Perspective from
Franklin Equity Group

Lower rates could spark strong global REIT returns

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Amid recent market disruptions and heightened risk aversion, interest rates remain significantly lower following a series of central bank rate cuts that began in 2024. With the potential for further reductions due to slowing economic growth, global real estate investment trusts (REITs) could be a particularly attractive asset category. Franklin Equity Group portfolio managers Daniel Scher and Blair Schmicker emphasize the historical outperformance of REITs following rate cuts as a compelling reason to consider allocating to this asset class.

Key takeaways

- **Historical outperformance:** Historically, REITs have typically outperformed during—and following—periods of declining interest rates.
- **Lower federal funds rate:** The Federal Reserve has cut rates three times since September 2024, setting the current federal funds rate at 4.25% to 4.5%, with the potential for additional cuts in the latter half of 2025 and 2026.
- **Gradual easing bias:** Many central banks, including the European Central Bank, Reserve Bank of Australia and the Bank of Canada, are maintaining a gradual easing bias due to slowing economic growth. Additional rate cuts are being considered in response to recent tariff-driven market disruptions.

Potential for continued global monetary easing

Many central banks maintain an easing bias given slowing economic growth. The European Central Bank (ECB), Reserve Bank of Australia, Swiss National Bank and Bank of Canada have all initiated further rate reductions in recent months. In the United States, Federal Reserve (Fed) Chairman Powell has responded to evolving tariff and trade policies by emphasizing the need to balance slowing economic growth with potential inflationary pressures. Following the Federal Open Market Committee (FOMC) meeting on March 19, the US federal funds rate has remained at 4.25% to 4.5%, with the possibility of additional rate cuts later in 2025 and into next year. Economists are currently anticipating a gradual series of US reductions, aiming for a federal funds rate of 3% to 3.25% by 2027.[1]

REITs & rates: Understanding the connection

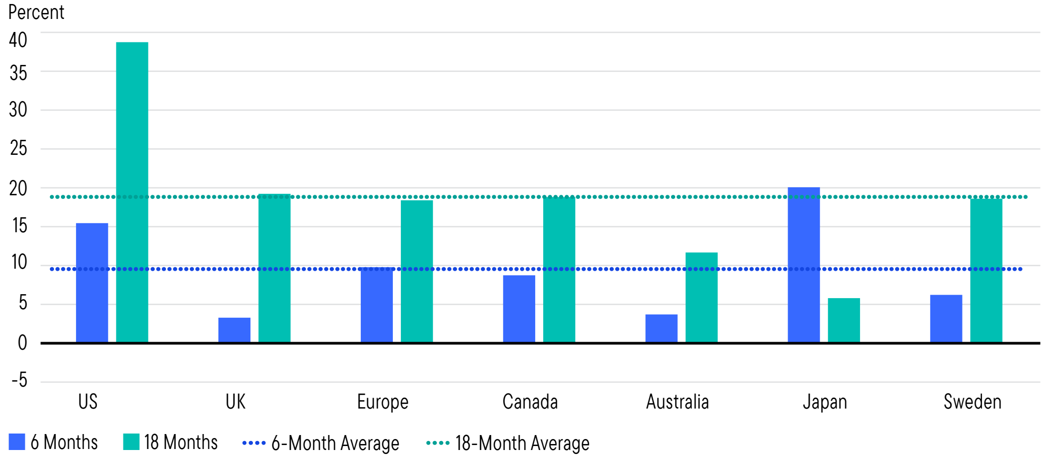
While REITs have historically performed well following declines in short-term interest rates, long-term rates have had the most significant impact on their returns. The correlation between slowing economic growth and declining long-term rates has historically driven REIT outperformance, with several factors contributing to this relationship:

1. *Economic outlook:* Long-term rates reflect investor expectations regarding economic growth and inflation. Today's lower rates reflect expectations for a global economic slowdown. REITs can serve as a defensive allocation, given the visible contractual nature of the income stream.
2. *Valuation:* The 10-year US Treasury yield serves as a benchmark for discounting future cash flows from REITs. Lower rates have historically made future REIT cashflows more attractive, enhancing valuations.
3. *Cost of capital:* REITs typically finance their operations with long-duration debt. Lower long-term rates reduce the cost of capital, improving profitability.
4. *Dividends:* REIT dividend yields are often compared to long bond yields (the interest rates paid on 10-year US Treasury bonds). In lower rate environments, REIT dividends may become more attractive.

