President Trump’s First 100 Days:
Implications for the Property Markets
The Overview
Trump’s First 100 Days: The Market Positives

- Equity markets have rallied since Donald Trump was elected. The S&P was up 10% during the first 100 days and the stock market has gained more than $3 trillion in wealth.

- Consumer and business confidence have soared to 15-year highs. Volatility measures are remarkably low, and signs of reflation are occurring.

- Odds are still high that some version of fiscal stimulus (tax cuts, deregulation) will be enacted, resulting in a stronger near-term economic trajectory.

- U.S. job growth has accelerated since the election; demand metrics for real estate space have remained steady.

- After the initial jump, the 10-year U.S. Treasury Yield has settled back down; CRE values have held up well (+2.4% since the election) and more product is entering the pipeline.

- There has been a tremendous amount of capital targeting U.S. commercial real estate, closed-end funds have $144 billion of dry powder – up 9.8% since the election alone.

- There have been no changes to real estate policy (1031, carried interest, etc.) that would fundamentally threaten the sector’s growth potential.

- The probability of a recession is at a cyclical low; 94% probability expansion continues.
Trump’s First 100 Days: The Market Negatives

- Markets have ridden promises of fiscal stimulus. It’s not clear that policymakers will be able to meet market expectations given political gridlock.

- Previous assumptions on fiscal stimulus have been scaled back. Given the politics, individual tax reform is looking less likely, and a watered-down version of corporate tax reform and infrastructure spending are looking more likely.

- Deficit spending looks increasingly likely, which will ultimately place upward pressure on the long-end of the yield curve.

- Even a full fiscal stimulus package would not change the reality that the U.S. is nearing full employment, which will ultimately slow job growth and demand.

- While confidence measures have soared, the hard data on the economy (GDP, retail sales) have not been nearly as impressive. GDP growth is on track for just 1% in Q1.

- Geopolitical risk is rising: North Korea, Russia

- Still many unknowns: debt ceiling, possible government shutdown, federal budget uncertainty, the status of NAFTA and other trade agreements, AHCA Repeal/Replace, immigration, tweet uncertainty, etc.
First 100 Days

- The President of the U.S. can propose a bill, but it is the U.S. Congress that makes laws.
- Much of what the Trump administration proposed to accomplish in his first 100 days has been met by staunch opposition by a very divided Congress.
- The battles over the Supreme Court Justice nomination – which required the “nuclear option” to push through – highlights the intense political divide.
- The two major parties have splintered into several schisms, making it very difficult to align on any piece of legislation.
Twitter Tracker

Donald J. Trump
@realDonaldTrump

21500
21000
20500
20000
19500
19000
18500
18000
17500
11/8/2016
12/8/2016
1/8/2017
2/8/2017
3/8/2017
4/8/2017

"I would have done even better in the election, if that is possible, if the winner was based on popular vote-but would campaign differently"
21 Dec 2016

"I don't know Putin, have no deals in Russia, and the haters are going crazy - yet Obama can make a deal with Iran, #1in terror, no problem!"
2 Feb 2017

"Big day for healthcare. Working hard!"
22 March 2017

"Today we make America great again"
11 Nov 2016

"Can you imagine if the election results were the opposite and WE tried to play the Russia/CIA card. It would be called conspiracy theory"
12 Dec 2016

"FAKE NEWS media knowingly doesn't tell the truth. A great danger to our country. The failing @nytimes has become a joke. Likewise @CNN, Sad!"
24 Feb 2017

"If Chicago doesn't fix the horrible "carnage" going on, 228 shootings in 2017 with 42 killings (up 24% from 2016), I will send in the Fed's!"
24 Jan 2017

"JOBS, JOBS, JOBS!"
6 April 2017

DJIA Close
How Have the Economy and CRE Performed Thus Far?
Equity Markets Rally Immediately

The equity markets have surged since Donald Trump was elected.
- The stock market has gained more than $3 trillion in wealth.
- REIT indices have also rallied, with industrial and office indices leading the pack.

Every $1 increase in the stock market boosts consumer spending by $0.03.
- A stronger consumer typically has a positive multiplier on demand for real estate space, at a lag.

Source: S&P Dow Jones Indices LLC, SIX Financial Information, Cushman & Wakefield Research
Volatility Remains Remarkably Low

CBOE S&P 100 Volatility Index

- The Volatility Index is a good measure of investor confidence/angst.
- Since the election, volatility has remained low, suggesting investors are taking the new policy/economic environment in stride so far.
- Volatility can spike quickly so this indicator needs to be watched for changes in investor sentiment.

