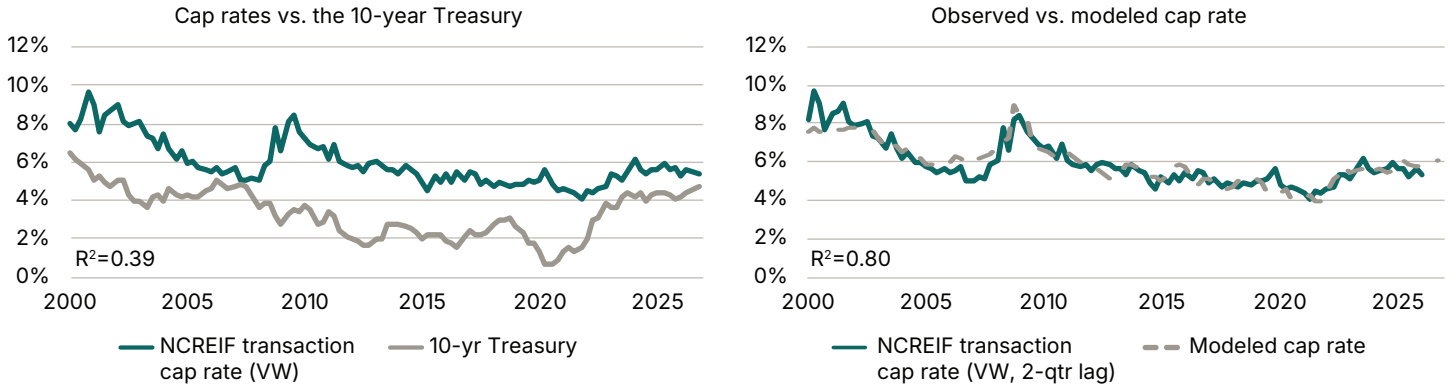
The backdrop has since changed considerably. The Fed delivered three rate cuts in late 2025, then reversed course after a Middle East energy shock pushed oil above $100 per barrel and inflation re-accelerated. In September 2026, the central bank raised the federal funds target range to 3.75%–4.00%, its first hike since 2023. Meanwhile, heavy Treasury issuance and concerns about the rising fiscal deficit in the U.S. has pushed term premiums higher. Since the second quarter of 2026, the 10-year Treasury has risen roughly 70 bps to 5.1%, the two-year Treasury about 70 bps to 4.7% and Baa corporate yields about 50 bps to 6.5%, even after the recent modest pullback from peak levels.

Whenever Treasury yields jump, investors reach for the "cap rate equals 10-year plus a spread" heuristic. The left panel of Exhibit 1 shows why that is a mistake: Between 2021 and the end of 2023, the 10-year Treasury rose 4.5 percentage points while transaction cap rates only rose around two percentage points. The 10-year captures the risk-free rate but says nothing about risk spreads or the outlook for property income growth, the other two components of a cap rate. Corporate bond yields and short-term Treasuries carry more useful information on both counts. Using NCREIF closed-transaction data since 2000, we estimate:

$$\text{Cap Rate}_{t+2} = 1.01\% + 0.92 \times \text{Baa Yield}_{t} - 0.17 \times \text{2–yr Treasury}_{t}$$

Higher Baa yields, which reflect both the risk-free rate and credit spreads, push cap rates up almost one-for-one. The two-year Treasury, a proxy for near-term inflation expectations and Fed policy, carries a negative sign: **Inflation lifts future rents and property income, supporting values even as rates climb**. The model explains 80% of the variation in transaction cap rates (Exhibit 1, right panel), and it has tracked actual pricing within its historical error over the four quarters since we published our first "Public Market Signals" piece.

Exhibit 1 | The 10-Year Treasury is the wrong benchmark; Baa yields and 2-year Treasuries are better



Sources: MetLife Investment Management (modeled cap rate calculations), NCREIF (value-weighted transaction cap rates) and Moody's and Federal Reserve Board via FRED as of October 29, 2026. The quarterly data used spans Q1 2000–Q3 2026, and we performed a regression on 104 observations through Q4 2025. The observed series in the right panel is lagged two quarters to align with model inputs.

What happens if cap rates stay where they are?

Exhibit 2 applies the model to recent spot yields. Because the Baa coefficient is so much larger than the two-year coefficient, the 50-bp rise in corporate yields dominates, but the rise in short-term Treasuries blunts the impact. The model-implied cap rate rises from roughly 5.9% to 6.2%.

Exhibit 2 | Model-Implied transaction cap rate, then vs. now

	10-yr Treasury	Baa yield	2-yr Treasury	Model-implied cap rate
Q2 2026 average	4.4%	6.0%	4.0%	**5.9%**
October 29, 2026	5.1%	6.5%	4.7%	**6.2%**
Change	+70 bps	+50 bps	+70 bps	**+30 bps**

Sources: Federal Reserve Board (DGS10, DGS2) and Moody's (DBAA) via FRED, latest observations as of Oct. 29, 2026; MIM model estimates.

What does this mean for investors?

1. **Don't anchor to the 10-year Treasury:** We think the move in cap rates over the last several months is smaller than the 10-year Treasury headline suggests. A roughly 30-bp rise in modeled cap rates is well short of the 70-bp rise in the 10-year Treasury. Holding income constant, it equates to a value decline on the order of 5%, versus the 10% decline a one-for-one benchmark would imply. Rates would also need to hold at current levels for at least a quarter to exert their full effect on transaction pricing, and our base case calls for rate pressure to moderate as inflation eases later this year and into 2027. We would therefore view a 5% decline as an upper bound rather than a central estimate. The REIT market appears to agree, with prices off roughly 2% from their second-quarter average. This is a growth-driven rise in rates with credit spreads still tight, a combination real estate has historically weathered well. Investors anchoring to the 10-year Treasury risk taking an overly negative view of market conditions, in our view, just as many did in 2022–23.

2. **Credit spreads matter as much as Fed policy does:** The move is nonetheless large enough to matter. Modeled cap rates are more than halfway to the 50-bp threshold we set in the original report for adopting a more risk-off posture when pricing new investments. We see today's reading as a "yellow" signal and are adjusting underwriting assumptions accordingly. The variable to watch from here is credit spreads: A recession that widened Baa spreads would do far more damage to modeled cap rates than further Fed hikes, because falling Treasury yields provide far less protection than tightening credit takes away.

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