TOWNSEND GROUP

November 2024

Townsend Perspectives

Trump 2.0 and the Implications for CRE

1. Overview

Presidential elections can trigger shifts in economic policies and regulatory frameworks, thereby influencing various sectors, including commercial real estate (CRE). Historically, property markets have responded more significantly to the macroeconomic landscape than to specific election results. Markets are volatile around elections, but this is temporary. Transaction activity may slow given the uncertainty around macro factors in an election year. Empirical evidence around election years demonstrates that commercial real estate is overwhelmingly driven by three broad categories:

1. The Outlook for the Economy
2. The Path of Interest Rates
3. The Election Outcome and Policy Changes

2. The Outlook for the Economy

The outlook for the US economy is a critical variable that impacts property market fundamentals. We anticipate US economic growth to average between 2.0% and 3.0% over the next two years, slightly below trend growth. Higher labor productivity in the US, compared to other developed economies, supports a resilient economy. The Fed has successfully tamed inflation by hiking interest rates without damaging economic output or labor market dynamics. A soft-landing scenario remains the most likely outcome, continuing to support the absorption of space across various property sectors. Trump's economic agenda is also stimulatory and should support near-term growth.

3. The Path of Interest Rates

The interest rate outlook is driven primarily by an independent Federal Reserve and the strength of the US economy. The Fed is anticipated to continue lowering interest rates as inflation rates decline closer to their targets. Continued 25 basis point cuts in the Fed Funds (FF) rate should proceed until the FF rate reaches 3.5%. The Fed has some concerns about weakening the labor market and will continue to lower rates to prevent further deterioration in hiring. Lowering interest rates will support greater financing and deal-making activity moving forward. Property assets are highly capital-intensive and employ a high degree of leverage, making interest rates a key factor in the commercial real estate sector through financing strategies.

4. The Election Outcome and Policy Changes

Elections have consequences. The current election results should influence fiscal and regulatory policies affecting commercial real estate. With Trump and Republicans winning the White House and Senate, they will have greater influence on policy. It is likely that Republicans will also control the House of Representatives, giving Trump more power to enact policy changes. On the campaign trail, Trump has been less clear on the specifics of his economic policy but has espoused a pro-business agenda. In Trump's first term, the focus was on deregulation and tax cuts.

Key policy areas that could impact commercial real estate include tax policy, regulations, housing policy, government spending, and trade restrictions.

Tax Policy

Trump has a pro-business agenda compared to the Democrats and Harris. The Tax Cuts and Jobs Act of 2017 enacted sweeping changes to the tax code, including reducing the corporate tax rate from 35% to 21%. This increased corporate confidence and capital flows to the commercial real estate market. These corporate tax cuts were set to expire next year, but under a Trump administration, they are anticipated to be extended. Trump has promised to continue cutting the corporate tax rate in his second term, further bolstering the attractiveness of commercial real estate by increasing after-tax profits.

The Democrats had discussed taxing unrealized capital gains, which will not be an option under a Trump administration. The continued favorable treatment of capital gains may further bolster capital flows to CRE as well.

Trump also enacted legislation changing depreciation schedules, including immediate expensing of certain property improvements, incentivizing businesses to invest in upgrading their facilities. The retail and industrial sectors benefited greatly. This preferential treatment of CRE is anticipated to continue in Trump's second term.

Finally, Trump has also called for expanding his opportunity zones policy, allowing developers to defer capital gains taxes if they invested in one or more of the 8,700 areas around the country designated as distressed.

Deregulation

As a long-time real estate developer, Trump has done away with many regulations impeding development. He pursued an agenda of deregulation aimed at reducing bureaucratic hurdles for businesses. For CRE, regulatory rollbacks and streamlining the permitting process have facilitated faster project approvals and reduced development costs. Rollbacks of environmental regulations, including those related to wetlands and air quality, have reduced compliance costs for developers, encouraging more development.

Housing

Both Harris and Trump agreed on lowering housing costs during their campaigns. Both discussed increasing the supply of housing to lower costs. But, beyond that, their plans differ significantly.

