

No, The Falling 10-Year Won't Bring Cap Rates Down, But It Will Help Stem the Tide

By BJ Feller

The most popular question every commercial real estate broker is being asked these days is: "how much are cap rates going to improve with interest rates going down so much?" It's the question that brokers loathe receiving – they're of course predisposed to telling clients what they want to hear, but deep down they know the truths of the current landscape, because they are living them on a daily basis.

In our last article, [Net Lease's Meteoric Rise in Inventory and What It Means for Cap Rates](#), we analyzed the supply of net lease assets on the market which ballooned by 168% between May 2022 and May 2024 to over \$24 Billion, even as cap rates climbed significantly by 88 basis points. We explored this staggering increase in on-market inventory, paired with a sharp decline in closed transactions, particularly among top tenants like Walgreens, Starbucks, and 7-Eleven. We warned that cap rates were likely to rise even further to restore market equilibrium.

Now, just a few weeks later, market conditions continue to evolve. We've seen the 10-year Treasury yield fall from 4.25% to around 3.70%, driven by softening inflation, weakening jobs reports, and fewer open job positions. There's growing speculation that the Federal Reserve will begin a rate cutting campaign for the first time in three years. The big question is whether this will ease the relentless upward pressure on cap rates.

Our answer? While the falling 10-year may provide some stabilization, don't expect it to bring cap rates down in any meaningful way. Let's explore why.

A Shifting Market, but Not a Reversal

As we outlined previously, despite cap rates rising steadily across the net lease market, we've seen an unprecedented supply glut. Inventory surged from \$9.05 billion to \$24.3 billion in just two years. This oversupply, combined with buyers demanding higher risk premiums due to rising interest rates, has created a major imbalance.

In the earlier piece, we noted that "transactions have collapsed" while "cap rates still have far to go to find market-clearing buyer demand." That's the key here. Even though the 10-year Treasury yield has dropped, the core market dynamics haven't changed. Buyers remain cautious, and the oversupply of assets isn't going away.

The drop in yields will certainly slow the pace at which cap rates have been climbing, but it's unlikely to cause a reversal. The gap between buyer and seller expectations is still too wide, and the broader economic uncertainty means investors will continue demanding higher returns to justify deals.

Softer Inflation, Jobs Reports, and the Fed's Next Move

The recent drop in inflation and cooling job market have undoubtedly played a role in the falling 10-year yield. Payroll growth has been softer than expected, and the number of open jobs has declined, signaling a slowdown in the once red-hot labor market. As a result, many are speculating that the Federal Reserve could start cutting rates in the near future, which would mark the first rate reduction in three years.

But as we highlighted before, cap rates are driven by more than just the 10-year Treasury yield. Even with inflation easing and the potential for rate cuts on the horizon, the market still faces a massive supply-demand imbalance. In Net

Lease's Meteoric Rise, we explained how sellers have been holding onto "hope certificates," waiting for favorable market conditions that simply haven't materialized. That hope now hinges on the Fed potentially pivoting – but it's misplaced.

Even if the Fed cuts rates, we're still dealing with an oversaturated market where motivated sellers must transact due to loan maturities and financial pressures. The downward pressure on cap rates isn't enough to fully offset the glut of available assets, meaning buyers and sellers will continue to wrestle with pricing for the foreseeable future.

Stabilization, Not Decline

While the falling 10-year Treasury yield won't bring cap rates down, it will help stem the tide of rapid increases we've seen over the past two years. Cap rates for net lease assets have risen sharply across the board – from Walgreens' average cap rate jumping from 5.60% in 2022 to 7.19% in 2024, to Starbucks increasing from 4.75% to 5.47% over the same period. Buyers, facing higher borrowing costs, have demanded better returns, and sellers have had to adjust pricing accordingly.

The drop in the 10-year should slow this trajectory, offering some stabilization. But stabilization does not mean reversal. As more sellers adjust to the reality that cap rates aren't coming back to 2021 levels, they'll likely start pricing their assets more aggressively to move them off the market. Buyers will benefit from slightly more favorable financing terms, but they'll still demand higher cap rates to account for the overall risk environment.

What Does This Mean for Buyers and Sellers?

In our last article, we predicted that highly motivated sellers would need to adjust their pricing aggressively, driving cap rates even higher as they try to clear the market. The falling 10-year Treasury yield offers a silver lining for these sellers – it might help slow the pace of cap rate increases, providing some breathing room before they're forced to make even more drastic adjustments.

For buyers, this is a critical moment to remain patient and focused. The falling 10-year yield could create some attractive opportunities, particularly as financing becomes slightly cheaper. However, buyers need to remember that the market fundamentals still favor higher cap rates. Deals will continue to reflect the broader economic risk environment and the oversupply of assets, so aggressive pricing isn't going away just yet.

Conclusion

As we wrote in Net Lease's Meteoric Rise in Inventory, the net lease market is undergoing a profound shift. The 10-year Treasury yield's decline will help slow the upward pressure on cap rates, but it won't bring them back down to pre-2022 levels. The market still faces significant headwinds in the form of oversupply and risk-averse buyers.

Sellers should be intentional in evaluating a wide breadth of market data to ensure they're properly positioned, while buyers should watch for opportunities to capitalize on higher cap rates without overextending themselves. The falling 10-year may not be the cap rate reset some were hoping for, but it will help stem the tide – and in a market as volatile as this one, that's a crucial step toward stabilization.