Public Market Signals for Private CRE Investors: Monitoring Pricing in an Uncertain Market

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KEY INSIGHTS

- The ongoing trade war has added volatility to financial markets.
- Private markets like the commercial real estate sector are less transparent, so monitoring price movements is a challenge.
- Public market data, specifically Baa bonds and short-term Treasuries, can reliably explain spot-market transaction cap rates (and thus real estate prices), and could be an early indicator that real estate is entering a new pricing regime.
- As of May 21st, bond markets are pricing a minor 30-basis-point (bp) increase in private real estate cap rates relative to April 1, before sweeping tariffs were announced.

MetLife Investment Management

Introduction

In today's volatile financial markets, private commercial real estate investors face a fundamental challenge: **market opacity makes real-time pricing hard to gauge**. This report argues that investors should pay closer attention to **public market signals** — such as corporate bond yields and short-term Treasury rates — as timely indicators of real estate pricing, even though bridging public and private markets is difficult in practice. Recent episodes of extreme market volatility (for example, sudden swings in equity markets following surprise tariff announcements) highlight how **quickly public markets react** to new information, whereas private property value changes are observable only after months of closed transactions. We will show that movements in public financial metrics often precede changes in private-market real estate pricing, offering institutional investors a leading indicator of where valuations are heading.

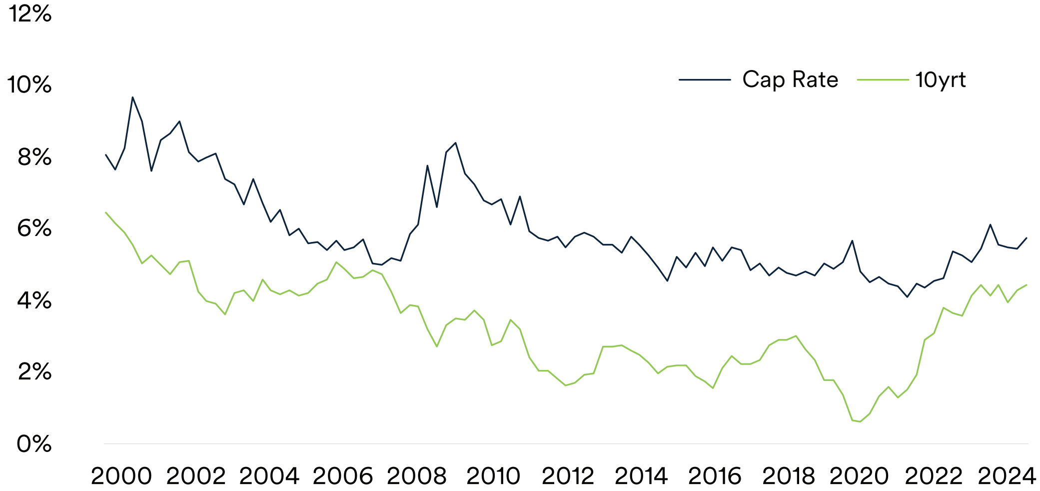
Cap Rates and Their Limitations in Opaque Markets

Commercial real estate investors often rely on the **capitalization rate (cap rate)** as a key valuation metric. Like the P/E ratio for public equities, the cap rate is calculated by dividing next year's expected income by the property's current value. Real estate prices can therefore be derived by applying prevailing market cap rates to property incomes. Cap rates are easy to understand, but have some key limitations, namely:

- **Stale or Missing Data**: Valuations based on cap rates depend on comparable property sales. In rapidly changing conditions, recent sale comps may be unavailable or not reflective of current sentiment, causing reported cap rates to **lag true market pricing**.
- **Incomplete Information**: A cap rate captures only the first-year income return and ignores prospects for future income growth or decline. It doesn't fully reflect investors' forward-looking expectations for income growth or price appreciation. Thus, during times of market stress or shifting outlooks, the cap rate alone provides an incomplete picture of value.

