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How Trump could shake up real estate finance
President-elect plans to ditch Dodd-Frank, ramp up federal spending
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At his campaign rallies, Donald Trump presented himself as an anti-establishment populist looking to rein in Wall Street’s gross excesses. But when he stepped in front of a crowd of finance and business big shots at the New York Economic Club on Sept. 15 to outline his economic policy, he showed a completely different face. “One of the keys to unlocking growth is scaling-back years of disastrous regulations unilaterally imposed by our out-of-control bureaucracy,” he said.

Bank stocks surged the day after he won the presidential election. And with good reason — despite his populist talk, Trump has given strong indications that he plans to deregulate Wall Street.

His plans could transform real estate finance. For the past eight years, the sector has grown accustomed to an environment of low interest rates and increasing bank regulations. That age could soon be over. Trump has already declared his intention to dismantle the Dodd-Frank laws enacted in the wake of the 2008 financial crisis. He’ll also get the opportunity to appoint a new chair of the Securities and Exchange Commission. And his planned debt-financed fiscal spending spree – assuming it makes it past budget hawks in Congress – could well push up inflation and interest rates.

“I think it’s fair to say that the economic narrative has changed,” the Blackstone Group’s head of real estate, Jonathan Gray, said at a conference a week after the election. (Gray, a Democrat, is reportedly bring considered for Treasury secretary.)

Here’s a rundown of how the Trump administration could impact real estate finance:

Dodd-Frank

Two days after the election, Trump's team announced its plans to "get rid of" the Dodd-Frank law enacted in the wake of the 2008 financial crisis. Along with the international Basel III agreement, which stipulated that banks have to hold a larger equity buffer to protect themselves against losses, Dodd-Frank has helped transform the financial sector in the post-2008 years in part by placing stricter rules on banks.

The law includes a myriad of regulations, but the ones that matter most perhaps are the so-called Volcker rule and imminent risk retention rules on the commercial mortgage-backed securities market. The Volcker rule prohibits banks that accept consumer deposits from trading on their own accounts. The intention is to protect small-time savers from big bank failures caused by risky investments, and the rule has made it harder for banks to invest in real estate or CMBS outright. Meanwhile, risk retention rules taking effect next month require CMBS issuers to keep five percent of loans on their books – reducing the volume of debt they can sell off to investors.

Whether Trump will keep the two rules in place remains unclear for now. But repealing wouldn't necessarily be a game changer for real estate finance. Despite the looming risk retention requirements, CMBS markets had a decent month with active trading, according to Sean Barrie of research firm Trepp. And the Volcker rule hasn't prevented banks from lending on real estate projects.

A Dodd-Frank repeal could have a bigger impact on the residential market, where the law has added a number of safeguards against reckless and predatory lending. Barney Frank, one of the law's authors and now a board member at Signature Bank, a major commercial real estate lender, sees that prospect as a misstep. "I do think that has the potential for causing a crisis," he said.

Basel III and Glass-Steagall

A far bigger deal for the commercial real estate industry are rules under the Third Basel Accord – commonly called Basel III – of 2010 that require banks to keep a larger equity cushion as a buffer against any loans deemed risky, including real estate construction loans.

"You can really see that the regulations are actually working, in the sense that they're slowing the lending community's willingness to finance construction, which is working to stop overheating and overbuilding," Boyd Fellows, a managing director at real estate lending firm ACORE Capital, said at Thursday's capital markets conference hosted by NYU's School of Professional Studies.

Basel III is a voluntary global framework, but in the U.S. the Federal Reserve has decided to enforce its provisions. Could Trump change that? Much will hinge on whether Fed Chair Janet Yellen – a President Obama appointee whose term ends in 2018 – decides to stay on under the new administration. And so far Trump hasn't indicated what he thinks of the framework.

Sam Chandan, an associate dean at NYU's Schack Institute, said leaving the Basel III rules would be difficult for any administration because it has the potential to unsettle financial markets and discourage investment in the short run.

On the campaign trail, Trump has also proposed reinstating the Glass-Steagall act that formerly separated commercial and investment banks. For example, lenders like Deutsche Bank would no longer be able to issue both balance-sheet loans and CMBS, said Mike Greenwald of accountancy Friedman LLP.

Barney Frank is skeptical that a return of the law has any chance in a Republican-controlled Congress that has tended to oppose finance regulations. "It certainly would be surprising if they were for Glass-Steagall," he said. And even if it did pass, it wouldn't necessarily have a big impact on real estate lending, according to Greenwald.

