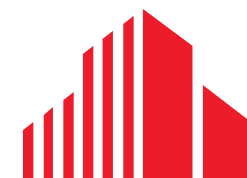


A DEEP DIVE INTO THE MIDTERM ELECTIONS

IMPLICATIONS FOR THE
PROPERTY MARKETS



**CUSHMAN &
WAKEFIELD**

Key Takeaways

- The U.S. will hold elections for the entire House of Representatives and one-third of the Senate on November 6, 2018.
- The outcome of the election **will impact the political environment** and possibly the policy environment, but it is much **less likely to significantly change the economic environment** or impact the performance of commercial real estate (CRE).
- The consensus is that growth in the U.S. economy is likely to **remain healthy regardless of the outcome of the election**, particularly in the near term: 2018/2019. Given the correlation, demand for CRE space should also remain healthy.
- The **real estate policy environment** is unlikely to change dramatically regardless of the vote, but under certain scenarios, more of a gridlock situation could emerge. Historically, congressional productivity has declined after the midterm elections.
- CRE values are more likely to be influenced by interest rates and the tremendous amount of capital targeting North American assets. Closed-end funds have **\$191 billion of dry powder as of October 2018**—up nearly 32% since year-end 2016.



A DEEP DIVE INTO THE MIDTERMS ELECTIONS

WHAT'S NEXT....

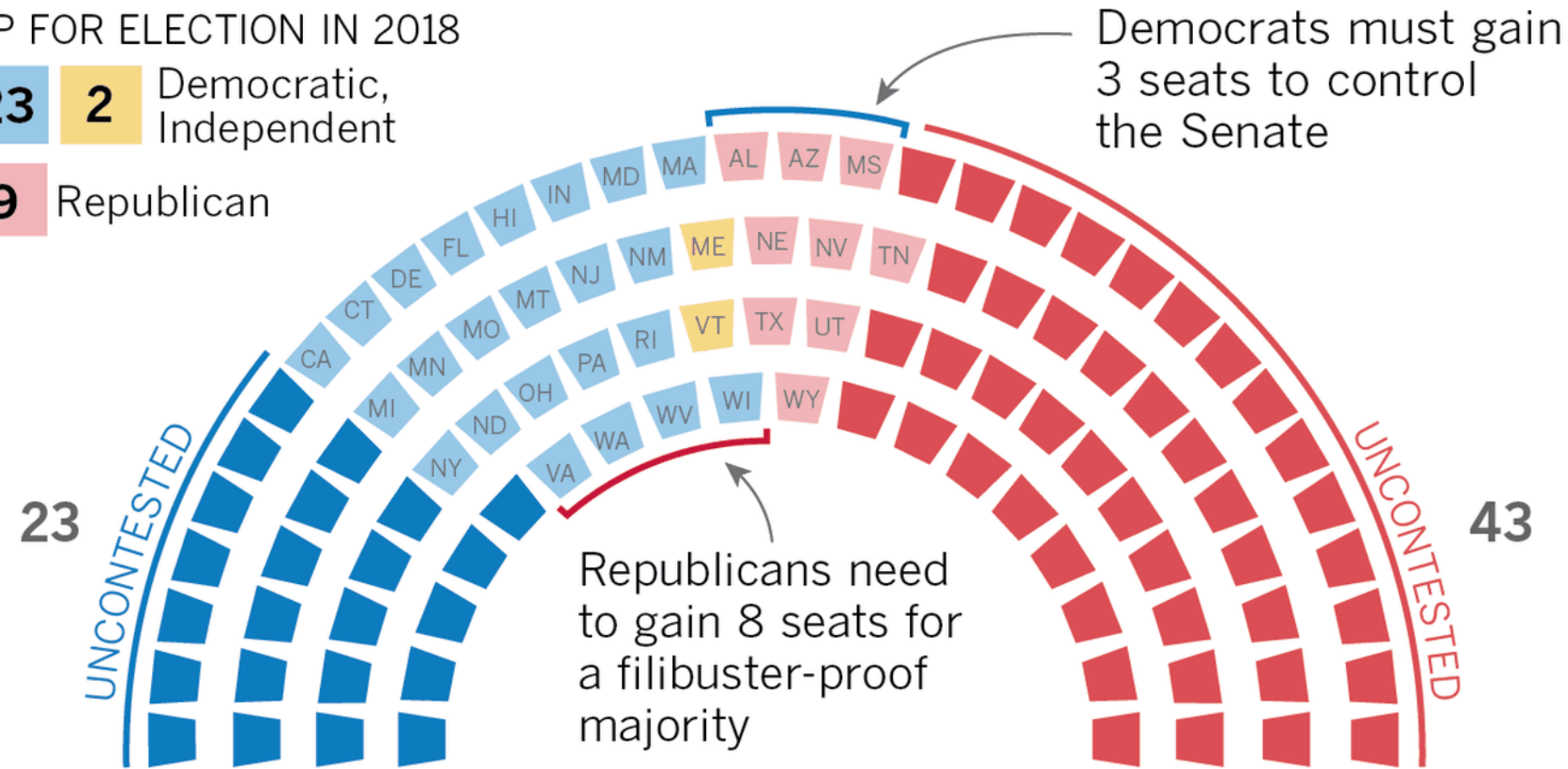
Current polls indicate that the Republicans are likely to keep control of the Senate and that Democrats will take control of the House. Regardless of who wins control of Congress, the economy is expected to remain healthy and favorable for CRE, although finding qualified employees is becoming more difficult.

The battle for Senate control

UP FOR ELECTION IN 2018

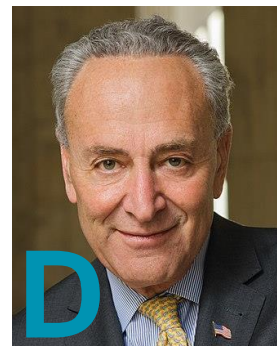
23 **2** Democratic,
Independent

9 Republican



@latimesgraphics

- Entire House of Representatives up for re-election
- 115th Congress major legislation:
 - Tax Cuts and Jobs Act (2017)
 - Bipartisan Budget Act (2018)
 - Economic Growth, Regulatory Relief and Consumer Protection Act (2018)
- **Hot issues for 116th Congress: immigration, healthcare, tax policy, infrastructure, and the budget**