Historical performance of REITs post rate cuts

Given their historically strong performance following a rate-cutting cycle, and the potential for additional cuts from several central banks following recent economic turbulence, REITs may be particularly attractive in the current market. Excluding the exceptional circumstances of the global financial crisis (2007-2009) and the COVID-19 pandemic (2020), US REITs outperformed the S&P 500 Index by an average of 38% during the 18 months after an initial Fed rate cut. This trend of strong performance extended globally, with major REIT markets delivering an average excess return of approximately 18% following rate cuts by their respective central banks.[2]

Exhibit 1: Global REITs Relative to Equities Following the Start of a Rate-Cutting Cycle[2]



Sources: Bloomberg. Franklin Templeton. Indices are unmanaged and one cannot invest directly in an index. **Past performance is not an indicator or a guarantee of future results.**

Historical snapshots: REIT returns following rate cuts

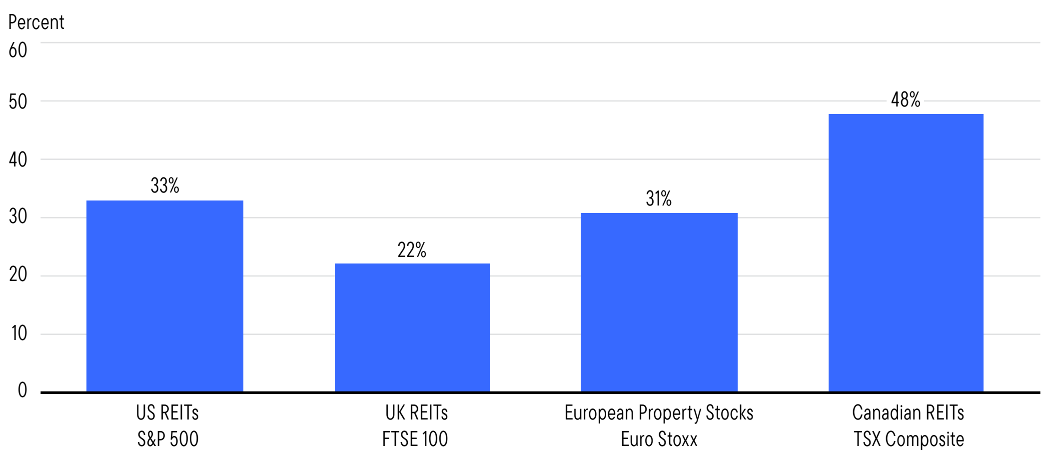
Let's look at how REITs performed historically during some specific rate cuts:

2001 (Dot-Com Era)

Following the burst of the dot-com bubble, the Fed acted swiftly, cutting rates aggressively starting in January 2001, with a total reduction of 475 basis points. In the 12 months after the initial rate cut, US REITs outperformed US equities (represented by the S&P 500 Index) by about 17%. Central banks worldwide followed suit with multiple rate cuts in response to the recessionary environment of 2001, leading to strong global REIT performance. Over the two-year period following their respective central banks' initial rate cuts, US, UK, European property stocks, and Canadian REITs significantly outperformed their respective stock markets.[3, 4]

Exhibit 2: Global REIT Performance Two Years after the Initial Dot-Com Rate Cuts[3,4]

REITs in US, UK, European Property Stocks and Canada showed strong results



Sources: Bloomberg, Franklin Templeton. Indices are unmanaged and one cannot invest directly in an index. **Past performance is not an indicator or a guarantee of future results.**

Mid-2000s

During this period, several central banks cut rates in response to faltering growth. For instance, the Bank of England reduced rates in August 2005 due to weak consumer spending. As a result, UK property stocks outperformed broader UK equities by approximately 25% over the following 12 months.[5]

2007-2008 (global financial crisis)

In late 2007, the Fed and other central banks implemented rate cuts in response to initial signs of financial market distress, which later escalated dramatically with the collapse of major financial institutions and a severe credit crunch. Initially, REITs underperformed as central bank policies proved limited against the systemic challenges facing financial markets.

