

Special Report

Trump Election: Investor Implications

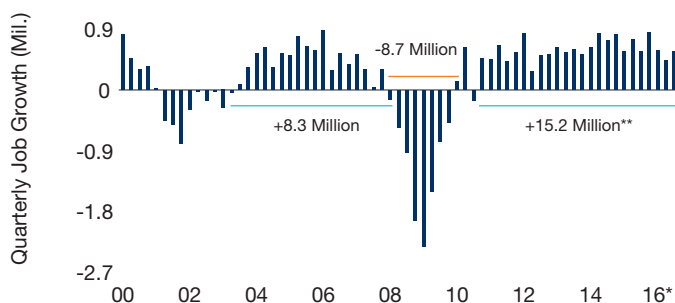
Trump Victory to Push Economy From Status Quo, Could Redefine Playing Field for Commercial Real Estate

Following the lengthy campaign, Donald Trump surprised pundits and pollsters by winning the presidential election. This unanticipated turn of events set off a rapid drop in both stock market and Treasury rate futures before they recovered early Wednesday morning. In the wake of this unexpected outcome, markets are repricing both debt and equity to factor in increased government infrastructure and defense spending as well as the prospects of higher inflation. Sentiment is fragile and volatility should be expected.

The U.S. economy now stands in its seventh year of a durable but moderate expansion, supporting job creation, wage growth and consumption. Stable 5 percent unemployment and 5.5 million unfilled job openings point to a tight labor market and prospects of 2.0-2.5 million new jobs over the next year. Barring a significant unanticipated event, these positive drivers will be sustained into the coming year, supporting commercial real estate demand, tight vacancies and sturdy rent growth.

Though changes will undoubtedly emerge, economic momentum and positive demographics should sustain healthy real estate fundamentals. These prospects are bolstered by the coming reduction of gridlock on Capitol Hill as both houses of Congress and the White House come under a single party. This will support the establishment of fiscal policy, including a new budget and an increase of the debt ceiling when needed. In addition, the potential of reduced taxes, increased infrastructure spending and deregulation could give the economy a boost over the short term. While more rapid economic growth could spark inflationary pressure and push interest rates higher, the acceleration could also generate more jobs and stronger wage growth, both positives for the commercial real estate sector.

Steady Hiring Underpins Strong Commercial Real Estate Performance



* Through 3Q16
 ** Through October

Executive Summary

A wide range of factors will determine whether campaign rhetoric transforms into action. This report offers a perspective that assumes stated goals are implemented.

- **Congressional gridlock to ease.** Single-party control of both houses of Congress and the White House increases probability of action. Fiscal policy including tax changes, setting the federal budget and raising the debt ceiling will likely be less contentious.
- **Increased infrastructure investment.** Potential for economic growth and job creation with a commitment to additional infrastructure investment.
- **Repatriation of overseas capital.** Proposed temporary tax incentive for corporations to repatriate overseas capital could boost domestic corporate investment.
- **Reduced taxes could favor investors.** Reduced business and personal taxes could favor investors but the details will matter. Potential changes to carried interest may affect developers and fund managers.
- **Deregulation likely.** Reduction of regulation including the repeal or modification of Dodd-Frank likely. Potentially less regulation on oil and gas industries.
- **Short-term stock market volatility.** Elevated post-election uncertainty could spark short-term stock market volatility as Wall Street recalibrates.
- **Potential for rising inflation.** Deregulation, infrastructure spending and reduced taxes could spark economic acceleration and increase inflationary pressure.
- **Fed still likely to raise rates in December.** More aggressive Fed in 2017 increasingly probable.
- **Upward pressure on interest rates.** Anticipation of increased government debt placing upward pressure on Treasury rates.
- **Commercial real estate drivers positive.** Job creation, positive demographic trends, wage growth and a generally limited development pipeline sustain the favorable commercial real estate outlook.