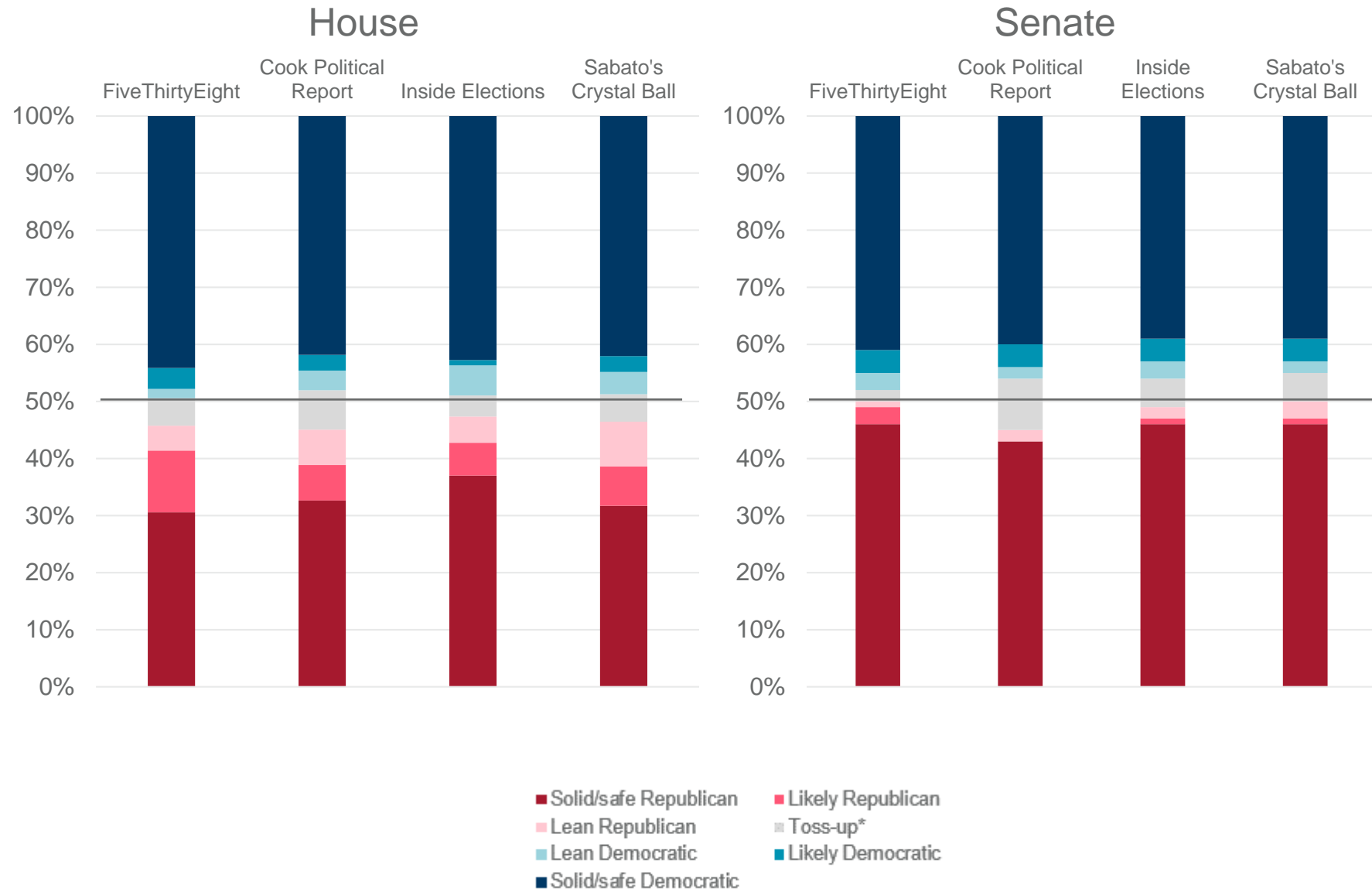
VS.



Tracking the Midterms – Toss-up Seats Are Key

Projected Composition of Congress based on Latest Polls

2018 Midterms



- The majority party in the House and Senate will be determined by who wins the “toss-up” seats (grey area)

- Those few competitive seats may influence the policy direction in the U.S. for the next two years

FiveThirtyEight is currently projecting:

- 6 in 7 (84%) chance Democrats take the House
- 5 in 6 (82%) chance Republicans maintain control of the Senate

- The number of seats that could be a “toss-up” for the House ranges from 16 to 30

- The number of seats that could be a “toss-up” for the Senate ranges from 2 to 9

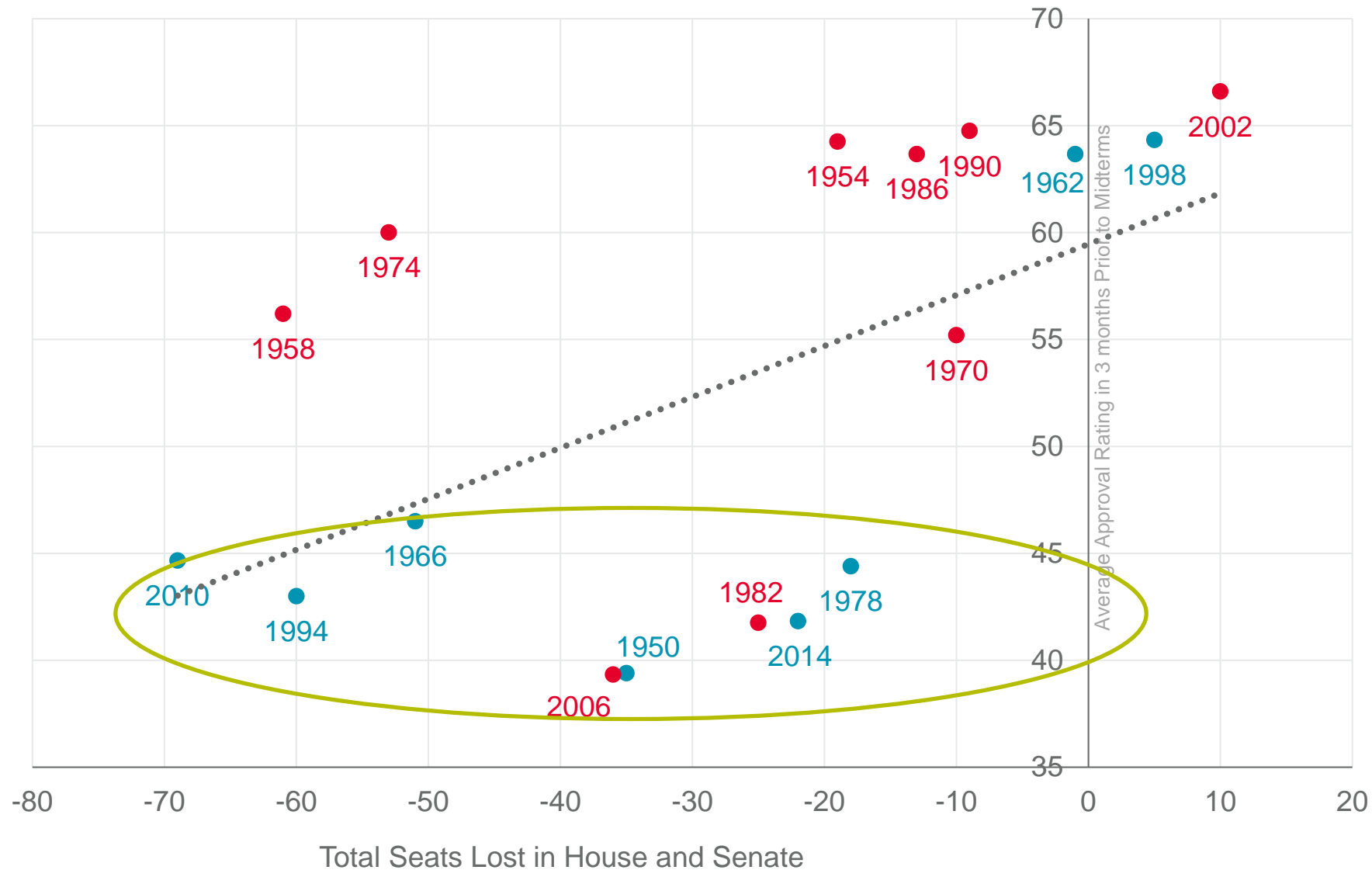
- Most of the party composition of Senate is set

- For the House, there are a large number of “solid” or “safe” seats

Source: FiveThirtyEight, Cook Political Report, Inside Elections, Sabato's Crystal Ball