First 100 Days

- When volatility rises, CRE pricing tends to soften or decline. Last year volatility spiked several times and we saw the smallest increase in prices since 2012. Sales volumes are also inversely related to volatility.
- Real estate investors are still adjusting to the new policy environment, particularly on interest rates, but with volatility low, investment sales expected to pick up.

Impact on CRE

Source: Chicago Board Options Exchange, Cushman & Wakefield Research
First 100 Days

- The Small Business Confidence Index surged immediately following the election and remains high.
- Consumer confidence also spiked in the five months since November and is hovering at a 15-year high.

Impact on CRE

- Higher confidence correlates with job growth, particularly in the office-using sectors. Higher sentiment due to an expectation of a pro-business agenda in DC will likely boost or lengthen the current run in job creation.
- Rising construction will start to push vacancy up, but demand for office space will now be stronger than it otherwise would be, assuming fiscal stimulus policies are enacted.

Job Creation Has Inched Up
U.S. Payroll Employment, Three-Quarter Moving Average

Source: BLS, Cushman & Wakefield Research

First 100 Days

- Election uncertainty contributed to a slowdown in job growth in Q3 and early Q4 of 2016.
- Since the election, job growth has slowly accelerated, averaging 172,000 per month, up from 144,000 in October/November.
- Regardless of policy, job creation is expected to decelerate as the U.S. nears full employment.

Impact on CRE

- Moody's Analytics estimates that the U.S. economy will create 2.2 million net new jobs in 2017, down slightly from 2.49 million created in 2016.
- Likewise, absorption levels will remain similar to the prior year but down slightly
Inflation and Interest Rates Have Already Risen

U.S. Interest Rates & Inflation Past Three Years

**First 100 Days**

- Treasury yields rose sharply following the election, but the yield curve steepened initially implying the move was primarily a re-rating of medium-term growth (and inflation) expectations.

- The Fed’s preferred measure of inflation has increased as well and is now higher than any time since mid-2011 on a three-month basis or mid-2012 on a year-over-year (YoY) basis.

**Impact on CRE**

- Higher interest rates could place pressure on cap rates if not offset by higher growth outlook.

- Debt capital becomes more expensive, but perhaps also more plentiful.

- More rapid return to inflation target increases the chance of Fed error, but a stronger near-term outlook is the most likely scenario.
Despite above-average building completions and a slowdown in leasing activity year-end 2016, office vacancy has hovered around 13.2% the past four quarters.

Office asking rents have continued to rise – increasing 4.6% (YoY) to $29.94 Q1 2017.

Demand for industrial space remains at record highs causing vacancy to decline to a 30-year low and rents to rise.

The leasing fundamentals will always be driven by economic and supply factors, which policy may influence.

Given the expected stimulus of tax cuts, spending increases, and deregulation, the near-term outlook for the demand metrics has been revised upward from previous estimates.
First 100 Days

- Investment sales volume fell 26% YoY Q1 2017.
- The weakness in activity was broad-based across market tier, product type and transaction size.
- Few deals entered the pipeline in Q4 2016 due at least in part to uncertainty surrounding the election.
- Buyers and sellers have been in a stalemate on pricing as they adapt to the new political environment and economic outlook – it is an open question who will be the first to move and exactly when, but NOT if.

Impact on CRE

- More product has already started to enter pipeline, and we expect this to accelerate.
- Stage is set for a strong second half with potential for 2018 to “borrow” volume from current stasis.

Source: Real Capital Analytics, Cushman & Wakefield Research

Investment Sales Slow, But Should Pick Up

U.S. Investment Sales Volume (Deals Over $5M)
First 100 Days

• CRE continues to deliver attractive returns relative to other asset classes.

• This cycle has seen strong outperformance by product types and markets with the lowest fundamental risk, but that has begun to shift.

• Industrial returns remain relatively healthy versus other product types, driven by the eCommerce revolution.

Impact on CRE

• Expect increasing investor interest in certain markets and product segments that have lagged the cycle heretofore where we have already begun to see a shift in pricing momentum.

• As capital expands its opportunity set, this should create a virtuous cycle of further price appreciation reducing spreads where they have run in advance of fundamentals.
What Is the Status of Key Policy Proposals?
Impact on CRE

• Past tax cuts from the 1980s and early 2000s did result in stronger economic growth.
• They also resulted in higher inflation and higher interest rates.
• Overall, the impact of tax cuts will likely be a stronger economic growth scenario and a stronger demand real estate space scenario in the short-run.