High housing costs have been a function of high interest rates, elevated construction costs, and local regulatory barriers that have slowed housing development. According to Moody's and Freddie Mac, there is a housing shortage of between 1.5 and 2.0 million units across the US. Trump's specific housing policy is less clear than Harris's. In the past, he has called for less regulation on builders, protecting single-family zoning, and opening up federal lands for development. Project 2025, which could be a useful guidepost even though not part of Trump's platform, firmly supports single-family zoning and opposes multifamily zoning.

Other Policies

A key facet of Trump's agenda is the deportation of undocumented migrants. Mass deportation of an estimated 11 million unauthorized immigrant workers from the US (including many who work in construction) would detrimentally impact CRE development. Construction has been dealing with a significant labor shortage for years.

A cornerstone of Trump's economic policy is sweeping tariffs on imported goods. There's still much uncertainty around how and when such tariffs might be implemented. If they were to take effect, they would likely raise prices for American consumers and disproportionately hurt lower earners. Higher tariffs on imported goods will raise prices and inflation, leading to higher interest rates, which is not positive for property markets.

Trump's policies will lead to more borrowing, which – in the absence of large spending cuts – will raise government debt further and increase interest rates. Extending the tax cuts would leave both the total and primary deficit—estimated at 6.4% and 3.1% of GDP in FY 2024—at uncomfortably high levels given that debt-to-GDP is roughly 100%. Trump does not seem too concerned, as his agenda would likely worsen the debt trajectory. Rising debt-to-GDP should lead to higher interest rates, crowding out private investment.

Trump's policies could also raise interest rates in other ways. His policies are stimulatory, raising US economic growth in the near term and leading to higher interest rates. While additional fiscal expansion could stimulate the economy in the near term, the long-term risks are to the downside. We see a rising risk that easy fiscal policy could become the norm rather than the exception. While some think the Fed would lower policy rates to keep interest costs down, our view is that the Fed would lean against easy fiscal policy. Lowering rates in the face of easier fiscal policy would cost the Fed its independence and create a recipe for repeated bouts of inflation.

5. Impact on Real Estate

Trump's stimulatory policies, like keeping corporate tax rates lower, will likely maintain the robust economic environment, benefiting sectors like industrial, cold storage, and retail.

The office sector may also benefit from these stimulatory policies, and from a push for government employees to return to the office. But given the sector's overall poor fundamentals, the impact may not be pronounced. Efforts to improve government efficiency could act as another headwind, diminishing demand for office space – particularly in and around Washington DC.

A possible inflationary environment, while keeping rates high, will increase investor demand for inflation-hedging opportunities, favoring certain real estate sectors. First, sectors like apartments with shorter lease terms can keep pace with inflation through rent growth. Second, sectors like industrial, where tenant demand has exceeded supply over the last few years, will benefit as most assets are rented below current market levels, with rising inflation further increasing the anticipated NOI growth rate. Third, higher inflation will keep interest rates elevated for longer, maintaining high mortgage levels and increasing demand for renting apartments and single-family homes.

Tighter control on immigration will lead to labor shortages, especially in construction, limiting supply and further improving tenant demand-supply imbalance. Rising construction costs and higher debt costs will increase the replacement value of existing assets. Many alternative sectors, such as data centers, outdoor storage, and senior housing, will also benefit from these trends.

On the capital flow side, real estate might benefit from capital reallocation away from fixed-income assets, which suffer during higher rates, toward more inflation-protected equities and many real estate sectors.

Conversely, a higher interest rate environment will continue to require rescue capital for assets facing refinancing. While some parts of the real estate industry will thrive, others will continue to face distress. Another major risk is policy uncertainty, which could keep investors on edge and push them toward lower-risk asset classes like fixed income, even though inflation may erode returns in those sectors.

In this environment, existing income-producing assets might become more valuable, leading to higher demand for accessing real estate through secondaries. Overall, despite some risks and uncertainties, we believe that real estate might be a net beneficiary of the election outcome.

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