President's Party Typically Loses Seats During Midterms

Most Likely Outcome

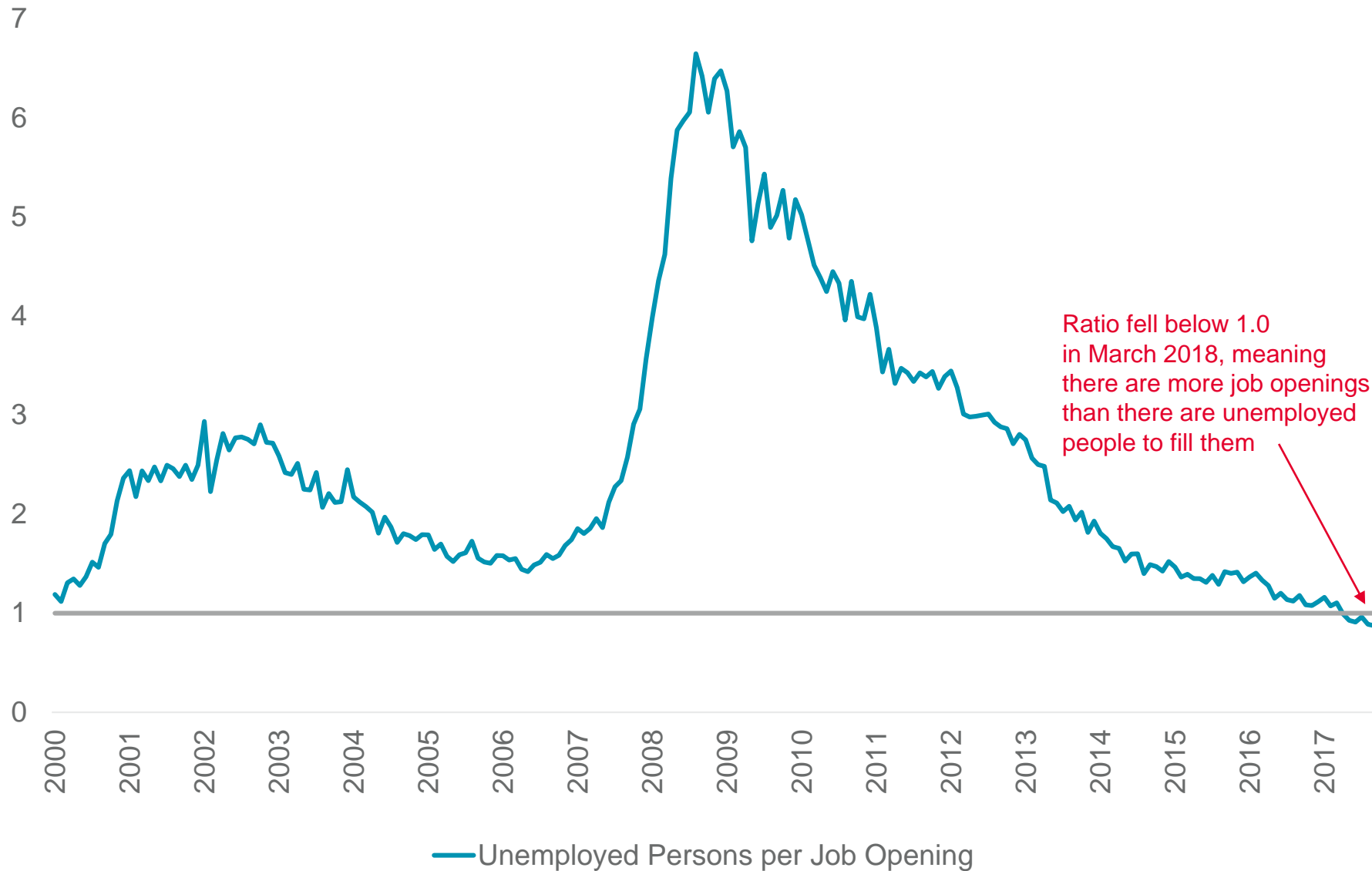


2018 Midterms

- Typically, the president's party loses seats in a midterm election
- When the approval rating for the president or his party is lower, there is typically a larger loss for the party in midterm elections
- There has been a wide range of outcomes for presidents with approval ratings below 50%, but there have been no cases with a net gain in seats
- President Trump's approval rating in late October was 41%
- **This suggests Republicans are likely to lose seats, but it is less clear if it will be enough to change control of either chamber of Congress**
- **Current polls indicate that the Republicans are likely to keep control of the Senate and that Democrats will take control of the House**

What Doesn't Change

Less than One Job per Unemployed Person for First Time Since 2000



2018 Midterms

- President Trump retains authority to make most trade and tariff-related decisions
- The Federal Open Market Committee is likely to vote to raise the federal funds rate in December, and for 3-4 more hikes in 2019
- Labor markets will remain extremely tight and worker shortages will become more common
- Wage growth and rising prices will create both opportunities and challenges
- Mandatory spending continues even if Congress does not pass a budget in a government shutdown scenario
- **Regardless of who wins control of Congress, the economy is expected to remain healthy and favorable for CRE, although finding qualified employees is clearly becoming more difficult**

How Does the Economy Perform Before and After Midterms?

WHAT'S NEXT...

In years following a midterm election, the S&P 500 2-year return has been highest under a split Congress. The stock market has an important wealth effect and a positive multiplier for CRE:

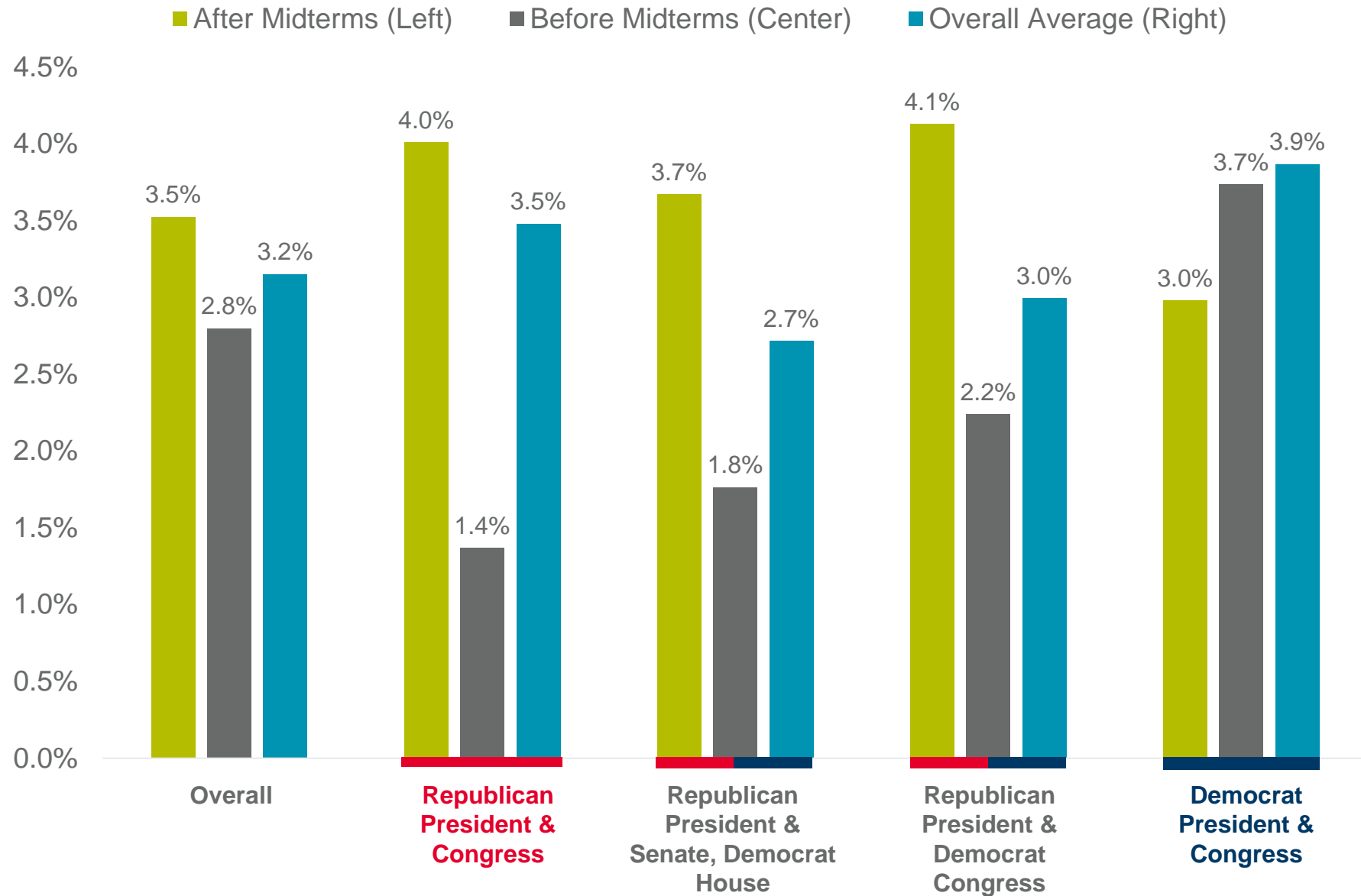
Strong consumer spending equals higher business profits equals stronger job growth equals stronger demand for space