Tax Policy

TRUMP’S PROPOSAL:
• Reduce corporate income tax from 35% to 15%.
• Reduce top income tax brackets, and number of tax brackets from seven to three.
• Repeal the estate tax and eliminate the alternative minimum tax.
• Advocate for a one-off 10% tax rate on repatriated corporate earnings.

WHERE IT STANDS AT 100 DAYS:
• The replacement of ACA and tax reform remain at the top of the agenda.
• Tax reform – a complete overhaul of entire tax code system – has not happened in 31 years and is looking increasingly unlikely for 2017.
• Tax cuts, on the other hand, have been passed many times in the past three decades and are more likely.
• The border-adjustment tax continues to be hotly debated and is looking less likely.

WHAT’S NEXT:
• House Republicans have put forward a tax reform proposal.
• The administration recently released its own plan on April 26.

Did you know . . .
Over more than 80% of economists surveyed expect corporate tax reform to occur by the end of 2018; 62% say it will happen in second half of 2017.

Source: BEA, Cushman & Wakefield Research

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When will we see policy change, if at all? Best Guess: September 2017
Border Adjustment Tax

TRUMP’S PROPOSAL:
• The Border Adjustment Tax, or BAT, would levy a 20% tax on all imports of good and services into the U.S.
• U.S. exports of goods and services would not be taxed at all.

WHERE IT STANDS AT 100 DAYS:
• While this proposal has earned the support of many large exporters, it is generally opposed by four major industries: auto, energy, aircraft, and especially retailers.
• The International Council of Shopping Centers (ICSC), National Retail Federation (NRF), and other retail trade groups have galvanized to block the BAT with support from more than 100 of America’s largest retailers. Retail groups say that the tax would mean much higher prices on the goods they import (from avocados to car parts, from apparel to televisions) and that those costs would be passed on to the consumer.
• The border-adjustment tax is looking less likely.

WHAT’S NEXT:
• The BAT is reportedly on life support already and may or may not be part of any tax reform that is put forward.

When will we see policy change, if at all? Best Guess: September 2017

Did you know . . .
The National Retail Federation claims that BAT will result in retail pricing increasing by 15% across the board and that it would cost the average American family $1,700 per year.

Impact on CRE

• BAT would increase pricing on imports and this would impact most retail categories, but particularly apparel and electronic goods.

• The impact on bricks and mortar retailers and eCommerce retailers would be roughly the same.

• Increased pricing would hurt retail sales and BAT’s impact would be most damaging to low income consumers.

• BAT could hasten the demise of many struggling mid-tier apparel retailers that are already struggling from heightened online and discounter competition.
U.S. trade with free trade agreement partners represented nearly 70% of all U.S. exports and 80% of all U.S. imports in 2016. Thus, trade-related movement of goods is an essential part of the industrial market.

Uncertainty surrounding trade policy can slow site selection, leasing and investment decisions, particularly in durable production zones and transportation corridors proximate to ports of entry.

More than 410,000 U.S. industrial tenants around the country engage in international goods trading. As a result, changes to trade policy that affect trade flows ripple throughout the U.S. industrial market.

On average, trade agreements have increased bilateral trade with partner countries by 26.3%.

China, Canada, and Mexico are the top three U.S. trade partners, making them a significant source of import-related leasing and key export markets.

Considering that China’s middle-class consumer population will exceed the entire population of the U.S. by 2026, it is an increasingly important export market for industrial occupiers.

NAFTA has dramatically increased the amount of truck traffic flowing between the U.S., Canada, and Mexico, which, in turn, has spurred warehouse development.

Since NAFTA went into effect, U.S. warehouse stock has increased by 3.5 billion square feet.
**The Wall & Immigration**

**TRUMP’S PROPOSAL:**
- Build a 1,250-mile wall on the U.S.-Mexican border (in three phases, extending existing wall almost the entire length of the border).
- Fund the wall (at least partially) through a Destination Based Cash Flow Tax applied to U.S.-Mexico trade.
- Strengthen border security and immigration enforcement, specifically augmenting enforcement against illegal immigration.

**WHERE IT STANDS AT 100 DAYS:**
- Two Executive Orders were signed on January 25.
- Cost estimates for the wall range from $12 billion to $25 billion.
- Funding for the wall is determined by Congress (Trump requested funds by April/May).
- Legal and operation issues need to be addressed.
- Third Executive Order (January 27) was struck down by courts.

