Some Thoughts on a Trump Administration's Possible Impact on the Real Estate Sector

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Most people overestimate the influence of the US president on the overall economy, much less on the real estate sector. How much economic growth the country experiences largely is determined by a huge number of independent decisions entrepreneurs, business executives, and investors make. And many of those decisions were made in the past. Think about the technologies underpinning the sharing economy, which is influencing a broad swath of real estate from hotels to housing. The investments needed to create them were made many years ago, and the government had relatively little to do with them. The same holds for the Web-based technologies that back Amazon and its impact on retail and industrial real estate.

Even in the short run, I focus more on the Federal Reserve than the White House (or Congress). That said, changes in administrations are special events. This one is especially so and not just because the new president is Donald Trump, a political novice. He comes into office with his party controlling the executive and legislative branches of government. That affords the opportunity for rapid action, as President Barack Obama showed in his first two years in office. However, specific policies are still unknown for the most part, so I will not spend space here trying to divine things such as whether carried interest will survive in any broad tax reform. We just do not know.

Effects on Markets

That said, the effects of the Trump election are already evident on the property markets. One is in what John Maynard Keynes called "animal spirits." This is evident in changes in the stock and bond markets that suggest investors believe growth is going to be higher, at least in the short run. The stock market is flirting with 20,000 on the Dow. Perhaps more relevant for real estate, as I write this article, the ten-year Treasury yield is up about 55 basis points since the Election Day close. Data from the TIPS market suggest that about half that increase is a result of a rise in expected inflation, with the other half representing an increase in the real rate of interest. A 50-basis-point increase in the risk-free rate from historically low levels is an economically meaningful rise that can influence real estate cap rates. I suspect that investors had already factored in this rise, so I do not believe it will affect property pricing all that much. The surprise is more in how quickly it happened. Investors need to consider what this might mean for the future. As noted, the initial evidence is consistent with higher growth, which suggests some of the impact of higher rates in the future will be counterbalanced by rising rents.

Regulatory Changes

The Trump administration's regulatory views also are likely to impact the real estate industry in a significant manner. Real estate is a very capital-intensive sector, so how the administration decides to reform the Dodd-Frank Wall Street Reform and Consumer Protection Act will be important for all borrowers. We cannot yet know the details, but it seems a good bet that there will be some relaxation of bank regulation, so capital should flow a bit more freely to the sector's borrowers, independent of the level of rates. Beyond that, we need to know the administration's attitude toward relaxing controls on the big money center banks, as opposed to smaller regional and community banks, to determine the impacts on large borrowers, the rise of so-called non-bank banks, and the like. The more constraints are relaxed on big banks, the more benefits are likely to flow to those with large and complex borrowing needs. Insured depository institutions have a lower cost of capital than typical credit funds, so they can lend at a lower rate if regulations permit it. Concomitantly, some real estate debt funds that have been the beneficiaries of the shrinking footprint of larger banks will find a more competitive lending and credit investment market. That there will be both winners and losers from changes imposed by a new administration is a point worth noting, and I will address it later.

Similar questions pertain to the commercial mortgage-backed securities (CMBS) markets. However, we need to know appointments at the sub-Cabinet level to understand how the Trump administration will view new rules such as "risk retention" in the CMBS market.

Other sectors likely to be affected by changed regulations are energy and infrastructure. Delays can raise costs of capital-intensive projects materially, and some of Trump's appointees and advisors favor streamlining the approval process for some of the larger projects in particular. In the energy sector, pipeline project approvals seem likely to be on a fast track for approval. This will influence a host of local real estate markets in and around shale deposit areas as well as the energy delivery infrastructure. Trump's appointees to various regulatory bodies ranging from the Federal Energy Regulatory Commission to the Surface Transportation Board, not just the Cabinet-level Environmental Protection Agency, will impact infrastructure more broadly. When combined with some type of tax program providing subsidies to investors, increased investment in infrastructure seems highly likely—and soon. People running infrastructure investment funds certainly must be working hard to try to understand what different regulatory and tax programs will mean for entities ranging from pipeline providers to railroads. Do not forget that there always are losers, not just winners, from these changes. Somebody is benefiting from the status quo and probably lobbied hard for it, so it is unwise for investors to throw money at everything in the sector.

Another important regulatory decision will be what to do with Fannie Mae and Freddie Mac. Trump's Treasury secretary-designee Steven Mnuchin has stated that he wants the two government-sponsored enterprises (GSEs) out of conservatorship, but it still is not clear what that means in practice, and Congress's desires undoubtedly will play a role in this outcome. The housing sector already is being influenced by the rise in interest rates, which are showing up in higher mortgage costs for buyers. Employment growth continues, so more people should be able to purchase homes, even if rates are modestly higher. I presume that political realities will ensure that any change in the statuses of Fannie and Freddie will not result in materially higher mortgage rates for borrowers (i.e., guarantee fees used to help fund the GSEs will not rise a lot), so the impact on the real estate industry is likely to be on the relative fortunes of banks and securities firms as well as investors in the two GSEs' preferred shares.

