RESEARCH BRIEF

Marcus & Millichap

CAP RATES

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If Interest Rates Ease, Will Cap Rates Follow? Analysis Reveals More Relevant Indicator

If interest rates fall, will a drop in cap rates not be far behind? Many investors believe that capitalization rates on commercial real estate transactions are linked to interest rates. If the Federal Reserve lowers the overnight lending rate, and other interest rates such as the 10-year Treasury yield also decrease, these investors expect cap rates will contract to some degree. While it is broadly true that both the 10-year yield and the average cap rate have trended lower over the past three decades, empirical analysis shows this relationship is limited.

- Between October 2001 and June 2025, movements in the 10-Year Treasury yield were only **40 percent** correlated with movements in the average apartment cap rate.
- There are **multiple instances** when changes in the Treasury yield did not line up with shifts in cap rates.
- In 1994 and 1996, **Treasury rates spiked, but cap rates trended lower**. Later, from 2002 through 2006, **the 10-year yield was rising slowly, while cap rates steadily fell.**
- Then, from 2006 until 2008, **Treasury yields dropped fast as cap rates went up.**

Alternative influence on cap rates more apparent. There is a different metric that is more correlated with cap rates but from an inverse perspective — transaction velocity. The correlation between changes in the number of trades and movements in cap rates since 2001 was **78 percent.**

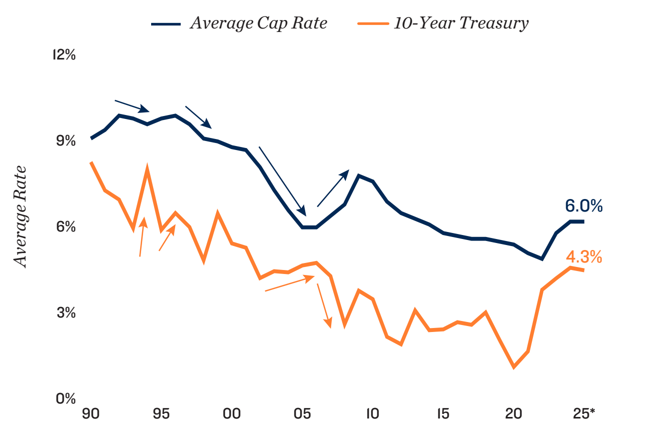
- There was a clear trend from 2002 through 2006 where **transaction flow was climbing and cap rates went down.**
- Then, in 2007 and extending until the end of 2010, **the count of trades fell and cap rates rose.**
- This **inverse relationship** is also demonstrated in the spike of sales activity that took place **in 2021 and 2022**, which coincided with a decline in cap rates.
- After that cycle, **when trading fell** in 2023 and 2024, **cap rates went up.**

Are interest rates instead linked to sales? Overall, there is only a **30 percent** correlation between interest rate movements and transaction velocity, even after accounting for the time it takes to conclude a trade. The most recent monetary policy tightening cycle is a clear exception, however. Given higher interest rates in 2023 and 2024 directly constrained sales, if interest rates were to drop in the near future, it could encourage more transactions, especially given supporting factors:

- Capital has accumulated on the sidelines, sitting at over **$200 billion** just among closed-end funds as of March of this year.
- Meanwhile, the volume of debt coming due in the near future is elevated at nearly **$960 billion** for 2025.
- Recent **tax reforms reduce** some of the upfront costs of completing a commercial property investment sale.

Cap rates may ease regardless. Even if treasury yields do not shift down in the coming months, these additional factors are likely to encourage some added level of sales activity. The relatively high inverse correlation between trade velocity and cap rates suggests that cap rates are poised to ease some. Even so, it will take time for this to occur, which may create short-term windows of opportunity for investors.

Interest Rates and Cap Rates Movements Do Not Always Align



** As of Sept. 2 Note: Correlation analysis accounts for lag time related to closing transactions.*
Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; Federal Reserve: IRS; Mortgage Bankers Association; Preqin; Real Capital Analytics