2020 PRESIDENTIAL ELECTION

Marcus & Millichap

SPECIAL REPORT *Policy Implications for Commercial Real Estate*

OCTOBER 2020

Economic Policy and Real Estate Investment Implications of the 2020 Presidential Election Overshadowed by the Continuing Health Crisis

Presidential and congressional elections to set economic policy. The outcome of the 2020 presidential election between former Vice President Joe Biden and President Donald Trump will open the door for divergent economic policies to go forward. How these policies are enacted into law will depend heavily on the result of several congressional races. If the Democratic Party holds on to a majority of seats in the House of Representatives while the Republican Party maintains its slim hold over the Senate, then it is unlikely any substantial new legislation will be passed regardless of who sits in the Oval Office. The electoral outcome most likely to foretell significant change would be the "Blue Wave" in which Biden is elected to the executive office and the Democratic Party obtains a majority in both houses of Congress. The results of numerous local campaigns will also have a driving impact on grassroots policy.

Pandemic more important to the economy in the near term. While important, the immediate influence of the presidential and congressional elections on commercial real estate investment will be overshadowed by the health crisis. The trajectory of the economy between now and the next set of elections in 2022 will be more profoundly impacted by the progression of COVID-19 than the policy goals of either Biden or Trump. The office of the president can nevertheless direct the national response to the virus moving forward, which could strongly influence the economic trajectory over the next few years, with plenty of implications for the performance and trade of commercial properties.

Top Implications for Investors

Investor Considerations Under Biden:

- Larger stimulus package likely to boost job creation, consumer spending, and rent payments in 2021, improving the financial stability of small businesses and local governments.
- Increased funding for health services including COVID-19 testing and tracking.
- Higher taxes on corporations and high-net-worth individuals; increased capital gains tax rate could change investor behavior and may drive accelerated sales before policy implementation.
- New tax incentives and industry-specific investment to have market-by-market benefits.

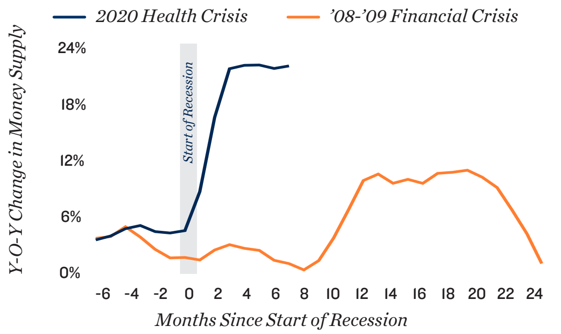
Investor Considerations Under Trump:

- Stimulus targeted at the most affected industries, including small businesses; less overall effect on 2021 growth.
- Investors' tax burdens likely to remain largely the same; deduction limits to continue influence on market migration.
- Additional tax cuts possible, but unlikely.
- Less clarity on strategies to combat COVID-19 and manage foreign policy create some uncertainty for investors.

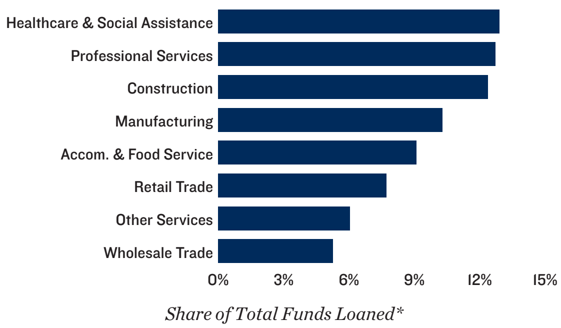
A Biden administration could usher in greater growth but also higher taxes. Mr. Biden would likely begin his presidency by assembling a substantial stimulus bill that could boost economic growth in the near term. The benefits to the financial health of consumers and businesses could help restore commercial property fundamentals and investment sentiment. These gains would be partially offset by a series of new tax policies. Besides higher tax rates for some individuals and businesses, Biden's proposed adjustments to U.S. tax code could have structural implications for investors if a proposed limit to Section 1031 tax-deferred exchanges is enacted. Biden has also championed amplified public spending on infrastructure, clean energy and education, which may provide short-term aid at the risk of dampening long-term growth by increasing the nation's debt burden. It is, of course, uncertain when or if these policies will be implemented. Nevertheless, if Biden is elected, investors considering selling properties may want to accelerate their plans to close deals before the risk of tax-related costs rise.