*Growth rates/returns cited in this section are 2-year CAGR;
E.g., for 2014 midterm election: 2 years prior = return from 2013-2014; 2 years after = return from 2015-2016



Economic Growth: 2018 Likely to be One of the Strongest in this Cycle

Real GDP Growth: 82nd Congress through Present (1951-present)



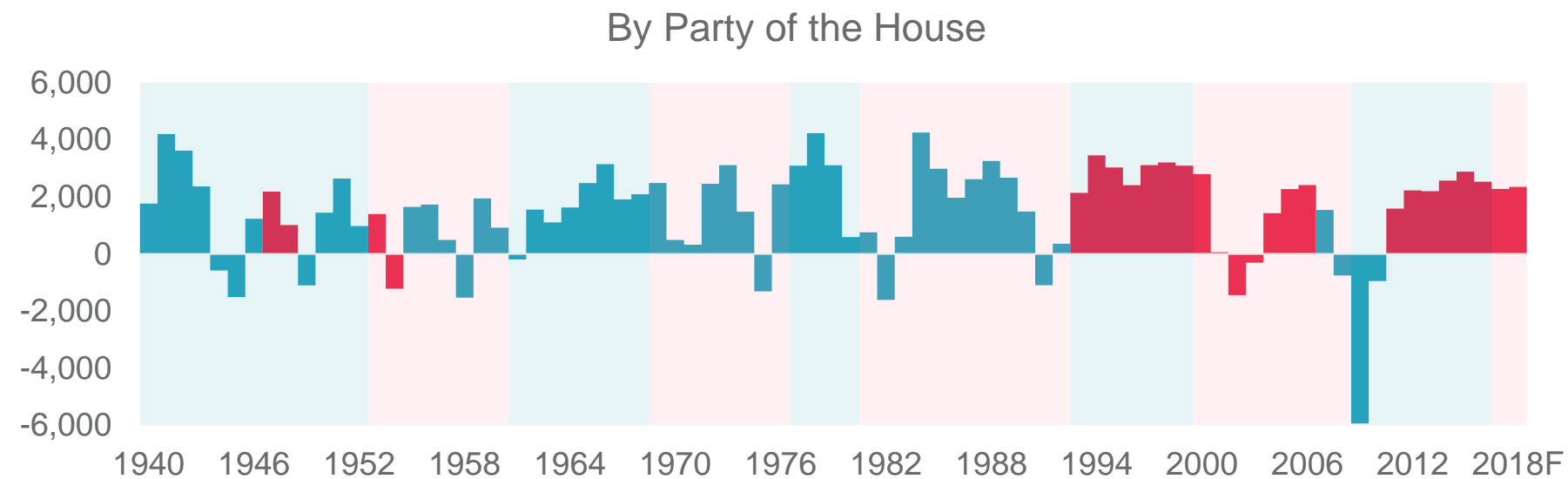
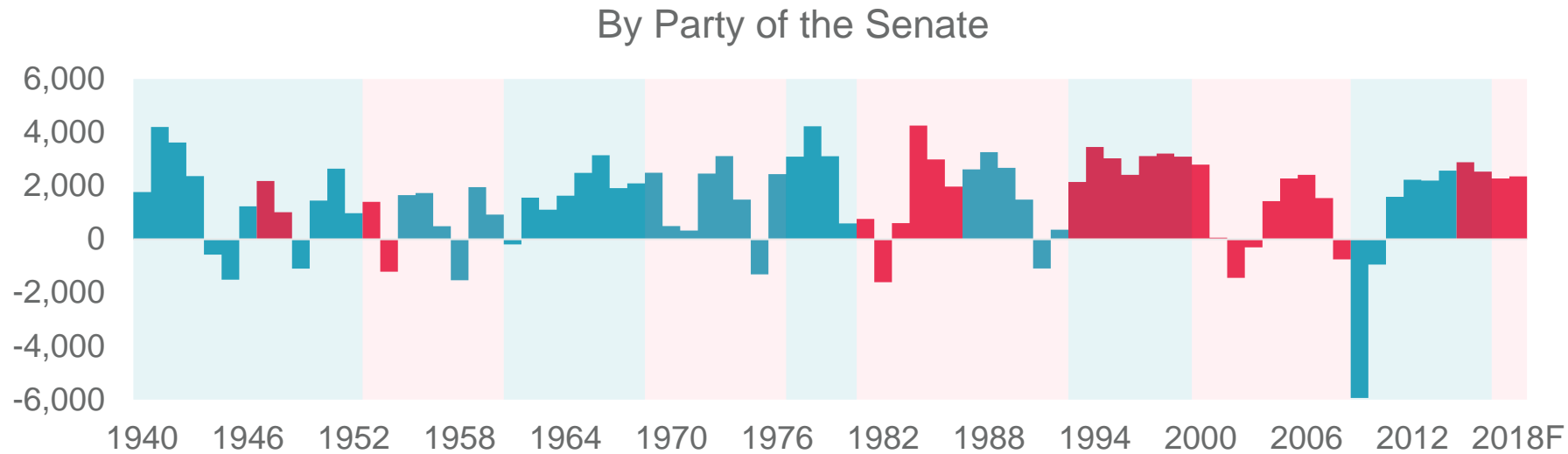
2018 Midterms

- Real GDP growth has averaged 3.2% since 1951
- Historically, economic growth has been stronger under a unified government, where one party controls both branches
- However, when Congress has been divided—such as the possibility of Democrats getting control of the House and/or Senate in the upcoming midterm election—economic growth has been lower
- **Real GDP growth is one of the most important indicators for CRE—when the economy is growing, businesses are expanding, driving demand for space**
- **2018 is likely to be one of the strongest years of the expansion and, regardless of the midterms, that strength is likely to carry over into 2019**

Nonfarm Job Growth

Job Growth Minimally Influenced by Make-up of Congress

By Party of Congress (000s), 77th Congress-present (1940-2018)