However, by 2009, the magnitude of rate cuts and the introduction of quantitative easing helped stabilize conditions, leading to a strong rebound in global REITs, which generally outperformed broader equity indices.[6] Given that current banking systems are broadly considered well-capitalized, we believe this cycle is unlikely to repeat in the current environment.

Early-2010s (eurozone debt crisis)

In November 2011, the Reserve Bank of Australia cut its cash rate, leading Australian REITs to outperform the broader Australian stock market (as measured by the S&P/ASX 200 Index) by about 18% over the following year.[7] Similarly, in December 2011, the ECB initiated rate cuts due to fears of a prolonged recession in the eurozone, with Sweden's Riksbank following suit later that month.[8] Over the next 12 months, their respective listed property sectors also outperformed their corresponding broader stock markets.[9]

Early-2020s (COVID-19)

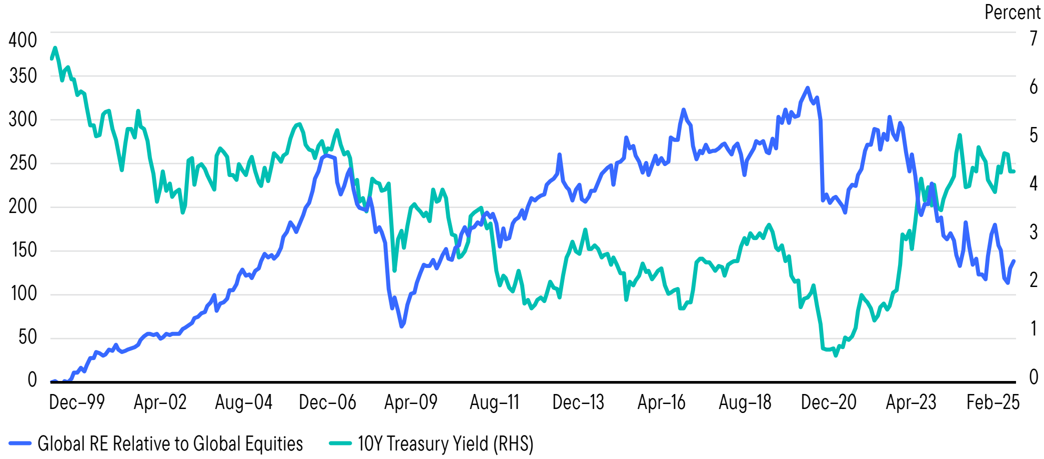
Central banks globally slashed interest rates as the COVID-19 pandemic spread, prompting lockdowns and cratering economic growth. Initially, real estate stocks struggled due to concerns over cash flows from properties with restricted foot traffic. However, once a vaccine was discovered, real estate stocks rebounded strongly, driven by optimism for the economy's reopening. Notably, we believe this cycle is not a suitable comparison to the current environment.

Historical global REIT outperformance

From January 1, 2000 through March 31, 2025, global REITs have significantly outperformed global equities, achieving an excess cumulative return of approximately 137%.[10] This outperformance has been closely correlated with decreases in long-term interest rates, with a correlation coefficient of 0.65.[11] This means that as long-term interest rates decrease, REITs have historically performed better, reflecting their sensitivity to changes in the economic outlook and cost of capital.

Exhibit 3: Global REITS Relative to Global Equities against the 10-Year Treasury Yield

January 1, 2000–February 28, 2025[11]



Source: National Association of Real Estate Investment Trusts. Indexes are unmanaged and one cannot invest directly in an index. **Past performance is not an indicator or a guarantee of future results.**

Conclusion

We believe further declines in interest rates could create tailwinds for global REITs. In our view, their historical outperformance, driven by factors such as economic outlook, valuation, cost of capital and dividends, makes them particularly attractive in the current lower interest-rate environment. Given the heightened risk aversion and potential for further rate cuts from central banks around the world, global REITs could offer stability and strong returns, potentially making them a valuable addition to investment portfolios.

