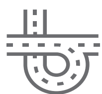
COHEN & STEERS

Spending and Taxing

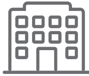
Implications of the U.S. Election

As investors gauge the potential ripple effects of the 2020 election, we focus on the three dimensions we believe will be most critical to real assets and preferred securities: fiscal relief, taxes and infrastructure spending.

Key proposals and potential economic effects	JOE BIDEN	DONALD TRUMP
Fiscal stimulus and economic growth Bridging the economy until a vaccine allows for a broader recovery 	• $2T in fiscal relief, focused on small businesses and middle/lower-income households; smaller bill likely if Republicans keep the Senate • Potential for faster recovery in the near term, favoring cyclical businesses • Longer-term growth uncertainty around increased regulation and higher taxes • Upside risk to inflation due to fiscal spending and inflation-tolerant monetary policy	• Downscaled fiscal relief, potentially around $1T, including unemployment benefits, paycheck protection and funding for schools and health care • Likely a more modest recovery in the near term, favoring secular growth businesses • Potential longer-term growth benefits from business-friendly policies and deregulation
U.S. Taxes Driving demand for tax-advantaged income 	• Corporate tax rate increased to 28% from 21% (vs. 35% pre-2017) • Top individual tax rate increased to 39.6% from 37%[1] • Caps on state and local tax (SALT) deductions eliminated; caps on itemized deductions restored • For $1M+ earners, dividends and capital gains taxed at 39.6% vs. 20% currently[1] • Social security payroll tax of 12.4% applied to wages above $400,000, split evenly between employers and employees (6.2% would fall to the wage earner) • Negative effect on corporate earnings, potentially offset by economic benefits of more fiscal spending	• Changes to tax rates unlikely; caps on SALT deductions maintained • May seek reduction in capital gains tax if Republicans retake the House • Provision allowing for immediate expensing of certain equipment and property purchases expires after 2022 • Low corporate tax rates positive for global competitiveness
Infrastructure and energy policy Spurring job growth and investing in the future of U.S. energy 	• $2T bill focused on clean energy and infrastructure • Subsidies for renewable energy sources (solar, wind, biofuels); stricter emissions standards; incentives for electric vehicles and investments in charging stations and battery technology • Ban on offshore drilling; no new oil and gas leases on federal lands; more difficult pipeline permitting	• Federal incentives to spur $1T in state, local and private infrastructure investment • Continuation of fossil fuel friendly policies, including reduced regulatory barriers for oil, gas and coal businesses

At October 30, 2020. Source: Candidate statements, Cohen & Steers.
(1) Additional 3.8% Medicare surcharge applied to investment income (interest, dividends and net capital gains) for U.S. taxpayers above certain thresholds.

Our view of potential investment implications

	JOE BIDEN	DONALD TRUMP
Real Estate (pg. 4) 	• Larger stimulus positive for overall demand, particularly for cyclical sectors (industrial, retail, self storage) • Coastal markets more affected by higher corporate taxes on tech and finance tenants, potentially shifting demand to suburbs and Sunbelt states • REITs (which do not pay corporate taxes) not directly impacted by higher corporate taxes • Modestly higher taxes on REIT distributions for top earners; potential rollback of 20% deduction on pass-through income, which includes REIT income • Elimination of like-kind tax exchanges—which would face heavy opposition from industry groups—could negatively impact transaction volumes, reducing REITs' ability to improve and prune their portfolios	• Smaller stimulus negative for consumers and retail • Relative winners may include secular growth sectors and beneficiaries of increased tech investment, such as cell towers and data centers • The transition to a digital economy transcends politics, driving significant growth potential for the REIT market over the coming decade
Preferred Securities (pg. 5)	• Higher taxes on interest income would increase the relative advantage of dividend-paying preferreds for households earning less than $1M • For $1M+ earners, preferreds' after-tax yields would still be higher than munis and investment-grade bonds, based on current yields (see Exhibit 1) • Corporate investors' Dividends Received Deduction (DRD) percentage may be adjusted to keep the historical tax rate on corporate dividends at 10.5% • Higher corporate taxes and stricter regulation modestly negative for banks	• Caps on deductions for mortgage interest and state and local income taxes should continue to drive demand for tax-advantaged income
Infrastructure (pg. 6)	• Positive for utilities and other companies with renewable energy assets • Pipeline development could face increasing pressure (although this comes at a time of little need for new pipeline assets) • Higher corporate taxes neutral for utilities, MLPs and cell towers; negative for railways	• Status quo for traditional fossil fuel industries • Efforts to accelerate permitting would remain limited by local regulatory bodies
Natural Resource Equities and Commodities (pg. 7)	• Reentering the Iran nuclear deal would lead to increased global supply in the near term, though drilling impediments and regulation could curtail supply over time • Increased demand for biofuels, silver (for solar panels), and metals and bulk commodities used in infrastructure • Acceleration of oil producers' push into renewable strategies	• Positive for refiners, meat processors and agricultural machinery • Negative for oil prices (limited constraints to new supply)