Five Areas of Change Could Alter Course For Some Commercial Real Estate Investors

Although election night has passed, the broader implications of a new president are yet to be seen. Many fear a radical shift or sweeping change, but the transition will require months, and many of the modifications will transpire over years. In the interim, economic momentum will carry forward with few anticipated threats to the broader economic outlook. That said, change will likely emerge in five areas:

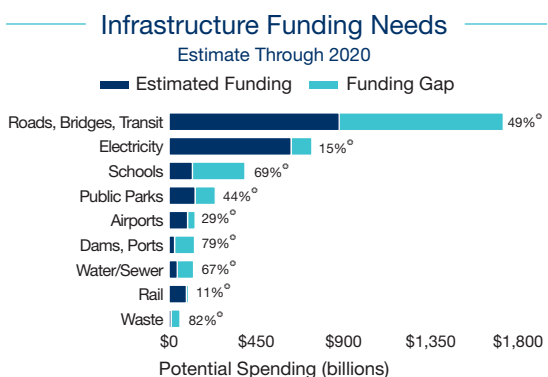
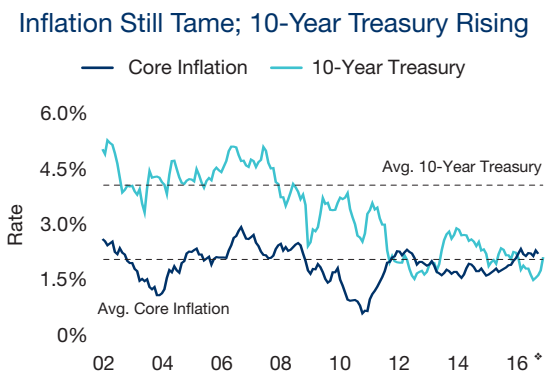
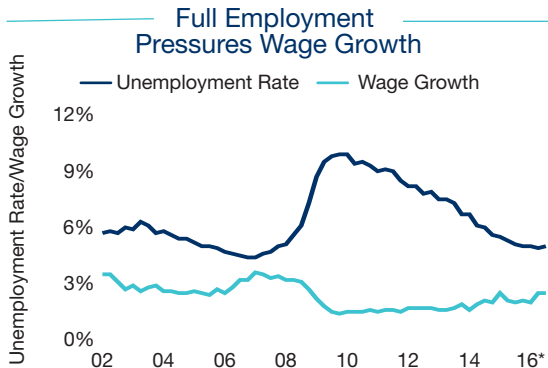
- Fiscal Policy:** With a united Congress and White House, Republicans will likely coalesce around a combination of tax cuts and increased investment into infrastructure and defense. In addition, much of the gridlock that stalled past budgets and debt ceiling increases could be avoided, bypassing the debates and gamesmanship that plagued Congress over the last several years. Trump's plan for comprehensive corporate and individual tax reform could come together if members of Congress align with the president-elect. The proposed tax code simplification would cut tax rates while raising the standard deduction and eliminating a large array of itemized deductions. If the numerous hurdles to tax change are successfully navigated, carried interest could also be eliminated, causing developers and some investor syndicates to reconsider their business structures.

- Infrastructure:** To spur economic growth, Trump has proposed a dramatic increase in infrastructure development. While there has long been consensus that additional infrastructure investment would be beneficial, the significant costs surrounding such an undertaking have stalled action thus far. Should meaningful additional infrastructure development be undertaken, it could yield substantive returns, including the creation of jobs and increased efficiency. Roads, transit, bridges, the electrical grid and numerous other projects would vie for funding, potentially benefiting surrounding commercial properties. Funding this additional investment could be a hurdle with a wide range of implications depending on how projects are financed.

- Monetary Policy:** Following the election, trends have remained stable enough to sustain the probability of a rate increase at the Federal Reserve's December meeting, though a significant disruption would cause the Fed to reconsider. From a broader perspective, if greater fiscal engagement including increased spending and reduced taxes accelerates economic growth as Trump believes, then higher inflationary forces will merit close monitoring by the Federal Reserve. The accelerated economic growth and ensuing inflationary pressure could prompt a quicker pace of rate hikes that are potentially more aggressive than exhibited over the past year.

- Regulatory Policy:** A main point of agreement among the Republican Party is the desire to reduce regulations in several key areas of the economy. This could include the repeal of the Dodd-Frank Act, which introduced numerous regulations on banking and Wall Street in an effort to protect consumers and investors. A rollback of environmental restrictions and increased access to federal land for oil and gas drilling could also emerge.

- Trade Policy:** A cornerstone of the president-elect's campaign focused on the rejection of notable trade agreements such as NAFTA and TPP. Based on this, future trade agreements would likely carry a more protectionist tone in an effort to bolster American manufacturing and employment. While these policies could crimp the flow of imports and exports, a potential increase in the U.S. dollar value could partially offset the rising cost of foreign goods.



