Financing Real Estate: It’s all about the Bond Market - by Daniel Calano

June 13, 2025 - Financial Digest

Daniel Calano

It’s crazy that we “real estaters” look to the Federal Reserve to “lower rates,” hoping and planning for cheaper borrowing, to build affordable housing, or that commercial building we’ve been waiting to build. The myth goes on...believing that lowering a quarter point here and there will make borrowing more available and feasible. Well, don’t hope for too long, or count on that rate. We have to look to the U.S. Bond market for the real deal. It’s a larger and more complicated story, and you need to know it. I do too.

Here is how the real process starts: The short-term interest rate that the Fed controls, is essentially an intra-bank short-term rate, vs the long-term typically 10-30 year bond rate, which is the rate that allows for the 10, 20, or longer term borrowing. Understand this, and we can better use the bond rate as a benchmark for future mortgage rates to use in our project pro-forma.

Still with me? Next step: When our government needs money (almost always), it sets up a “bond auction,” at a given yield to the buyer, be it an individual, or governments around the world. If it is a successful balance, the demand for buying bonds increases, ultimately allowing for government to reduce the yield rate to the buyer. If the auction disappoints, government raises the yield to better entice buyers. It is an inverse relationship. If bond yield rates are too low, buyers move to other investments such as stocks, As a result, the annual U.S. deficit, and thus growing national debt, is harder to “pay down.”

A good start, but it is unfortunately more complicated than that. There are various other issues that are at work in determining long-term debt. One important factor is that Treasuries are considered “risk-free” since they are backed by the U.S. Government. That said, risk free is not a true situation.Treasuries will also fluctuate with things like burgeoning annual budget deficits, resulting in growing long-term debt, often followed by lowering of confidence in the U.S. economy.

This can be followed, as shown by Moody’s recent, downgrading of U.S economy, incurring a lower credit rating as determined by such well established agencies. If the U.S. loses credit-worthiness, individuals and foreign countries may also cut back in purchasing our bonds, which purchases we need to pay down dept or reduce annual budget deficits, a somewhat troublesome situation.

Additionally, inflation, or even worry about inflation, can also impact long-term and short-term interest rates. Inflation is also troublesome to the economy, This is where the Fed rate has has an impact, as we have seen recently, and rates are set higher to discourage excessive demand, thus potentially lower costs of living.

Additionally, recent tariffs on imports may raise actual U.S. import prices, thus increasing inflation. Wars such as Ukraine and Middle East clearly cause problems as well. The list goes on. Clearly, it is a complicated process, with continuously moving parts.

So, how does it finally impact our borrowing rates? Too many factors to predict perfectly. The situation is clearly uncertain, and easily changing. Mortgage rates can increase, despite dreams of lower rates. For example, recently, borrowing rates were expected to decrease, but moved higher instead. We simply do not know. Best advice: Keep studying and understanding exogenous impacts you never have thought about. And, remember the process has far more moving parts than simply the changing Federal Reserve short-term rate.

Daniel Calano, CRE, is managing partner and principal of Prospectus, LLC, Cambridge, Mass.