Endnotes

1. Source: Federal Reserve Bank of Saint Louis. March 19, 2025. There is no assurance that any estimate, forecast or projection will be realized.
2. Sources: Bloomberg. Franklin Templeton. Includes performance following rate cuts after 2000, excluding the GFC and COVID-19. US (2001) represented by the FTSE EPRA NAREIT US Index (Financial Times Stock Exchange European Public Real Estate Association National Association of Real Estate Investment Trusts US Index), UK (2001, 2005, 2016) represented by the FTSE EPRA NAREIT UK Index, EU (2001, 2011) represented by the FTSE EPRA NAREIT Europe Index, Canada (2001, 2003, 2015) represented by the FTSE EPRA NAREIT Canada Index, Australia (2001, 2011) represented by the FTSE EPRA NAREIT Australia Index, Japan (2001, 2016) represented FTSE EPRA NAREIT Japan Index, Sweden (2001, 2011) represented by the FTSE EPRA NAREIT Sweden Index. Equity performance represented by the following: (US) S&P 500 Index, (UK) FTSE 100, (Europe) Euro Stoxx 50 Index, (Canada) S&P/TSX Composite Index, (Australia) S&P/ASX 200, (Japan) Nikkei 225 Index, (Sweden) OMX Stockholm 30 Index. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**
3. Initial rate cut occurred on January 3, 2001. The Fed reduced the federal funds rate by 50 basis points to 6.0%. US REIT performance is represented by FTSE EPRA NAREIT US Index.
4. Sources: Bloomberg, Franklin Templeton. The Bank of England made its first rate cut following the dot-com bubble on February 8, 2001. The ECB made its first rate cut on May 10, 2001. The Bank of Canada made its initial rate cut on January 23, 2001. US REITs represented by the FTSE EPRA NAREIT US Index, UK REITs represented by the FTSE EPRA NAREIT UK Index, EU REITs represented by the FTSE EPRA NAREIT Europe Index, Canada REITs represented by the FTSE EPRA NAREIT Canada Index. Equity performance represented by the following: (US) S&P 500 Index, (UK) FTSE 100, (Europe) Euro Stoxx 50 Index, (Canada) S&P/TSX Composite Index. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**
5. Source: Bloomberg. UK Real Estate is represented by FTSE EPRA NAREIT UK Index, and the UK stock market is represented by the FTSE 100 Index. Performance from August 1,2005 – July 31,2006. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**
6. Based on the performance of the FTSE EPRA NAREIT Developed Total Return Index, which measures the performance of listed real estate companies and REITs worldwide, relative to the MSCI World Index for the calendar year 2009.
7. The Reserve Bank of Australia cut rates on November 1, 2011. Australian REIT performance represented by the FTSE EPRA NAREIT Australia Index.
8. The ECB made a significant rate cut on December 8, 2011. The Riksbank of Sweden cut its repo rate on December 20, 2011.
9. Sources: Bloomberg, Franklin Templeton. Performance of European REITs is represented by FTSE EPRA NAREIT Europe Index, European Stocks are measured by EURO STOXX 50 Price EUR, Swedish REITS are represented by FTSE EPRA NAREIT Sweden Index and Swedish Stocks are represented by OMX Stockholm 30 Index. Performance is measured from December 1, 2011- November 31, 2012.
10. Cumulative performance of Global REITS Based on the performance of the FTSE EPRA NAREIT Developed Total Return Index relative to the MSCI World Index.
11. A correlation coefficient of 0.65 suggests a moderate to strong positive correlation between the outperformance and decrease in long-term rates.

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All investments involve risks, including possible loss of principal.

Equity securities are subject to price fluctuation and possible loss of principal.

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Risks of investing in **real estate investments** include but are not limited to fluctuations in lease occupancy rates and operating expenses, variations in rental schedules, which in turn may be adversely affected by local, state, national or international economic conditions. Such conditions may be impacted by the supply and demand for real estate properties, zoning laws, rent control laws, real property taxes, the availability and costs of financing, and environmental laws. Furthermore, investments in real estate are also impacted by market disruptions caused by regional concerns, political upheaval, sovereign debt crises, and uninsured losses (generally from catastrophic events such as earthquakes, floods and wars). Investments in real estate-related securities, such as asset-backed or mortgage-backed securities are subject to prepayment and extension risks.

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