* Through 3Q
 † Treasury through Nov. 10; core inflation through September
 ° Unfunded portion

Commercial Real Estate Performance Trends Healthy; Positive Trajectory Supported by Range of Drivers

Apartment: Healthy employment growth and strong household formation will sustain demand for apartments, particularly as the 80 million strong millennial cohort comes of age. More than 68 percent of the 20- to 34-year-old segment live in rental housing and 1.4 million additional young adults will enter this age range over the next five years. The upswing in multifamily construction will carry into 2017 as developers add 370,000 new units next year, with about half of that total in just 10 markets. Though submarket level performance will vary, this development will not disrupt the broad-based performance momentum of the sector. The U.S. vacancies is expected to end the year at 3.8 percent and then rise modestly in 2017.

Retail: The steady employment outlook, together with wage gains, will raise per capita discretionary income, supporting the potential for increased consumption. Additionally, the prospect of tax cuts could spur further retail transactions in the coming months. Retail space demand has risen for the last few years and is positioned to underpin a contraction in vacancy of 40 basis points to 5.6 percent in 2016. Retailers with a strong online presence, along with bars and restaurants, are best positioned to benefit as these segments are among the fastest-growing categories of retail sales.

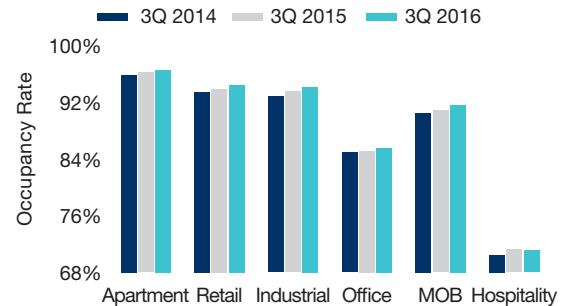
Industrial: Led by the expanding warehouse needs of e-commerce, the industrial sector remains highly favored by investors. Low inflation and rising incomes are fueling growth in retail sales and generating new warehouse and distribution needs. These factors have been enough to overcome a surge in development, with the U.S. vacancy rate expected to fall to 5.9 percent in 2016, a 16-year low. Moving forward, the possibility of protectionist trade policies could restrain industrial asset performance, particularly in port markets, but a potentially strengthening dollar that reduces the cost of foreign goods could partially offset this trend.

Office: Job gains in office-using employment sectors will fuel office demand and drive new space requirements. Positive labor market trends, though, have not yet provided the powerful push necessary to transition to more robust property performance. A key factor supporting performance has been subdued development, which will support a continued downtrend in the national vacancy rate to 14.4 percent in 2016. The limited construction pipeline will amplify the effects of even small increases in space demand.

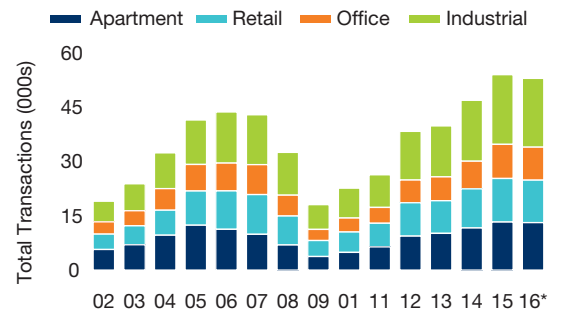
Medical Office and Seniors Housing: The aging U.S. population will remain a powerful driver for both the medical office market and seniors housing. A repeal of the Affordable Care Act (Obamacare) could change the market dynamics for these service sectors, though it will likely take considerable time for actual policy changes to come into play. These sectors will be supported by strong demographic drivers, particularly the aging of baby boomers, leading to moderate but steady performance gains across these asset types.

Hospitality: The consistent growth of the national economy has driven demand in the hospitality market, but it appears the sector is approaching a transition. Corporate and leisure travel remain on track to sustain steady demand for hotel rooms, but increasing construction will temper occupancy growth and RevPAR, both of which are coming off record highs. Although performance may moderate, U.S. hotels are still performing well and are likely to maintain a favorable outlook. Their performance will vary by market, depending on local new supply trends.

