Real Estate Highlight

Trade Wars: Tariffs and Commercial Real Estate

April 2025

Key Impacts on Real Estate Markets

With President Trump's return to the Oval Office, the global economy is experiencing shifts and volatility in U.S. trade policy.

Tariffs on imports and exports have historically triggered widespread economic effects, and the real estate industry is no exception. Their impact extends across multiple facets of real estate, influencing construction costs, property values, rental affordability, and borrowing costs.

According to President Trump, the tariffs aim to prioritize "America First" by protecting domestic industries and declaring economic independence. However, the short- and long-term consequences will be significant for investors and consumers alike. On February 4, 2025, President Trump formally announced highly anticipated tariffs on certain imports from Canada, Mexico, China, and other major importers to the U.S. Following the announcement, the tariffs were initially delayed and then imposed in stages, with certain tariffs on China doubling and some temporarily lifted during ongoing trade negotiations. On April 2, 2025, labeled "Liberation Day" by the President, the full scope of tariffs was announced, as discussed later.

Sources: USA Today, PB Mares, NBC News, 208 Properties, Colliers Canada, Investing in CRE, National Association of Home Builders, National Association of Realtors, AP News, Trepp, Costar, WSJ Real Estate, Tax Foundation, Yahoo Finance.

Higher Construction Costs

- **Construction Material Costs:** Tariffs on essential building materials like steel, aluminum, lumber, and timber have driven up construction costs for both residential and commercial properties across the U.S.
- **Project Delays and Cancelations:** As a result, developers and builders are adjusting budgets and underwritings to account for these rising costs, often leading to project overruns, postponements, or cancelations, especially for those projects already operating on tight margins amid years of elevated inflation.

Supply Chain Disruptions

- **Import Restrictions:** Tariffs on goods from trading partners limit the availability of critical building components, further delaying projects, construction starts, and completions.
- **Logistics Challenges:** Increased costs for imported equipment and materials can strain the flow of goods between contractors and suppliers, further driving up project costs and causing delays.

Impact on Housing Market Affordability

- **Homebuyers:** The National Association of Home Builders reports that tariffs on building materials will significantly reduce the affordability of new homes. Since December 2020, material costs have surged by 34%, far exceeding the rate of inflation of 16% for good and services over the same period.
- **Renters:** Rising construction costs driven by tariffs will push rental rates higher across commercial properties. Developers and property owners are passing these increased costs down to tenants. This trend is putting upward pressure on rents, especially in sectors where demand remains strong and new supply is facing constraints and delays.

Cross-Border Investment

- Trade tensions and tariff uncertainties are impacting cross-border investments in commercial real estate. The unpredictability of U.S. trade policies, including recent tariffs, is prompting investors from all over the globe to reconsider or further delay investments in U.S. real estate as they assess the short- and long-term impacts of these tariffs on market conditions and returns.

Key Impacts on Real Estate Markets (cont.)

Sector-Specific Effects

Supply chain disruptions and rising operational costs and material costs are creating new challenges and opportunities across key real estate sectors. As tariffs and shifting trade dynamics continue to reshape the landscape, sectors are adapting to changing tenant demands and economic conditions.

Industrial and Logistics

Supply chain disruptions, higher operational costs, and shifting tenant demand.

- Tariffs will likely hurt manufacturers and distributors with higher production costs, lower profit margins, and increased consumer prices. However, supply chain bottlenecks may shift demand toward domestic production, boosting the need for manufacturing and warehousing.
- Markets with strong port activity (e.g., Los Angeles, Houston, and Savannah) may see lower tenant occupancy as trade routes adjust.
  - Outcome: Inland distribution hubs such as Dallas–Fort Worth, Indianapolis, and Atlanta may benefit as companies seek alternative supply chain solutions, whereas port cities reliant on global trade may face temporary slowdowns.

Retail

Higher costs for goods, reduced consumer spending, and tenant struggles.

- Increased tariffs on imported consumer goods generally raise prices, potentially leading to lower retail sales and possible store closures.
- Retailers with lower margins (e.g., discount stores) face challenges, while luxury brands may be less impacted.
- Shopping centers, malls, and other brick-and-mortar retailers reliant on international brands could see reduced expansion activity.
  - Outcome: Domestic manufacturers and retailers with strong U.S.-based supply chains will likely benefit, while box stores and department stores reliant on foreign-made imported goods may struggle with higher costs and lower consumer demand.

Office

Corporate investment uncertainty and demand shifts.

- Companies facing higher costs due to tariffs may slow hiring or downsize office footprints, further impeding the office sector, which had only recently begun to show signs of recovery from the impacts of COVID-19.
- Markets reliant on global trade and foreign investment (e.g., Boston, San Francisco, Chicago) could see slower leasing activity.
- Supply chain disruptions impacting construction could delay office developments and renovations.
  - Outcome: Sunbelt cities and other non-gateway markets with strong domestic corporate bases will be less impacted. However, major gateway markets with significant international tenant presence may see a leasing slowdown.