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Tax Reform

I have stayed away from tax reform thus far because its shape is far from clear, and until it is, we can only speculate on near-term impacts. I believe a major reform of the corporate tax code is likely, as well as middle class tax relief on the personal income tax side, not just a lowering of the top rate for rich households. Two important consequences arise from those assumptions. One is that a corporate tax reform that allows US firms to repatriate dollars presently held overseas for tax purposes will not necessarily result in an upsurge in domestic investment. Those overseas accounts already serve as effective collateral for US corporations, and many have borrowed against them. The question is whether the money raised will be used for share repurchases or net new investment in capital. Thus far, it has primarily been the former. There is no reason to presume that corporate tax reform alone will change that. However, renewed animal spirits from a more favorable business environment might.

Second, middle class tax reform that lowers the tax burden of those households seems likely to be spent, not saved. That could provide a significant boost in consumer spending in the relatively short term. To be sure, any associated increase in the federal deficit (which seems very likely) ultimately has to be paid off. That said, the net effect would be stimulating in the short run, and some of that would spill over to the real estate sector and retail and housing in particular.

Immigration and Trade

Immigration and trade are two other policy areas that could have substantial impacts on parts of the real estate industry. Trump has vigorously supported building a wall on the southern border with Mexico, and I presume we will see action on the ground in fairly short order. Removing undocumented immigrants, whose precise number obviously is unknown but certainly is in the many millions, will take substantially more time. A host of legal and some legislative hurdles will slow any marked upsurge in deportations. Whatever happens, this is going to reduce demand for housing, lower-end multifamily especially. And there will be some spillover into the retail sector. The impact will be greatest where immigrants are most concentrated (i.e., in states along the southern border), but immigrants live throughout the United States.

Everybody has to live somewhere, whatever one's immigration status. The US Census Bureau recently announced the lowest annual population growth rate of 0.7% since the late 1930s, at the end of the Great Depression. Vigorous policy geared to removal of at least some undocumented persons, as well as increased barriers to new entry, will help ensure that overall population growth remains low, absent a sharp increase in domestic fertility (which seems highly unlikely). This will stunt demand for housing and retail, compared to what it would have been in the absence of such policy. Real estate is a long-lived asset that depends upon economic growth for strong, long-term demand. That immigration has been an important component of demographic growth in US property markets differentiates the US from most of its developed economy counterparts around the world. Changing this would be both new and important for real estate owners and investors and certainly not in a positive way on balance.

Trade policy in the new Trump administration also holds the potential for negative effects on parts of the real estate industry. History shows that trade wars can escalate very quickly, and US law gives the president fairly wide latitude regarding the ability to impose tariffs, duties, and the like under certain circumstances. Global trade growth already has slowed sharply in recent years. Trump administration actions that generate countermeasures from a large country such as China are likely to directly affect a host of real estate investments—starting with those in key port markets. Spillovers will then occur in a host of areas, including in the transportation and storage networks. Some of these effects will be counterbalanced as domestic alternatives are developed, but those will take time and be more expensive. If that were not the case, the country would not be engaging in costly trade in the first place.

More broadly, indirect effects that negatively affect asset values are likely to result from lower growth. It simply is not true that trade lowers American growth; rather, it raises it and Americans' standard of living—on average. What is true is that trade can have very unbalanced outcomes, with some benefiting greatly while others lose their jobs. Restrictive trade policies likely to result in lower long-term growth reflect a political failure to compensate the losers from the globalization of supply chains and goods and services production. And they certainly should not be expected to help the real estate industry in general. Higher overall growth does not arise from being less efficient in production, and as noted just above, capital-intensive, long-duration assets such as property need strong economic growth to justify high asset values.

Manufacturing

One thing I do not encourage real estate investors to bet on is a material rebirth of manufacturing in the US. Sound research does show that the rise of China negatively impacted various US manufacturing markets. However, that does not imply that "free trade" is primarily responsible for the decline of manufacturing employment in the US labor force. It is not, as indicated by the long-term trend decline in manufacturing's employment share, which predates the rise of China. Rather, technological advances ranging from automation and robots to machine learning are thought to have played a more important role than trade. Manufacturing's share of national output has not declined, by the way. The sector has become much more efficient over time, producing a greater amount of output with fewer workers. Trade policies, even trade wars, seem highly unlikely to change these fundamental forces in our society and economy.

Conclusion

In sum, whatever your political views on the new president, US productivity and economic growth generally are determined by the creativity and willingness of private sector actors to take risks. Whether Donald Trump or Hillary Clinton was elected does not change that basic fact. Still, government can make the investment and production markets better or worse for entrepreneurs and business people. A less onerous (but still effective) regulatory environment, particularly with respect to financial markets, combined with corporate and personal tax reform that leads to more-efficient decisions by firms and workers, is a boon to the private economy in general and to a capital-intensive real estate sector specifically. Expectations of changes along these lines well may lie behind the more favorable equity and debt securities markets since the election. Expectations of a fiscal boost via infrastructure investment subsidies and deregulation in the energy sector also may be influencing asset prices. However, there are long-term policy risks for real estate in the Trump administration. Foremost among them are increasingly restrictive immigration, which weakens an important demographic driver of demand for residential property and retail goods, and restrictive trade policies, which increase the risk of retaliation and a more general trade war. Economic history around the world is clear that asset values will be lower, not higher, if severe trade restrictions are imposed and economic efficiency falls.

As the country embarks on another presidential transfer of power, I am reminded of my grandmother's admonition to watch out for what I wished. In this case, I have always wanted to live in interesting times. ■

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