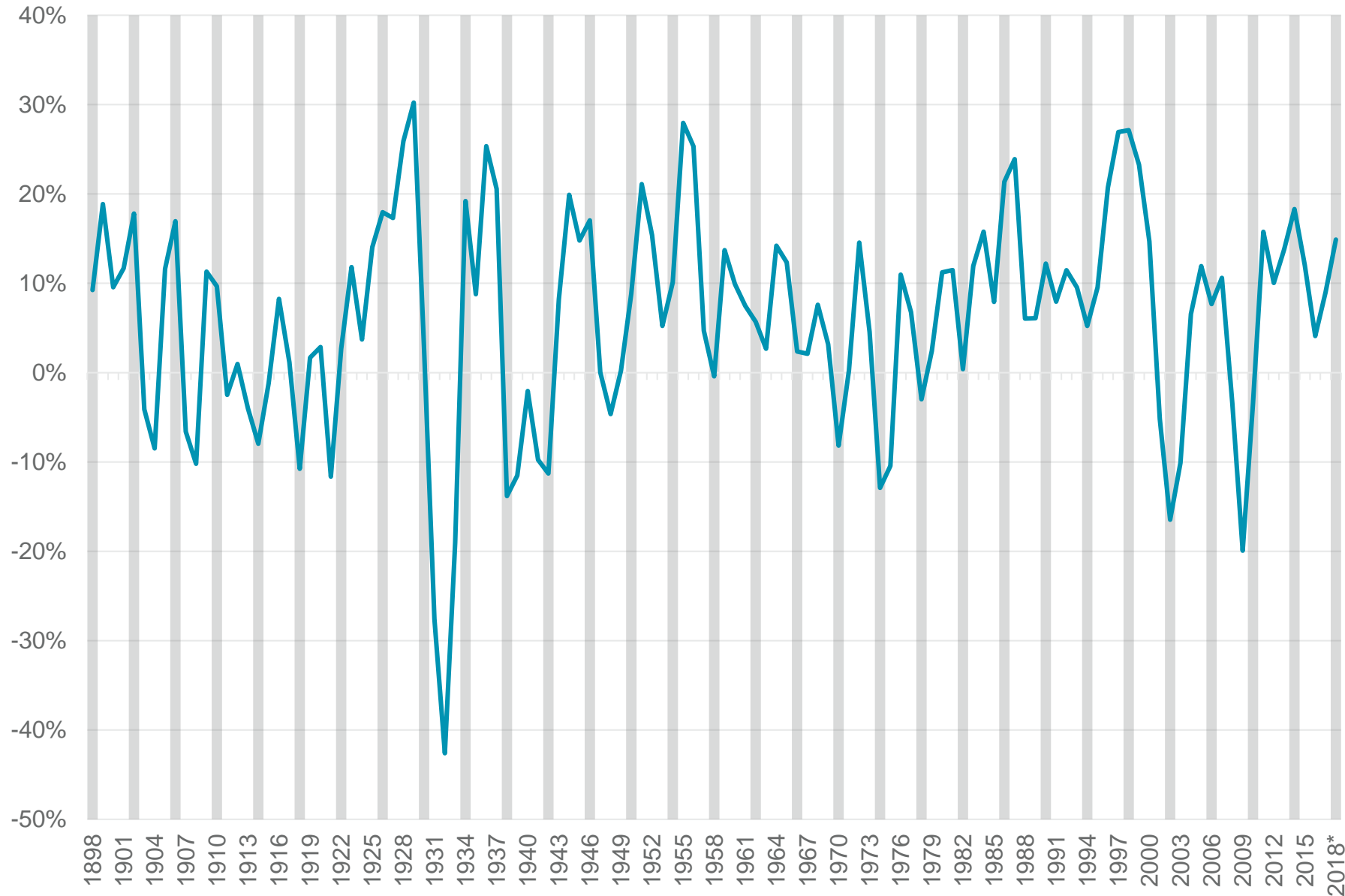


2018 Midterms

- Nonfarm job growth has averaged 2.1% year-over-year since 1939
- In periods following midterm elections, job growth has averaged 2.1% when Congress is split
- However, the correlation between the party in power in each chamber and job growth is only 0.1—essentially, nonexistent
- Thus, we apologize for wasting your time with this slide
- **Job growth is a key driver of demand for CRE space of all kinds and is minimally influenced by the makeup of Congress**

Stock Market Usually Accelerates After Midterms

S&P 500 Two-year Performance Before and After Midterms: 55th Congress-present (1898-2018)



Source: Standard & Poor's, Cushman & Wakefield Research

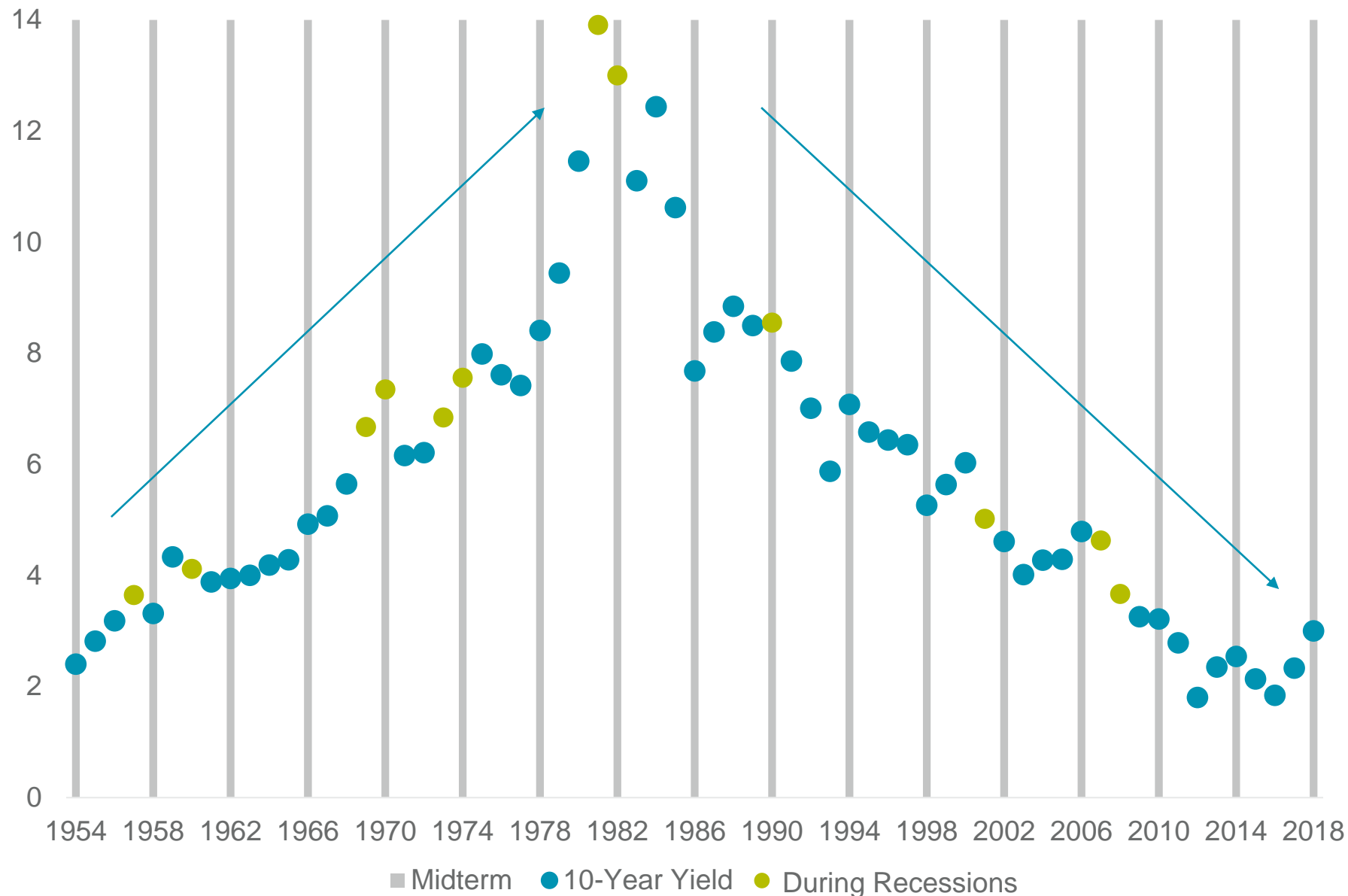
Years of midterm elections

2018 Midterms

- The S&P 500 has registered an average 2-year return of 5.6% since 1898
- In years following a midterm election, the S&P 500 2-year return has been highest under a split Congress (12.3%); it has averaged 4.5% under a unified government
- **The stock market has an important wealth effect; in the current cycle, every \$1 increase in the stock markets boosts consumer spending by 4.5 cents**
- **And it has a positive multiplier on CRE: Strong consumer spending = higher business profits = stronger job growth = stronger demand for space.**