**WHAT’S NEXT:**
- Congress decides on budget—will influence abilities of DHS and ICE to fulfill Executive Orders, including building the wall.
- Trump has said he supports broader immigration reform, but details have not been released.

*Did you know . . .*

Between 1986 and 2015, the budget for patrolling the border has increased more than 20 times, and the number of border patrol agents has increased more than 5 times.

**Impact on CRE**

- A Destination Based Cash Flow Tax would likely increase import prices (even if the dollar strengthens).
- Although current law allows for 65,000 H-1B visas to be issued each year, in FY 2014, more than almost 125,000 were issued—many companies that need skilled workers (STEM and tech) rely on such immigrants.
Healthcare Reform: AHCA Repeal/Replace

**AMERICAN HEALTH CARE ACT (AHCA) PROPOSAL:**
- Remove penalties for individuals who do not purchase insurance.
- Maintain pre-existing condition requirement, but allow insurance companies to impose a 30% premium surcharge after lapse in coverage.
- Replace premium subsidies with age-based tax credits.
- Eliminate penalty for large businesses (50+ employees) that fail to offer employees coverage.
- Freeze Medicaid expansion after 2020 followed by a gradual phase-out.

**WHERE IT STANDS AT 100 DAYS:**
- AHCA reform bill was drafted, but never brought to vote due to lack of sufficient support in the House.
- In the midst of uncertainty the GOP goes back to the drawing board.

**WHAT’S NEXT:**
- House Republicans will re-visit health care legislation.
- No timeline has been offered for re-draft.
- There is an April deadline for insurers to indicate participate in Health Exchanges for 2018.

**Did you know . . .**
- Congressional Budget Office estimated that passage of AHCA would result in 14 million people becoming uninsured by 2018, and up to 24 million by 2026.
- If passed, AHCA is expected to cut the Federal deficit by $337 billion over the next decade.

**Impact on CRE**
- Likely to see the same medical office/healthcare assets trade multiple times between REITS/Investors as capital continues to chase limited product.
- New healthcare development activity may cool. If it is not already funded, it will be difficult to line up financing.
- Hospital M&A activity slowed in Q1 2017 and may stay soft until uncertainty of ACA future is resolved.

**When will we see policy change, if at all? Best Guess:** ?
Trump’s Budget Request, FY 2018
(by Agency)

- Environmental Protection Agency: -31%
- State Department: -29%
- Agriculture Department: -21%
- Labor Department: -18%
- Health and Human Services: -18%
- Commerce: -16%
- Education: -14%
- Housing and Urban Development: -13%
- Transportation Department: -13%
- Interior Department: -6%
- Energy Department: -6%
- Small Business Administration: -5%
- Treasury Department: -4%
- Justice Department: -4%
- NASA: -1%
- Veterans Affairs: 6%
- Homeland Security: 7%
- Defense Department: 9%

Federal Budget

| Year | Defense | Homeland Security | Veterans Affairs | NASA | Justice Department | Treasury Department | Small Business Administration | Energy Department | Interior Department | Transportation | Agriculture | Commerce | Education | Housing and Urban Development | Health and Human Services | Agriculture | Defense |
|------|---------|------------------|-----------------|------|--------------------|--------------------|------------------------|----------------**|-------------------|----------------|-------------|-----------|----------|-----------------------------|---------------------------|-------------|---------|
| 1970 | 100%    | 50%              | 20%             | 10%  | 5%                 | 10%                | 20%                    | 5%              | 10%              | 20%           | 10%         | 5%        | 10%      | 20%                         | 10%                        | 5%          | 10%     |
| 1980 | 20%     | 10%              | 5%              | 1%   | 1%                 | 1%                 | 1%                     | 1%              | 1%              | 1%            | 1%          | 1%        | 1%       | 1%                         | 1%                        | 1%          | 1%      |
| 1990 | 10%     | 5%               | 1%              | 1%   | 1%                 | 1%                 | 1%                     | 1%              | 1%              | 1%            | 1%          | 1%        | 1%       | 1%                         | 1%                        | 1%          | 1%      |

Debt as a % of GDP
(Current Baseline)

- The President submits a budget request at the beginning of each year for spending plans in the following fiscal year (Oct 1, 2017 – Sept 30, 2018).
- Given the fractured nature of Congress, as was the case with Obama era budgets, Trump’s is likely D.O.A.
- If an agreement is not reached, then the previous year’s budget remains in force.
- Without structural reforms to mandatory spending programs (Medicare & S.S.), debt to GDP ratios will continue to rise.
The U.S. is again bumping against its borrowing limit. The limit was breached mid-March. Extraordinary measures are under way to pay the nation’s obligations.