Multifamily

Rising development costs, affordability challenges, and shifting renter demand.

- Tariffs on steel, lumber, and other materials increase construction costs, making new apartment development more expensive.
- Higher construction costs could drive up rents as developers pass the increased costs to tenants and stall existing or new projects.
- If tariffs slow economic growth, job losses could reduce demand for new rentals.
  - Outcome: Existing apartment owners in high-demand markets will benefit as new supply slows, while developers facing higher costs may struggle to complete current projects and launch new ones.

Hospitality

Travel costs, foreign tourism, and hotel development.

- Tariffs on imported goods increase costs for hotel construction and renovations, especially for property improvement plans, which were waived during COVID-19 but are typically required every 10 years.
- Trade tensions could discourage international tourism, impacting hotel demand in major destinations like New York, Los Angeles, and Miami.
- Business travel could decline if corporations cut costs due to trade-related uncertainties.
  - Outcome: Domestic-focused hotel brands and more budget-friendly hotels will likely be less impacted than luxury and international-dependent hotels, which could see lower occupancy rates.

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Key Impacts to Real Estate Markets (cont.)

Inflationary pressures and capital market uncertainty have been impacting the real estate market for the past several years, causing fluctuations in interest rates and influencing borrowing costs and investment activity. With the introduction of tariffs, continued economic uncertainty persists, thus impacting commercial real estate returns and valuations across different markets and sectors.

MAKING HEADLINES

- On April 2, 2025, the President delivered a speech in the Rose Garden declaring it "Liberation Day" and announcing significant changes to U.S. trade policy.
- The announcement had immediate global repercussions, sending shockwaves through markets worldwide.
- A baseline tariff of 10% was introduced on all imports, effective April 5, 2025, with higher rates for specific countries considered "bad actors" to go effective April 9, 2025. Notable higher tariffs include 34% on Chinese goods, 20% on European Union products, and 24% on Japanese imports. Canada and Mexico were temporarily exempted from these higher rates.
- In total, approximately 185 countries are impacted by the new imposed tariffs.
- Trump indicated certain reciprocal tariffs will remain in place for the entirety of his presidency.
- The U.S. effective tax rate has surged to levels not seen since 1910.
- Analysts warn tariffs could trigger a global recession, increase inflation, and lead to prolonged economic uncertainty.

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Interest Rates and Investment Trends

- **Inflationary Pressure:** Tariffs are expected to exacerbate the already inflationary environment, which could lead the Fed to further pause rate cuts and even consider rate increases again. As a result, interest rates could remain higher for longer, increasing borrowing costs for developers and investors.
  - According to Wall Street analysts, the Fed is no longer expected to make any rate cuts this year as tariffs are expected to keep inflation levels elevated.
- **Capital Markets Uncertainty:** Commercial real estate investors may delay transactions again, just as activity was picking up in late 2024 and early 2025. Economic uncertainty driven by the variable tariff activity does not create comfort in the capital markets.

Impact on Returns and Valuations

- **Impacts on Returns:**
  - Higher development costs and longer construction timelines due to supply chain delays may lower expected IRRs and ROIs for existing developments and increase required returns for future development due to increased market uncertainty.
  - Slower rent growth coupled with higher risks of vacancy (due to tenants struggling to pay higher rents) may lead to further rent concessions and abatements, resulting in lower net operating income.
  - Increased borrowing costs and expanded cap rates make financing and refinancing more difficult and new deals tougher to pencil.
- **Impact on Valuations:**
  - Higher development costs may limit supply in some markets and sectors, supporting higher property valuations in supply-constrained markets.
  - Heightened uncertainty from tariffs may lead to cap rate expansion, thus reducing property values. When coupled with higher expenses due to inflation, the impact could be significant for some.
  - In inflationary environments, landlords may prioritize stability over long-term rent growth. As a result, properties with long-term, high-quality credit tenants should be able to maintain value and stability and better navigate the impact of tariffs.

Forward-Looking Observations

Mitigating Construction Cost Increases

As tariffs influence supply chains, there may be a growing demand for industrial and logistics properties. Developers may focus on alternative, domestically produced material sources such as RCA, recycled steel, and CLT to manage increased costs. Additionally, stockpiling building materials, appliances, and other crucial imported goods will help manufacturers, suppliers, and developers offset any additional costs and import constraints.

Focusing on Low-Capex Properties

By focusing on properties that require minimal renovations, investors can safeguard returns and reduce exposure to market uncertainties. With fluctuating material costs, many investors may steer clear of assets that will require significant capital expenditures in the near term.

Locking In Long-Term Lease Terms

To address rising costs, landlords and tenants alike may benefit from securing long-term leases to avoid the fallout that increased costs have on leases.

Investment Opportunities Amid Volatility

As the tariff situation evolves, investors can prioritize stable assets in regions that are less affected by tariff fluctuations. Specifically, the industrial and logistics sector may present attractive opportunities, as there will be a shift toward domestic production in the coming years.

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