At October 30, 2020. Source: Candidate statements, Cohen & Steers.

Economic impact

Fiscal relief key to stabilizing demand. The resurgence in virus cases reminds us that the economy has yet to fully recover, and that businesses and households remain vulnerable. Fiscal stimulus may help to provide a bridge for the economy until a vaccine allows for a broader recovery and a return to some semblance of normal life.

- If Democrats sweep the election, there will likely be little motivation to pass a smaller bill before inauguration day, when they could pass a much larger bill closer to the $2 trillion package passed by the House. Larger fiscal stimulus would likely support a faster recovery in 2021–22 that could benefit cyclical deeper-value sectors.
- Despite Trump's support for a larger stimulus deal, Senate Republicans favor a leaner package. If Trump wins, there could be an agreement on a scaled-down bill before year-end. Smaller stimulus would likely mean a more modest recovery in the near term, but also less risk of tax increases, potentially sparing tech companies and financial institutions.

Continued need for tax-advantaged income. We expect taxes will remain a major focus for many investors regardless of the election outcome, potentially benefiting asset classes that generate tax-advantaged income, including preferred securities, real estate investment trusts (REITs) and master limited partnerships (MLPs).

- Biden has proposed raising the top tax rate for individuals from 37% to 39.6%. In addition, households earning over $1 million would pay double the current tax rate on investment income, with long-term capital gains and dividends taxed at 39.6% instead of 20%. Democrats would likely seek to eliminate the $10,000 cap on deductions for state and local taxes (SALT), which disproportionately affects higher-tax (often Democrat) states, although some of this benefit may be offset by Biden's plan to cap itemized deductions to 28% of their value for those earning more than $400,000.
- Trump has discussed lowering the capital gains tax rate further. On the other hand, despite the 2017 tax cuts, many higher-income households—especially residents of high-tax states—have seen their tax bills rise in recent years due to caps on deductions for mortgage interest and state and local income taxes.

Corporate tax headwinds. The 2017 tax cuts were a windfall to companies, while also contributing to economic growth and employment. A partial reversal could raise questions about growth over the medium term.

- Biden's proposal raises the corporate tax rate from 21% to 28%, potentially creating an economic drag that could offset some of the benefits from additional federal spending. Tech companies, banks and railway operators would likely feel the impact of higher taxes the most, whereas REITs, MLPs, cell towers and utilities would likely be less affected.
- In a second Trump term, corporate taxes would likely remain at current levels. However, the "full expensing" provision in the 2017 tax law, which allows companies to deduct the entire amount of certain equipment, expires at the end of 2022. Congress will need to decide whether to extend it, although maintaining the tax break after 2022 could discourage businesses from making investments in the short term.

Reversing decades of infrastructure underinvestment. Infrastructure spending has historically been one of the most efficient ways to drive economic growth and create jobs—yet U.S. public investment today sits near an all-time low as a share of the economy. We are seeing increasing bipartisan support for infrastructure investment due to the potential benefits for the economy and job growth. We believe this could be a catalyst for reducing barriers to private infrastructure investment and creating new pathways for putting private capital to work, such as public-private partnerships and asset recycling programs.

- Biden has proposed $2 trillion in direct investment targeting clean energy and infrastructure, including carbon-free power and grid infrastructure, mass transit, eco-friendly buildings, sustainable housing, electric charging stations and more.
- Trump has often mentioned support for a $1 trillion infrastructure program, using federal incentives to spur state, local and private investment.

U.S. REITs

Biden

Larger stimulus positive for overall demand, particularly cyclical sectors. A more substantial fiscal relief package would likely provide a lift for the economy, small businesses and consumers, likely benefiting industrial, retail and self storage the most. Loan forgiveness and affordable higher-education initiatives could be positive for college enrollment, potentially driving post-COVID demand for student housing. Infrastructure spending could have a meaningful impact on demand for all property types.