Critical Factors Influencing the Economy and CRE

Key Metrics on Radar of Monetary Policymakers



2018 Midterms

- Movements in inflation and interest rates can be impacted by the business cycle but are also influenced by longer-term structural factors
- **There is no statistical evidence that changes in the party in the White House or in majority in Congress have any significance in explaining the level of interest rates, or inflation**
- In fact, the Federal Reserve has staunchly defended its independence no matter the party in power
- However, over time, the Fed has become more open about its deliberations and policy actions and this policy of openness is likely to continue after the midterm elections
- **Interest rates are a critical factor influencing CRE pricing and the level of economic activity, which impacts demand and supply**

How Does CRE Perform Before and After Midterms?

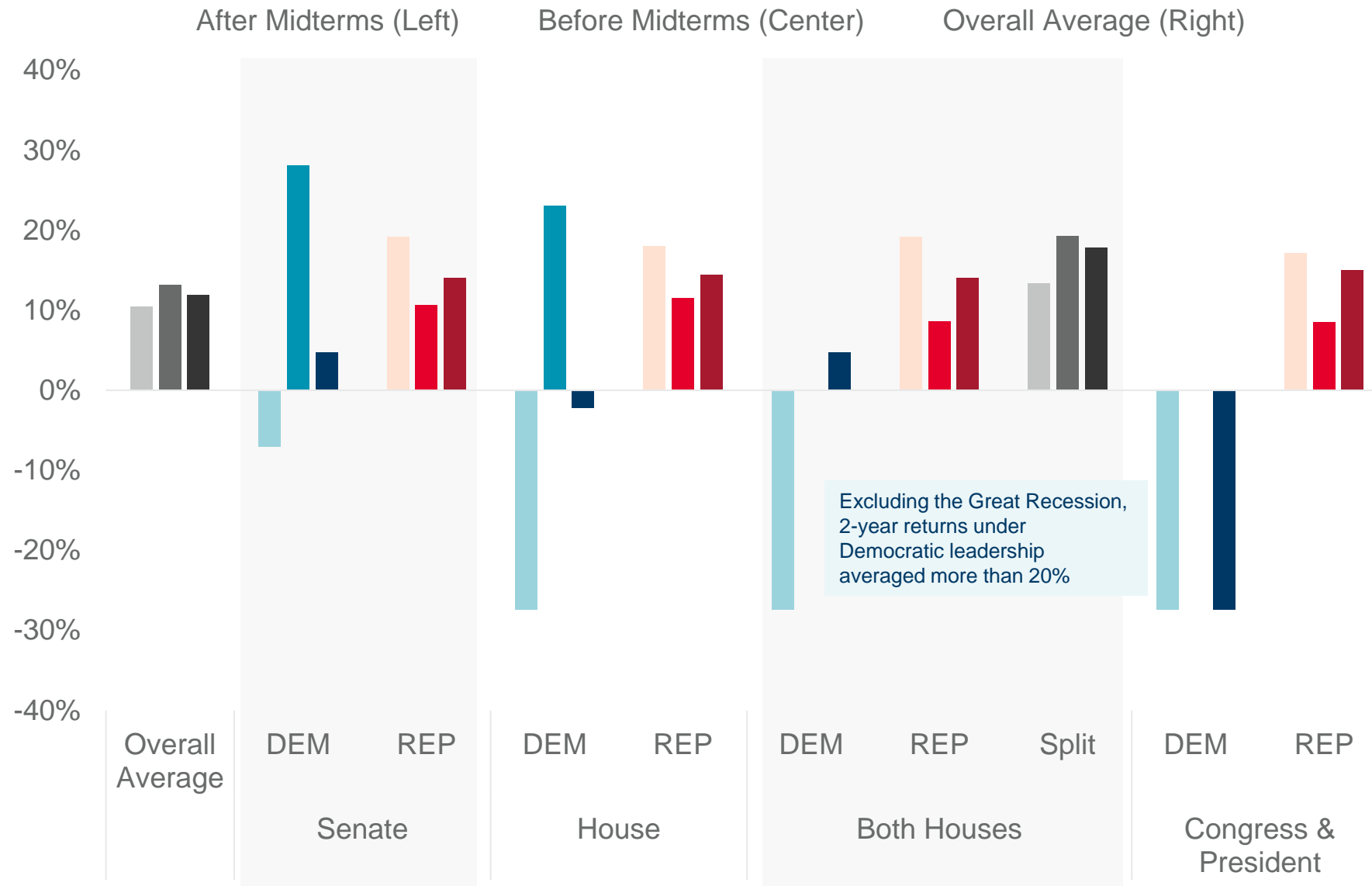
WHAT'S NEXT...

While there are some differences depending on timing and party in power, the rate of growth of CRE prices barely changes before or after a midterm election.

Historically, average NCREIF returns have been higher in periods immediately following a midterm.

Stock Markets & REITs: No Sign that Party Matters

Equity REIT Performance: 104th Congress through Present (1995-present)