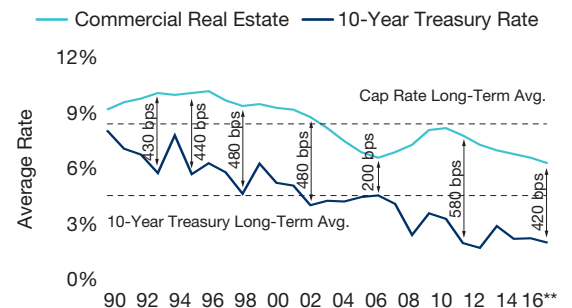
Commercial Real Estate Occupancy Making Steady Gains



Commercial Real Estate Transactions Easing From Peak Levels



Commercial Real Estate Yields vs. 10-Year Treasury



* Preliminary estimate for trailing 12 months through 3Q
 ** Through Nov. 10
 Sources: CoStar Group, Inc.; Real Capital Analytics

Tax Reform Increasingly Probable, But Few Details Defined

Tax reform would lower rates, but true effects yet to be defined. The unification of the White House and Congress under a single party offers the prospect of more rapid fiscal policy decisions. A plan for comprehensive individual and corporate tax reform will likely gain traction, but numerous details including prospective changes to deductions and adjustments to the carried interest provision could take time to clarify. Trump's stated tax reform goals involve lowering rates and reducing loopholes.

- **For Individuals: Simpler structure, higher standard deduction.** President-elect Trump's individual tax reform plan centers on simplifying the tax brackets while simultaneously lowering tax rates. The standard deduction would be raised, but individual deductions would be eliminated. The rules for carried interest may also change, forcing developers and fund managers to review their business structures and their business models.
- **For Companies: Repatriation, simplification, reduction.** Corporate tax reform centers on lowering the business tax rate from the current 35 percent to 15 percent while limiting tax deductions available to firms. Also under consideration is the idea of repatriating overseas business profits, applying a one-time 10 percent tax rate rather than the standard 35 percent rate. This would encourage companies such as Apple, Alphabet (Google), Microsoft, Oracle and Cisco Systems to bring money back to the U.S. An estimated \$1.3 trillion is currently held overseas by U.S. companies.

Transaction Market Pulls Back Modestly; Buyer and Seller Expectations Diverge

Transaction activity has modestly pulled back from last year's record levels, though it remains elevated by historical standards. The slowing investment sales market may seem at odds with healthy occupancies, solid rent growth and ample availability of financing offered at rates near historic lows, but this transition is a natural result of a maturing expansion cycle. The rapid rise in values and sales velocity over the past five years, as well as added uncertainty from a number of external factors, are naturally beginning to restrain transactional velocity.

The absence of overbuilding and overleveraging during this cycle is preventing distress, leading to a still-healthy business outlook. At the same time, these factors will continue to foster a lack of urgency and a wider than usual bid/ask spread in the near term, with buyers and lenders applying added scrutiny and tighter underwriting. Market liquidity remains strong, with ample volumes of capital from every type of investor seeking commercial real estate investments, which, coupled with sold property fundamentals, should support an active albeit slower investment marketplace.

Rapid economic growth could be a double-edged sword. Although the prospect of accelerating economic growth holds a great deal of appeal, it will likely be pursued by inflationary pressure and rising interest rates soon thereafter. Commercial real estate tends to perform comparatively well in such environments as it offers some inflation resistance through rent increases either upon renewal or by inflation-adjusted lease agreements. Should interest rates rise quickly, the bid/ask spread could widen further as buyers recalibrate pricing based on rising capital costs. This would apply upward pressure to cap rates.

Investor Considerations For a New Administration

The impending administration change and resulting policy shifts could hold significant implications for commercial real estate investors. Substantive modifications to taxes and trade policies together with an injection of infrastructure spending and prospects of accelerated economic growth, rising inflation and an elevated interest rate environment, all merit careful deliberation. Below are some suggested areas of focus for investors:

- Inflation risk will affect asset performance and values. Review lease escalations.
- Rising interest rates could influence cap rates and property values. Carefully consider investment strategies.
- In-process transactions, refinancing and all existing debt should receive a close review ahead of potentially rising rates.
- Accelerated infrastructure development, particularly roads and transit, could significantly influence property values.
- Protectionist trade practices will impact commercial real estate, particularly in cities near ports of entry.
- Opportunistic investors may be reinvigorated by changing climate.
- Changing tax environment could influence yields. Merits close monitoring.

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Note: Employment growth is calculated based on the last month of the quarter/year. Sales data includes transactions valued at \$1,000,000 and greater unless otherwise noted.

Sources: Marcus & Millichap Research Services; American Society of Civil Engineers 2013 Report Card; BEA; Bureau of Labor Statistics; CoStar Group, Inc.; Moody's Analytics; MPF Research; Real Capital Analytics; U.S. Census Bureau.