Second Trump term likely a continuation of the status quo. Trump's goals for a second term are less defined than his opponent; however, past actions provide insight into future behavior. Additional stimulus to combat the human and economic costs of the pandemic is expected under Trump. A Republican majority in the Senate would reduce the ultimate level of spending, however, slowing the near-term recovery. Trump has also shared his support for greater public spending on infrastructure, which would bear some of the same long-term costs as under a Biden presidency, although specifics of a Trump plan are unknown. In regard to tax policy, a second Trump administration is highly likely to maintain the provisions passed as part of the 2017 Tax Cuts and Jobs Act (TCJA). Trump may also pursue additional cuts to payroll and capital gains taxes; however, it is unclear if such policies would be passed by a divided Congress. Overall, the benefits and costs that investors have contended with over the past two years would be likely to continue, including uncertainty over some aspects of foreign policy and health crisis management.

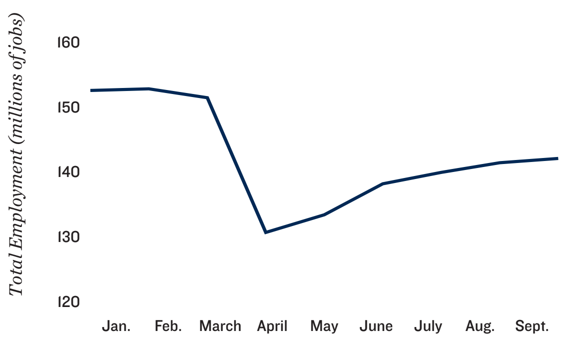
Fed Moved Urgently to Offest Shutdown



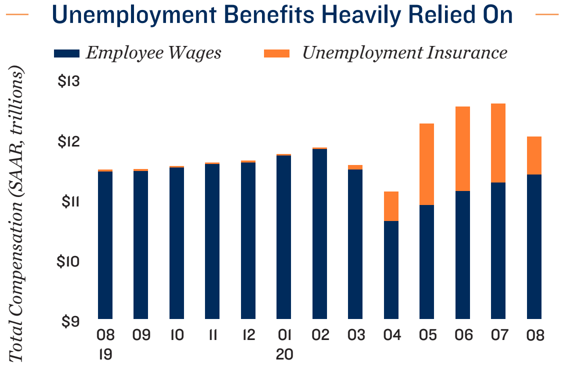
Top Sectors by PPP Funds Received



Total Employment Recovering



Unemployment Benefits Heavily Relied On



** As of August 2020, nine of 21 sectors listed*

Sources: Bureau of Labor Statistics; Federal Reserve; Small Business Administration

Health Solution Eclipses Elections In the Near Term

Next president to influence, not control the outcome of the health crisis. An overall health solution to COVID-19 will be integral to fully restoring the economy, and while neither presidential candidate can completely control the coronavirus, the White House will play a pivotal role in allocating resources and supporting the development and distribution of a vaccine. State and local governments, however, are expected to take the lead on deciding if conditions warrant additional lockdowns, as was the case in the spring and summer. The economic costs of these actions will fall on whomever sits in the Oval Office, though. Unless the situation deteriorates significantly, a more substantial stimulus package is more likely with Biden than Trump, especially under a unified government scenario. A larger aid package could notably boost consumption, housing demand, and business expansion in 2021.

Bipartisan support for the Paycheck Protection Program to aid real estate. The most critical stimulus measure for commercial real estate is additional funding for the Paycheck Protection Program (PPP), which expired in August. The PPP has been an essential pillar of support for troubled small businesses and their employees. However, several sectors of the economy continue to be heavily challenged, including the hospitality, travel, tourism, and live entertainment industries, as well as several aspects of retail trade. Demand for these types of enterprises is not anticipated to fully recover for at least the next year, well exceeding the initial timeframe of PPP aid. Both candidates support additional funding for the PPP, such that a separate PPP bill may proceed under the current Congress before a more comprehensive stimulus is agreed upon. Even with this aid, numerous businesses will continue to face steep hurdles, contributing to continued high unemployment.