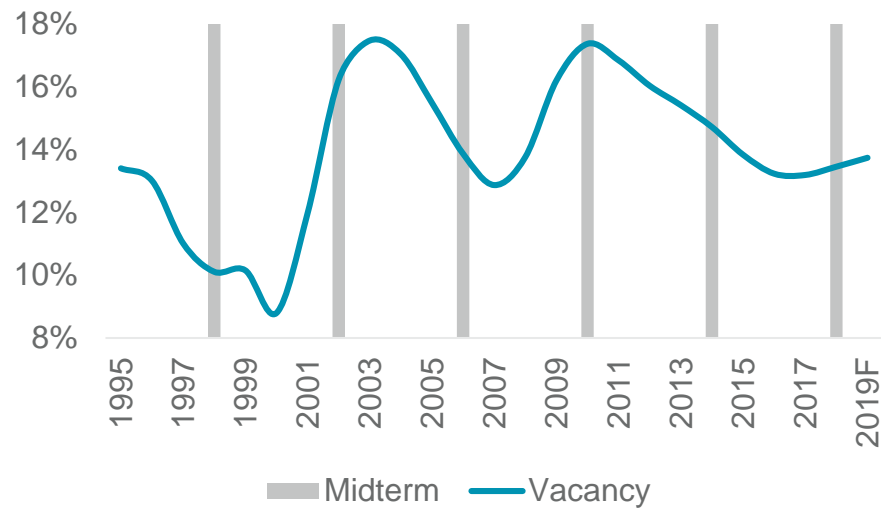


2018 Midterms

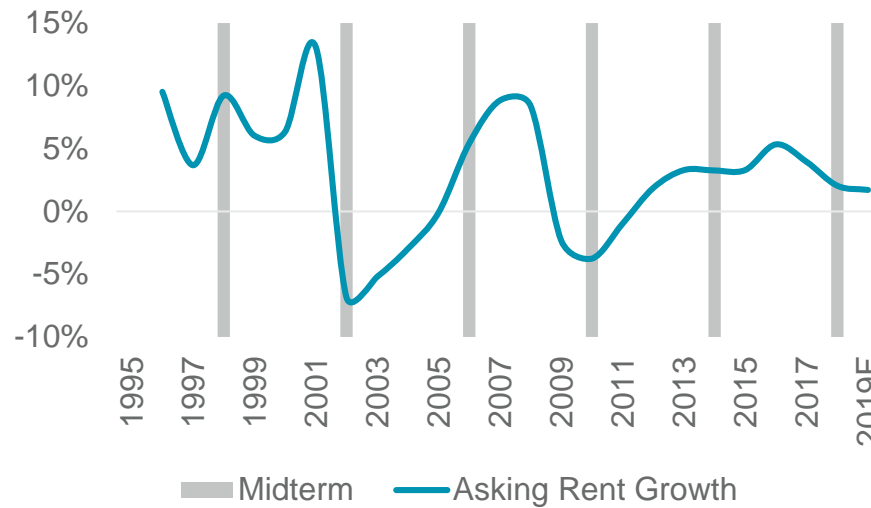
- The 2-year average return for equity REITs between 1995 and 2018 is 11.9% (but 15.2% excluding the Great Recession)
- Equity REIT returns tend to be higher in the 2 years before a midterm election than in the 2 years after
- The highest average returns, regardless of there being a midterm election, were observed under a split Congress:
 - At the start of Clinton's second term (1997-1999)
 - In Bush II's last two years (2007-2009)
 - During Obama's middle four years (2011-2015)
- These periods are associated with economic growth—boom periods—and/or a low interest rate environment
- **The economic and financial market backdrop has more to do with REIT performance than the party in power**

Leasing Fundamentals: Changes in the Economic Cycle Matter Most

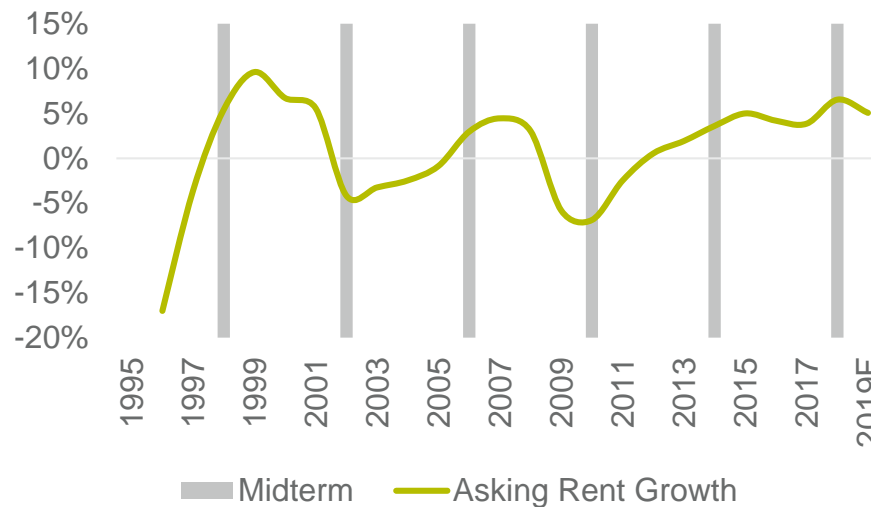
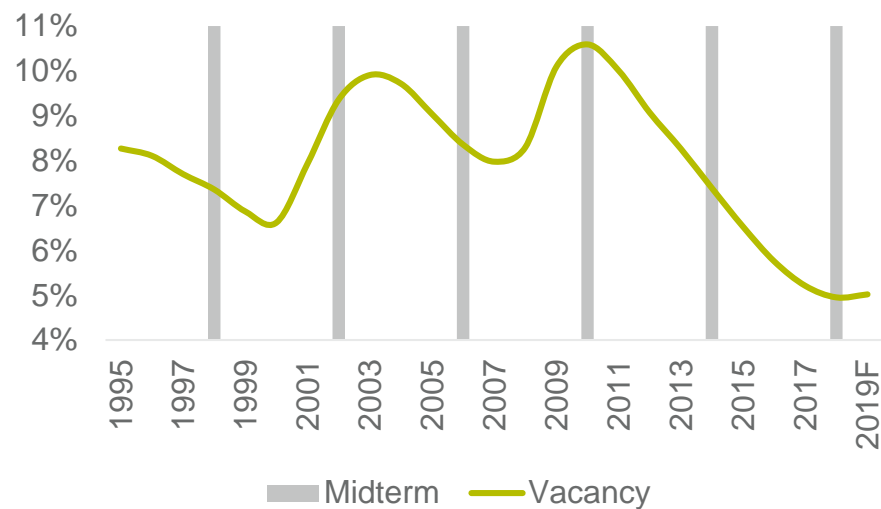
Office



Midterm Elections of Minimal Consequence



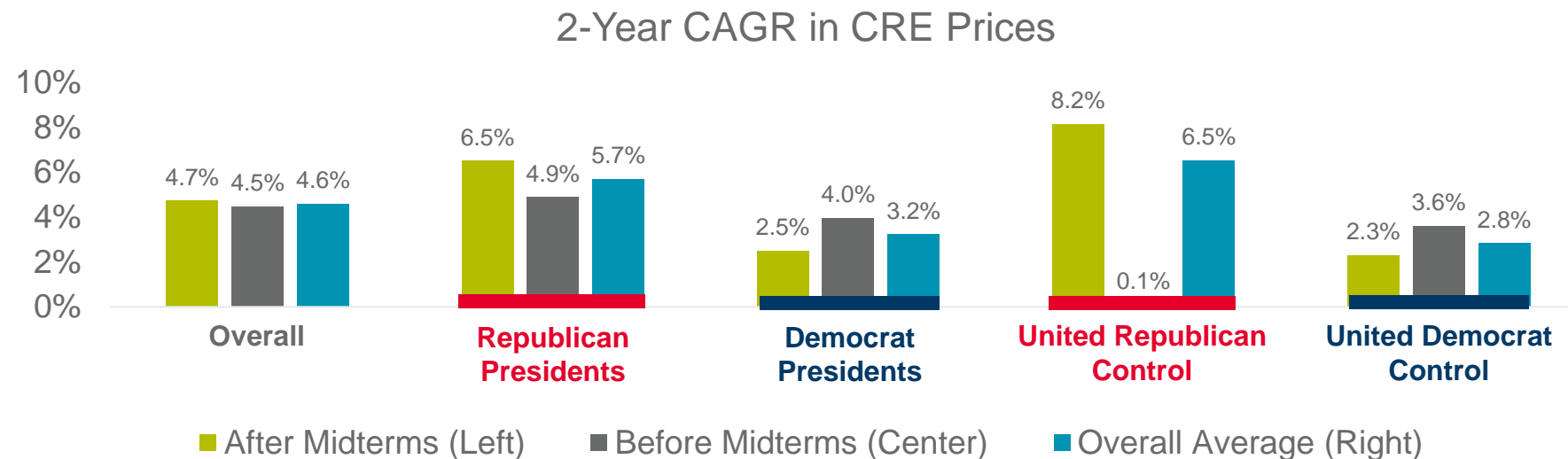
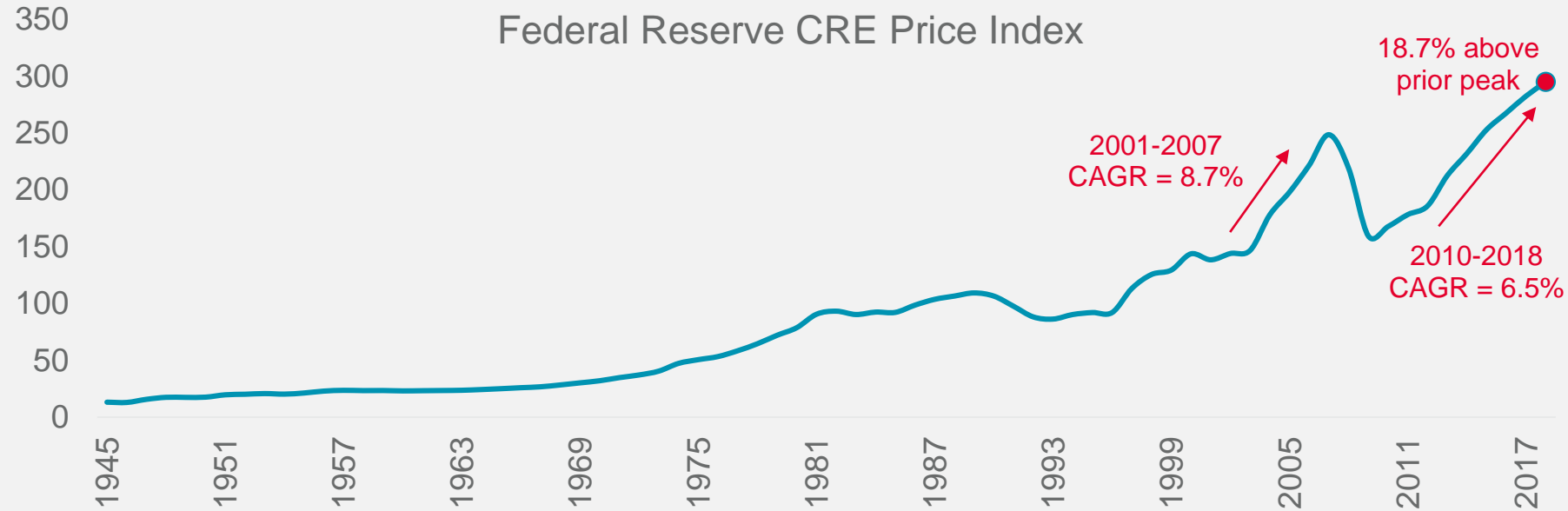
Industrial