These limitations often lead investors to ask, "What should market cap rates be today?" when the usual reference points are unclear or unavailable. One common shortcut is to compare cap rates to the **10-year Treasury yield** plus a typical risk premium (the extra "spread" real estate is expected to earn over Treasuries). However, this approach is not truly apples-to-apples — it matches a risk-free **interest rate** with a property's **income yield**, ignoring potential appreciation. In theory, we'd prefer to compare Treasury yields to a property's total yield (income **plus** expected value growth via an unlevered IRR), but unlevered IRRs require **forward-looking projections and judgment**. As a result, they vary widely depending on underwriting assumptions. Data availability is a secondary challenge.

Chart 1 | NCREIF Transaction Cap Rate vs. 10yr Treasury



Source: MIM, NCREIF, Oxford Economics. May 2025.

For example, if investors see rising vacancy and a large construction pipeline in a market, they may expect slower rent growth ahead. In that case, they could demand higher current income yields, pushing cap rates up even if Treasury yields remain low. Simply put, "10-year Treasury is X, so cap rates should be Y" is an oversimplification.

Public Market Signals as Real-Time Indicators

Given the shortcomings of cap rates, **public market signals** offer a valuable real-time supplement for pricing insight. Public markets benefit from continuous trading and broad information flow — prices of bonds, REITs and other securities adjust within minutes to new economic data or policy changes, providing **instant feedback from a large number of market participants**. In contrast, private real estate valuations emerge slowly from infrequent transactions and appraisals, and a shallower pool of market participants. By monitoring certain financial indicators, private-market investors can infer the direction of property values **ahead of traditional metrics**.

Corporate bond yields and **short-term Treasury yields** are two such critical signals. Our analysis shows that a simple model with just two variables — the Baa corporate bond yield and the two-year U.S. Treasury rate — can explain a significant portion of movements in transaction cap rates.

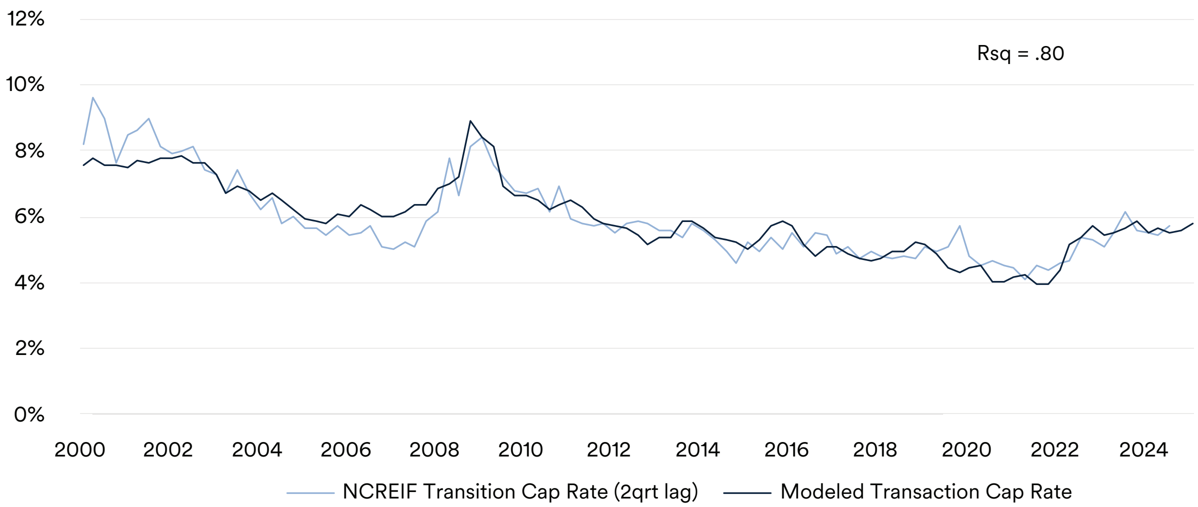
These two public rates encapsulate important forces: the Baa yield reflects the **risk-free rate and credit risk premium** facing investors' opportunity cost of capital, while the two-year Treasury is closely tied to the **near-term inflation outlook** and associated Federal Reserve policy. As expected, the model indicates that, all else equal, **higher corporate bond yields translate to higher cap rates** (and thus lower property values), as higher debt costs and risk premiums push up required returns. Counterintuitively, a rising two-year Treasury yield — often a signal of rising inflation expectations — is associated with lower cap rates (higher property values) once credit spreads are accounted for. This result occurs because expectations of rising inflation can drive higher future NOI growth, which supports property values even as interest rates climb. For example, even in a stagflation scenario, rising construction costs might constrain new supply, bolstering rent growth for existing assets.