Unemployment insurance, housing relief also on the ballot. Backed by bipartisan support, some form of federal unemployment insurance will likely be included in the next comprehensive stimulus bill. This would help unemployed individuals pay rent, benefiting apartment owners, as well as support broader consumer spending at restaurants, retailers, and other businesses. A unified government under a Democratic executive would likely result in the most substantial level of unemployment insurance, as well as a strong chance for a second round of direct stimulus payments to households. Biden may also push for greater housing relief, including expanded funding for the Section 8 voucher program, which subsidizes rent payments for lower-income renters by compensating apartment operators directly. Trump's administration, based on previously drafted legislation and the Lost Wages Assistance program, seems inclined to provide a more targeted level of financial aid, possibly requiring state contributions. Businesses and property owners may recover more slowly under this scenario, possibly leading to additional permanent closures.

Local government aid more likely under Biden. A stimulus bill shepherded by a Biden administration may include additional provisions absent from a Republican sponsored law. This includes expanded funding to state and local governments that could help diminish substantial budget shortfalls expected this year. These shortages add pressure to state and municipal legislatures to raise local taxes; however, any deficit-driven federal expenditures create the possibility for dampened long-term growth. Ultimately, the cost of the recession on local governments will have a negative impact on property holders, either through higher taxes or other cut resources.

Two Opposing Tax Policies at Play; Both Plans Present Pros and Cons for Investors

Some sellers could face larger capital gains taxes under Biden plan. Two notable tax code changes proposed by Mr. Biden could significantly increase costs for sellers and force investors to change their strategies. First, capital gains for individuals who earn more than $1 million would be taxed as ordinary income, at an effective rate around 40 percent, essentially doubling the current cost. This added tax burden creates a greater incentive for sellers to engage in Section 1031 like-kind exchanges, deferring payment on those capital gains. However, Biden has also proposed a $400,000 income cap to quality for a 1031 exchange. If passed, this combination would likely cause more investors to hold assets longer rather than selling assets and paying the higher taxes. Investors may also expedite their plans, selling under the current tax laws rather than waiting for the new rules to come into play. Notably, legislators have considered eliminating Section 1031 for real properties numerous times, but have not done so because removing this provision could result in a significant reduction in real estate sales activity, constraining any capital gains revenue gains.

Restored deductions could aid investors, sway migration patterns. Biden intends to eliminate the $10,000 cap on state and local tax deductions on federal returns that was enacted as part of the TCJA. This would reduce the tax burden on those who own assets in states and metros with high property taxes. Investors in markets with higher tax burdens may now have more options closer to home and could notably lessen the flow of wealth to other parts of the country. Another provision that could affect where buyers wish to invest is a first-time homebuyer tax credit of up to $15,000. More renters may use this incentive to become homeowners, moving to lower-cost areas. This household migration and resulting population growth could enhance the long-term outlook of local properties for both tenants and investors.

Impacts of Tax Cuts and Jobs Act on investors likely to continue under Trump. If Trump is elected to a second term, he will likely support the continuation of the TCJA, passed during his tenure in 2017. Some of the TCJA's provisions are temporary and set to expire by 2026 or earlier. A highly probable objective of a second Trump administration would be to make these provisions permanent unless later amended by Congress. Some of these provisions are key for investors. The TCJA increased the bonus depreciation deduction for qualified property and expanded the application of bonus depreciation to include previously owned buildings. Owners of certain pass-through entities were also eligible for a deduction on qualified business income of up to 20 percent, given a series of stipulations. These provisions lowered the tax burden for some investors, and under a more solidified structure could permit them to shore up long-term plans, insofar as those plans are affected by tax policy. This includes preserving the cap on federal deductions from state and local property taxes, continuing the incentive for some individuals to relocate to states with lower tax burdens.

Additional Trump tax cuts possible, but unlikely. In a second term, Trump may also pursue cuts to the income, payroll and capital gains tax rates. To pass, the additional tax reform would require at minimum for the Republican party to maintain its influence in the Senate. Even then, a Democratic majority in the House of Representatives may block the legislation. Unless the 2022 mid-term elections restore a widespread Republican majority, as when the TCJA was passed, the most likely outcome under a second Trump presidential term would be the continuation of the status quo.