Reinstating Glass-Steagall wouldn't necessarily mean banks will lend less on real estate, he said – on the contrary. "I personally think that's going to make more capital available," he said, pointing out that banks would be left with few other investment options. "Where else are those banks going to get the type of yield to satisfy their investors and depositors?"

To the point, a 2013 paper by economist Charles Calomiris and political scientist Stephen Haber noted the "Glass-Steagall Act did nothing to limit lending on real-estate."

Jonathan Miller, of appraisal firm Miller Samuel, suggested that a return to Glass-Steagall could benefit commercial real estate. "It's been an 18 year transition so I don't think it is practical or possible to simply bring Glass-Steagall back," he said. "But I think anything that reduces the massive over regulation of financial reform and increases the separation of the two forms of banking could normalize commercial lending."

SEC change

While Yellen may well stay on, the chair of another crucial finance body has decided to step down: SEC chair Mary Jo White. Counting White, three seats on the five-person commission will be empty when Trump takes office. He can appoint their replacements, which will allow him to shape the agency for years to come.

Under White, who assumed office in April 2013, the SEC has left its mark on real estate finance in two ways, according to Richard Morris, a securities lawyer at Herrick Feinstein: enforcement actions against financial misconduct by individual firms, and the rollout of crowdfunding rules.

White has overseen a "record number of enforcement actions," Morris said, adding that this could change.

In September, for example, the commission charged two former executives at American Realty Capital Properties (now VEREIT) for allegedly covering up accounting errors by inflating earnings numbers.

Private equity and real estate fund managers have also had plenty of trouble with the SEC. In August, Apollo Global Management paid $52.7 million to settle SEC charges that its management "improperly" charged fund investors for personal expenses. During White's tenure, the SEC has brought charges against 10 private fund managers, including the Blackstone Group, according to the New York Times – often focused on opaque fee structures that allegedly misled investors.

But White has also been criticized for being too close to (and too soft on) big business interests. As late as October, Sen. Elizabeth Warren called for Obama to dismiss White after she issued a rule that public companies don't have to disclose political spending. She's also been criticized for having to recuse herself from dozens of high-profile cases to avoid a conflict of interest, which detractors say has taken the sting out of the agency.

In recent months, the SEC has rolled out new rules allowing for real estate crowdfunding within the framework of the JOBS Act. The changes have led to a flurry of real estate crowdfunding startups, but some industry insiders have argued that the SEC is stifling the industry somewhat by restricting the sums crowdfunding platforms can raise from unaccredited investors.

"Given Mary Jo White's conservative predecessors, I think the industry should be happy with the start that Regulation Crowdfunding has been given," Sherwood Neiss, head of Crowdfund Capital Advisors, wrote in an email. "Given Trump's pro-business stance and entrepreneurship focus we would expect to see him appoint a Chair that is very much focused on easing regulation that (…) restricts capital formation for startups and small businesses."

Interest rates

Arguably the biggest way in which Trump's victory could impact real estate finance is through interest rates. Trump has proposed a major infrastructure plan and tax cuts. "I think you are talking about a bigger deficit – ironically, since Republicans were complaining about that," Frank said. A debt-financed spending spree typically can accelerate inflation, which in turn is likely to push up interest rates. Investors certainly seem to think so: the yield on 10-year Treasury bonds has surged since the election on the expectation that interest rates will rise.

Rising rates are good and bad news for real estate: on the one hand, they make debt financing more expensive, push cap rates up and property prices down. On the other hand, rising rates are usually a sign of economic growth, and improving fundamentals tend to push up income from real estate. Blackstone's Gray, at the NYU conference, said the latter tends to outweigh the former.

There's another dimension to rising rates: Other things being equal, if interest rates in a country are high, that tends to attract more foreign investment. If more money flows in from abroad, the dollar appreciates. Again, investors appear to predict this will happen: the dollar has appreciated by about 4 percent against the Euro since Nov. 8. Chandan argued that because the dollar could well continue to rise, investors may continue to flock into New York real estate to benefit from the appreciation.

Chandan argued that Trump's victory and the potential for trade wars has increased global economic risk. New York's real estate market, widely regarded as relatively safe, could benefit from that uncertainty. "Even though the U.S. may be the source of this increase in perceived global risk," he said, "it may be counterintuitive, but that encourages capital to flow into the U.S."