To illustrate, the below regression model uses historical data on closed transactions from NCREIF and shows the following relationships:

NCREIF Transaction Cap Rate ≈ 1.0% + .92 × (Baa Corporate Yield) – 0.17 × (2-yr Treasury Yield)

In other words, a 100-bp increase in Baa yields would lead to a 92-bp increase in cap rates, and a 100-bp increase in the two-year Treasury would lead to a 17-bp decrease in cap rates. Interestingly, we found the strongest relationship when using a two-quarter lag between cap rates and public market signals, which is an indication of **how long real estate investors must wait** to observe changes in pricing. While simple and imperfect, this framework highlights how credit spreads and inflation expectations can quantitatively inform cap rates and real estate price movements.

Chart 2 | Observed vs. Modeled NCREIF Transition Cap Rate



Sources: MIM, NCREIF, Oxford Economics. May 2025.

A review of recent history emphasizes the importance of this more nuanced view. Between 2021 and the end of 2023, the 10-year Treasury rate rose from about 0.5% to 5.0%. If investors had assumed that cap rates would move in lockstep with the 10-year Treasury (a common industry assumption), they would have expected cap rates to rise by 4.5 percentage points.

In reality, cap rates increased by only 1.5 to 2.0 percentage points. This could mean the difference between making overly negative disposition decisions or missing new investment opportunities.

Despite financial market volatility, public market indicators are not pricing a significant change in real estate prices today. Baa yields have moved up slightly — on the order of 30 bps from pre-tariff lows as of this writing, and the two-year Treasury (and longer-term inflation expectations) have been flat. A more than 50-bp increase in cap rates as measured by this approach could cause us to adopt a more risk-off posture when pricing new investments.

Private real estate investors looking for additional public markets data points to cross reference this analysis can consider the REIT market. A broad index of U.S. REITS shows a modest 2.3% decline in prices between April 1 and May 21st, which is within a reasonable margin of error to suggest no change in private market values thus far resulting from tariff announcements.

Conclusion

Perhaps the most interesting takeaway from this analysis is evidence of the real estate sector's response to and resilience against various macroeconomic factors. On one hand, it shows that real estate is sensitive and highly reactive to changes in global capital markets, and that **it is maybe not as opaque of a sector as its reputation suggests**. But the analysis also shows how the sector's income returns and positive response to inflation offer beneficial portfolio diversification versus other institutional investment sectors.

Private real estate markets will never have the immediacy of public markets, but that doesn't mean private investors should ignore the information pouring out of public exchanges each day. **Volatile public market indicators — from bond yields to REIT prices — provide timely insight** into the cost of capital and sentiment shifts that eventually filter into property values.

By supplementing traditional private market analytical methods with public market indicators, institutional real estate investors can anticipate market inflection points and adjust strategies more proactively. Although practical implementation is constrained by the illiquidity of real estate, these signals provide timely input for adjusting underwriting assumptions and portfolio strategy. In summary, by incorporating public market data into their analysis, institutional investors can better anticipate market shifts and make more informed investment decisions. While private real estate markets will always lag public markets in pricing transparency, using these public signals can help investors adjust their strategies proactively and manage risk more effectively.

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