There will be political drama, but the debt ceiling will likely be raised by this summer, if not sooner.

Trump’s FY 2018 proposed budget calls for a full repeal of the caps on spending known as “the sequester.”

Again, this is something that needs to be reconciled in Congress during the budget process, but could result in significant government spending increases particularly for defense and infrastructure.
The rollback of the sequester and increases in Defense and Department of Homeland Security spending should benefit commercial real estate investors in the jurisdictions that have historically attracted these budget dollars.

Experts predict that between $50 to $100 billion per year in new defense spending will be needed to accomplish defense policy goals.

The Trump budget’s initial request is for an additional $54 billion in new defense spending.
Markets to Watch
Proposal: Increases to Federal Defense and Homeland Security Spending

Impact on CRE

- Look for federal procurement to surge and office and industrial demand to increase where there are large military installations, headquarters locations of large federal contractors, and the sites of tank/ship/submarine/aircraft manufacturing facilities.

- On the defense side, certain Virginia, California, Arizona and Connecticut jurisdictions stand to benefit the most.

- On the homeland security side, the DC Metro region’s jurisdictions stand to gain the most with 5 of the top 10 jurisdictions receiving the most contracting opportunities.
**1031 Exchange**

**Current:** Investors can defer capital gains taxes on the sale of investment properties provided they reinvest the proceeds subject to IRS restrictions and requirements.

**Any change?** Rumors could be eliminated as part of comprehensive tax reform.

**Most Impacted?**
- Small, private real estate investors
- Single family rental properties
- Lower transaction size
  - Net lease investment
  - Strip centers
  - Multifamily
  - Condominiums
  - Motels

**Carried Interest**

**Current:** General partner of a private investment fund’s participation in fund returns is taxed as long-term capital gains (top rate 23.8%) rather than ordinary income (top rate 39.6%).

**Any change?** During the campaign, Trump proposed treating carried interest as ordinary income.

**Most Impacted?** Private equity real estate fund managers

**Offsets**

Trump and Republican plans also propose reductions to corporate and pass-through tax rates which means funds may be able to reorganize and minimize final tax impact.

**Interest Deduction**

**Current:** Interest on debt is tax-deductible. Capital assets are depreciated over time and that expense is tax deductible.

**Any change?** Trump has proposed giving manufacturing companies the option of 1) immediately expensing investments or 2) taking interest and depreciation deductions over time.

Republican tax blueprint calls for elimination of tax-deductibility and mandatory 100% expensing of investments for all businesses.

**Most Impacted?** Every actor in the economy – much greater risk for unintended consequences in Republican plan.

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*Exceptions made for banks, insurance and leasing companies. Investments includes buildings but not land.*
What to Watch
What to Watch

**Government Shutdown**
- Not likely, short-term funding bill expected to keep government open.
- But debt ceiling debate looms – likely to heat up this summer as Treasury runs out of extraordinary measures.

**Federal Budget/Sequester**
- What will the first budget resolution under this Congress look like?
- It could telegraph winners and losers for real estate markets.

**Political Gridlock**
- The Trump administration has until the Q4 2017 to enact its agenda. After that, it becomes more difficult as we enter the 2018 election cycle.

**Equity Markets**
- If they stay positive or roughly the same, it’s good news for real estate. With a protracted plunge, negative wealth effect, all bets are off.

**Protectionist Movement**
- This is the biggest wild card. Massive implications for many areas of the U.S. economy; it could greatly impact inflation/interest rates, population growth, trade and capital flows.

**Bond Market**
- Holding steady, but a spike scenario is still on the table as Fed tightens, inflation mounts, and deficit increases.
Most probably scenario is that U.S. GDP grows by 2+% in 2017/18, enough growth to create roughly 2 million net new jobs per year.

- Inflationary pressures put slight pressure on treasury yields but global forces keep rates on a reasonable upward path.
- Some fiscal stimulus is assumed, but only slight impact on growth.
- Leasing fundamentals remain healthy but supply finally catches up with demand, pushing vacancy higher and slowing rent growth.
- Sales activity pick up in second half of 2017 as investor comfort level improves and newest wave of capital is deployed.

Source: BEA, BLS, Cushman & Wakefield Research