- CRE leasing markets respond to the economic backdrop
- However, policy can have a *marginal* influence on CRE, especially via the labor markets
- At present, development is picking up and is expected to cause an inflection in the supply/demand balance at the national level
- Most construction is concentrated in a handful of markets for both the office and industrial sectors
- Vacancy for office/industrial will begin to rise slowly, but sufficient demand will allow that upward movement to be modest in most markets
- **In the last 20 years, midterm elections have had no correlation with turning points in the CRE cycle—rather, turning points are associated with changes in the business cycle**

CRE Pricing Holds Up Just Fine

Federal Reserve Commercial Property Price Index, 79th Congress-present (1945-2017)

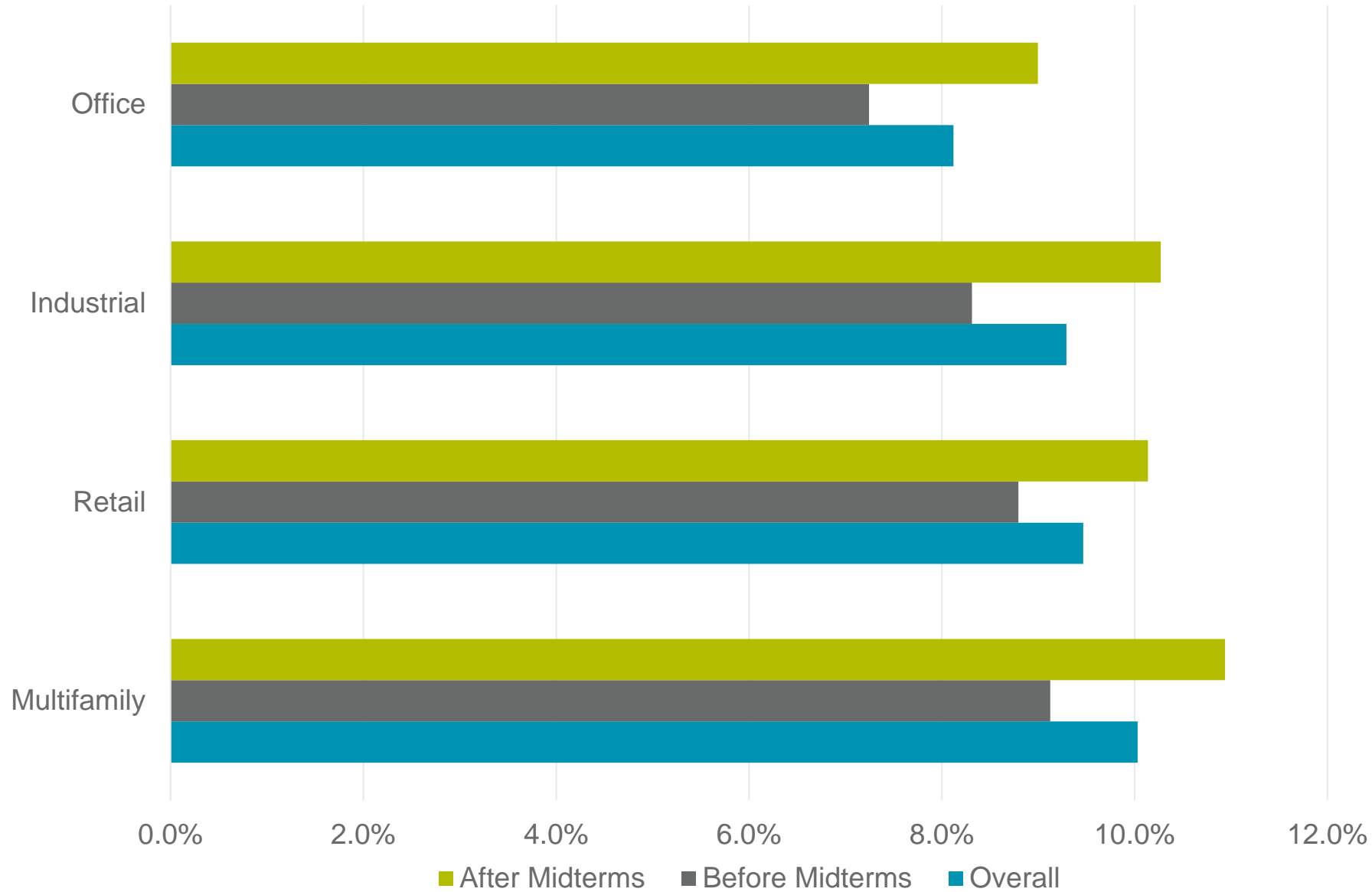


2018 Midterms

- The Federal Reserve's CRE Price Index currently tracks price movements on properties for transactions of all sizes
- Although the current expansion has seen prices reach record highs, the speed of appreciation has been more moderate than in the 2001-2007 period
- CRE prices have grown faster under Republican presidents and under Republican leadership (united or not)
- Historically in periods after midterm elections, when the Republicans had control of the presidency and the Senate, and Democrats the House, CRE prices have grown at an average of 5.0%
- **While there are some differences depending on timing and party in power, the story is on the far left of the bottom chart: the rate of growth of CRE prices barely changes before or after a midterm election**

NCREIF Returns by Asset Class Before and After Midterms

96th Congress-present (1979-2017)



2018 Midterms

- While returns have performed better under a Republican Senate, they have also been higher under a Democratic House
- The best performance for NCREIF returns for all asset types has occurred when there is a Republican president and Senate and a Democratic House—both in general and after midterm elections
- According to most polls, this is a highly expected outcome for the 2018 midterm election
- **Historically, average NCREIF returns have been higher in periods immediately following a midterm election**

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