NEWS

Economists, CRE Industry Begin to Assess ‘Trump Effect’ on Property Markets

Though Uncertainty Remains and Caveats Abound, Pro-Business Policies Could Boost U.S. Economy Tempered by Trade Protection Impact on Jobs

By Randyl Drummer November 9, 2016

Like many business sectors, the U.S. real estate industry on Wednesday began to grapple with the unexpected economic and regulatory impact of an upcoming Trump presidency after the famous reality TV star and Manhattan real estate mogul defied pundits and pollsters to defeat Hillary Clinton and become president-elect of the United States.

Although global stock markets girded for a Brexit-style tumult following Tuesday's election, calm prevailed as the shock of the election results wore off and was quickly replaced by the realization that the same party now controls the White House, the Senate and the House of Representatives for the first time since 2005, when George W. Bush was in the White House.

With the Republican control of Congress and the executive branch, brokers, economists and industry leaders weighed in on the potential effects on U.S. property and capital markets, citing potentially reduced political gridlock, significant tax reform, increased protective measures for U.S. trade policy and rollbacks in the nation’s financial and business regulatory framework.

However, other than broad positions taken during the campaign, without a previous track record much remains essentially unknown about a Trump administration. He rode the populist wave through the election under his "America First" banner.

"He's basically Bernie Sanders in a better suit with a different agenda," noted one Washington DC-based broker. "We know he's a master campaigner, but we don't really know the details on how he plans to govern."

Observers outlined several potential winners and losers under a Trump administration. With plans to increase active duty military personnel and scale back international alliances, increased spending is likely to provide a boost to defense and aerospace industries. Trump said he also plans a $1 trillion infrastructure spending program over the next decade that could boost construction, and he also supports energy independence under his America First energy policy approach, and is expected to seek to ease restrictions on new off-shore drilling and fracking while vowing to roll back environmental regulations, cancel U.S. involvement in international climate change pacts, increase domestic natural gas production and revive U.S. coal mining.

The biggest changes, of course, are expected in the health care industry as Republicans have long sought to repeal Obamacare. The financial services sector can also expect major changes as Trump has said he plans to join congressional Republicans to fashion major tax reform and also likely rollback the Dodd-Frank regulatory framework enacted in the aftermath of the Great Recession.

Editor's note: For the reaction of UK property markets to the U.S. election,
check out the coverage of our CoStar News colleagues in the United Kingdom.
Trump's emphasis on border enforcement, increased security and deportation of illegal immigrants suggests immigration reform is likely, along with the imposition of trade barriers and plans to withdraw from TPP and renegotiate NAFTA.

"This outcome was a lot like Harry Truman's in 1948 - roundly unexpected," noted Hans Nordby, managing director with CoStar Portfolio Strategy, referring to the 33rd President's stunning upset of Republican Thomas E. Dewey. "Therefore, most analysts were likely not using a Trump victory as their baseline economic scenario for the future."

Nordby said potential impact to commercial property included in Trump's campaign proposals include immigration reform and the potential for trade barriers, including tariffs on manufactured goods coming into the U.S. While higher tariffs could stimulate U.S. auto production, they may also result in rising consumer costs and inflation, and declining household income.

Increased manufacturing production in Rust Belt and auto manufacturing in the Southeast could offset that impact as tenants absorb warehouse and light manufacturing space, and bring increased demand for apartment and retail investments in those regions, Nordby added.

At minimum, enforcement of existing immigration laws by a Trump Administration would likely increase the cost for low-skilled labor. At the same time, immigration reform could also halt the requirement that college students from foreign countries must exit the U.S. soon after graduation.

"There is a shortage of STEM (Science, Technology, Engineering and Mathematics) talent in the U.S., and these same people are kicked out of the country shortly after they graduate form U.S. universities," Nordby said. "This is an economically stupid practice that, if fixed, could boost economic and job growth, and boost real estate demand for all types of properties."

"Despite all the noise, Trump in my mind won on a promise of growth," said John Kevill, Avison Young principal and managing director for U.S. Capital Markets. "His proposed infrastructure spending, plans for lower taxes, moving jobs back and a target of 4% growth all speak to that. If it appears that things are starting to happen in that regard, expect CRE investment to follow as yield will look to be relatively attractive. For now, investors will be hanging on his every word and every appointment until late January and not making too many major bets."

bets.