Biden Key Tax Policy Positions

Individual

- Restore top individual marginal tax rate to 39.7 percent from 37.0 percent for individuals earning over $400,000
- Tax capital gains as ordinary income for those earning over $1 million
- Subject earnings above $400,000 to a 12.4 percent Social Security payroll tax
- Reestablish First-Time Homebuyer tax credit
- Increase the Child Tax Credit above current level
- Repeal step-up-basis for capital gains

Corporate

- Raise the corporate tax rate from 21 percent to 28 percent
- Double the rate on Global Intangible Low Tax Income earned by foreign subsidiaries of U.S. firms to 21 percent
- Establish a 15 percent minimum tax on book income for corporations with at least $100 million in income
- Enact "financial risk fee" on certain liabilities of financial institutions with over $50 billion in assets

Trump Key Tax Policy Positions

Individual

- Maintain changes from the Tax Cuts and Jobs Act, including:
  - Lowered individual tax rates, including top marginal rate to 37 percent
  - Doubled the standard deduction to $12,000 (single)
  - Cap state and local tax deduction to $10,000
  - Doubled the Child Tax Credit
- Forgiveness of deferred payroll tax
- Possible cuts to payroll and capital gains tax rates

Corporate

- Maintain changes from the Tax Cuts and Jobs Act, including:
  - Lowered corporate tax rate of 21 percent
  - Deduction on qualified business income
  - Full expensing of short-term capital investments
  - Repatriation of currently deferred foreign profits
  - Eliminated corporate alternative minimum tax

Biden, Trump Public Spending Goals to Help Certain Markets; Bipartisan Support for Reshoring to Benefit Industrial Properties

Biden aims to foster job creation via clean energy projects. A key component of Biden's platform for economic recovery is greater public spending on infrastructure, including several clean energy initiatives. By investing more in renewable energy and building everything from new roads and bridges to sustainable housing and zero-emission public-transit systems, Biden aims to facilitate strong job growth. The added employment could help drive a greater need for housing, offices, various retail centers, distribution facilities and a range of other real estate. Funding is likely to be allocated unevenly across the country, however. Markets geared toward solar, wind and hydro power will likely benefit more so than other areas. Over time, new industries could take root in previously overlooked or underutilized parts of the country, which could in turn foster a wave of commercial property development and investment from the private sector. The greater deficit spending undertaken to initiate these projects, however, come at the risk of a lower long-term growth trajectory.

City economies linked to national defense may benefit under Trump. Trump has also championed public investment in infrastructure, making it a key part of his 2016 campaign. The concept has failed to gain much traction among members of his own party over the past four years, however. Instead, more funding has gone to national defense over that time, a trend that is likely to continue under a second Trump administration. This could increase the demand for office and industrial space by government agencies and contractors in metros where the defense industry already has an established presence, including Washington, D.C., and Colorado Springs. A democratically controlled Congress could restrict the passage of these measures. A Republican majority in the Senate could do the same for Biden's clean energy initiatives. By contrast, both candidates have demonstrated support for improving domestic manufacturing.

Manufacturing returning to the U.S.; election to help. The manufacturing landscape in the U.S. is changing. As production processes become more technologically complex and automated, the reliance on lower-skilled labor is declining. Declining labor costs lower the incentives for companies to distance their supply chains to other parts of the globe, especially when the recent health crisis has highlighted the drawbacks of a multinational supply chain. Over time, this trend will support the development of U.S. production processes across a range of industries, raising demand for domestic manufacturing space. This will likewise increase industrial investors' interest in manufacturing buildings, adding to tailwinds the sector is already experiencing from the continued growth of e-commerce. The outcome of the election may sway this trend further.

Candidates' separate approaches to boosting U.S. production could help or hinder industrial real estate. Biden and Trump support expanding U.S. manufacturing operations, a concept sometimes referred to as reshoring, that has been given new weight by the health crisis. Distributed supply chains led to key supply shortages early on in the pandemic. Biden has proposed new federal funding and tax incentives to increase the purchasing of American-made goods, accelerate domestic research in leading technologies, and revitalize older industrial properties. The feasibility of these goals are greater under a Democratic Congress. Trump, who is unlikely to have a unified legislature until at least 2022, will have to utilize other methods. In his first term, Trump supported domestic production via executive order, increasing import taxes at the cost of higher international tensions. The phase one trade agreement with China will have to be renegotiated because of the pandemic's disruption to global shipping, possibly sparking renewed hostilities. This could spill over into financial market volatility, clouding investor sentiment, as was the case last year.

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Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; donaldjtrump.com; Federal Reserve; joebiden.com; Moody's Analytics; Small Business Administration