
10-Year Treasury Note Hits 3% and Its Impact on Net Lease

| By Jonathan Hipp
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Jonathan Hipp

The 10-Year Treasury rate hit 3% this week, the highest it's been in several years. The hike in the 10-year will ripple through the debt market. Financing real estate will become more expensive, pushing up the cap rate 'floor' for investors using debt to acquire properties.

Higher rates are likely to affect all-cash buyers as well. The 10-year Treasury rate is commonly referred to as the risk-free rate of return. With the risk-free rate moving up, investors will expect returns on their investments to trend in the same direction. Average cap rates may not reflect this change immediately as the cycle of real estate transactions is much longer than trading securities. Properties with their price already negotiated are unlikely to be affected while properties currently or soon to be on the market are going to trade at slightly higher cap rates.

A major economic factor to keep in mind is the spread between the short term and long term Treasury bond. Investors expect a higher return for keeping their money in securities with longer maturity dates. Short term securities will offer higher returns than longer term bonds when an economic downturn is expected. Investors are willing to tie up their capital for longer periods and lower returns to keep it protected during the anticipated recession.

This flight to security could be an influx for real estate. Investors looking for stable long term assets that will weather a recession could turn to net lease. The amount of new investors will have a large influence in movements in cap rates in the future. If a small amount of new money flows into net lease, cap rates will continue to rise along with rates. If a mass exodus from other forms of investment to real estate occurs, this swelling demand could slow the growth of cap rates driving the spread between average cap rates and the 10-year Treasury rates even further down.

The spread between 10-year Treasury notes and average cap rates has hovered at historic lows, creating a strong expectation of rising cap rates in the future. We expect to see a shift in cap rates as properties currently on the market begin heading toward closings.

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