Most of president-elect Trump's proposed policies on corporate, individual and foreign taxes have been widely embraced by the real estate and financial industries, with the exception of Trump’s vow during the campaign to scrap the deduction for carried interest income, a position also advanced by Clinton.

The Real Estate Roundtable, one of the CRE industry’s most active lobbying groups, said in a statement that the major planks of tax and financial regulatory reform, infrastructure investment, immigration issues, energy policy and physical and cyber security will all present opportunities to advance the economy and the stability of U.S. real estate markets.

"Real estate public policies are non-partisan," said Roundtable CEO and President Jeffrey D. DeBoer. "They should be based on objective economic principles, responsive to changing economic cycles and sensitive to societal demands."

Will Trump Tax Reforms Inflate Federal Deficit?

Previous guidance provided by the Trump campaign reported that Trump’s tax reform plan would reduce marginal tax rates on individuals (top rate of 25%) and businesses (top rate of 15%), increase the standard deduction to nearly four times current levels, and put a cap on existing tax breaks other than mortgage interest and charitable giving.

His tax plan would repeal both the alternative minimum tax and the estate tax.

However, in contrast to other Republicans and in keeping with the populist tone of his campaign, Trump would not exempt foreign earnings of US multinationals from the US tax base. He said he would go further than current law - which provides for the deferral of tax on foreign earnings - and tax multinationals currently on their foreign income.

Regarding real estate ownership and investment, Trump said he would tax long-term capital gains at a maximum rate of 20%, impose a “reasonable cap” on the deductibility of business interest expense, and tax carried interest as ordinary income.

According to a widely cited report by the Tax Policy Center (TPC) of candidate Trump's tax proposal, it would “... reduce federal revenue by $9.5 trillion over its first decade and an additional $15 trillion over the subsequent 10 years, before accounting for added interest costs or considering macroeconomic feedback effects."

While most of the revenue loss would come from individual income tax cuts, about one-third would come from reducing the corporate income tax rate and introducing special rates on pass-through businesses.

While the TPC report noted that Trump’s tax proposal would improve incentives to work, save, and invest, unless accompanied by equally large spending cuts, Trump's plan could increase the national debt by nearly 80% of gross domestic product by 2036, (Tax Policy Center, Analysis of Donald Trump’s Tax Plan, Dec. 22, 2015.)

Supports of tax reform contend that the cuts will stimulate economic activity that will offset the projected revenue losses.

Trump will face the same daunting challenges as President Obama to address growth in the federal deficit and ongoing bipartisan pressure to reduce the federal government real estate footprint, said Kurt Stout, executive vice president. government solutions for Colliers International. The impact of Trump initiatives on government-dependent metros such as Washington, D.C. is unclear at present.

"Among individual agencies, there will be winners and losers, but I'm not ready yet to speculate on how each will fare or what that might mean for the federal inventory of leased and owned space," Stout said. "Trump doesn't neatly fit into any of the normal political conventions, so I think the only prudent thing to do is to wait and see."

However, at least one market participant in Washington, D.C. believes that generally slower government growth in recent years and Trump's military, immigration and infrastructure stimulus initiatives will actually result in growth in the government property footprint.

"We will more than likely see a significant increase in spending on real estate by the General Services Administration (GSA), government contractors, consultants, and, of course, lobbyists," added Avison Young's Kevill.

End of Dodd-Frank?

Earlier this year, House Financial Services Committee Chairman Jeb Hensarling (R-TX) unveiled a Dodd-Frank reform plan in a speech before the Economic Club of New York, followed by a meeting then-presumptive GOP nominee Donald Trump. Trump is on record as saying he wants to make major changes to the 2010 financial regulation law, enacted in response to the global financial crisis, and is expected to be a defining element of the Republican financial services agenda under a Trump administration.

Under Hensarling's proposal entitled the Financial CHOICE Act, financial institutions that meet certain capital thresholds, including a 10% leverage ratio - a measure of capital held by a bank against its total assets that governs the amount of lending it can engage in -- would be granted regulatory relief.