Coastal markets more affected by higher taxes on corporate tenants. Stricter regulation of the technology and financial industries would have the greatest impact on offices and housing in coastal gateway cities, potentially shifting demand to Sunbelt markets. Furthermore, higher tax rates on top earners and increasing social spending could drive migration to suburbs and lower-tax states in the Southeast. Democrats would likely remove caps on state and local tax deductions, while a surge in fiscal spending and support for state and city workers could help long-suffering municipalities, limiting the negative feedback loop on taxes and business migration.

Limited tax implications for REITs and REIT investors. REITs do not pay corporate taxes, and therefore would not be directly affected by a higher corporate tax rate if Democrats sweep the election. REIT shareholders pay taxes on income distributions according to their individual tax rate, which could rise for top earners from 37% to 39.6% based on the Biden tax plan. Additionally, the 20% pass-through deduction on qualified business income, which applies to REIT dividend income, could be adjusted to create parity with a higher corporate tax rate, and could be modified or eliminated for high-income taxpayers.

Keeping an eye on like-kind tax exchanges. Biden has proposed eliminating the "like-kind" tax exchange, a key provision that allows real estate investors to defer capital gains if proceeds of property sales are reinvested in other assets. We would expect significant pushback from industry groups, and previous attempts have been unsuccessful. However, if it moves forward, it could be material to the real estate industry, reducing transaction volumes and affecting REITs' ability to improve and prune their portfolios.

Trump

Focus on growth sectors over cyclical value. Smaller fiscal stimulus in the near term could result in a slower economic recovery, which would be a modest negative for consumers and retail. While hotels and gaming also tend to be more cyclical, we would expect to see little impact, as a demand recovery in these sectors is more dependent on a virus solution and the resumption of business and leisure travel. Relative winners would likely include sectors driven by secular demand, such as cell towers and data centers.

Increased tech investment could benefit Next-Gen REITs. Trump's focus on deregulation and winning the 5G race could benefit technology tenants, driving increased demand for e-commerce–related REITs and potentially benefiting West Coast markets. Biden has also proposed significant investment in broadband infrastructure—and while increased regulation of the tech sector would likely be negative for West Coast landlords and data centers, breaking up "Big Tech" could increase the pool of potential tenants. More importantly, although policy may affect certain aspects of these businesses, the transition to a digital economy transcends politics, and we expect it to drive significant growth for the REIT market over the coming decade.

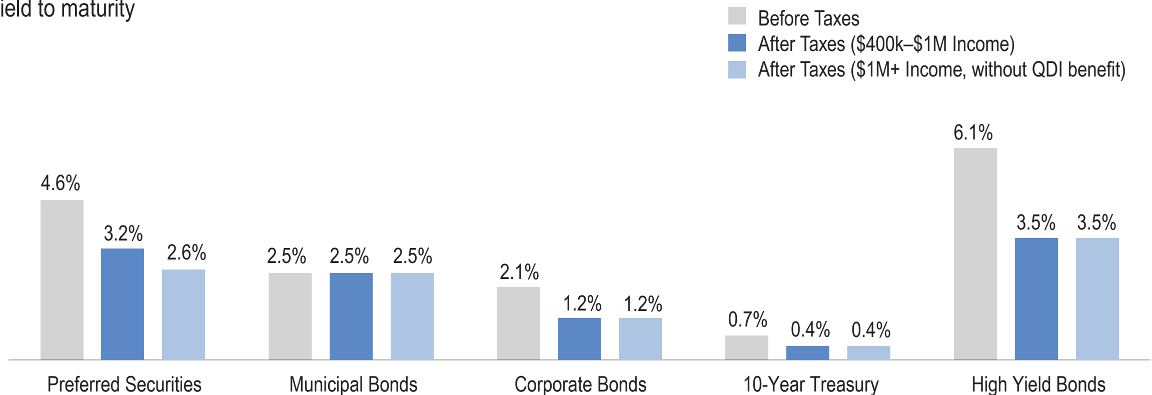
Preferred securities

Biden

A larger benefit from tax-advantaged distributions. Biden's proposal to raise the top tax rate from 37% to 39.6% would increase the relative advantage of preferreds that pay qualified dividend income, which would continue to be taxed at a maximum rate of 20% for households earning less than $1 million. Exhibit 1 shows the yield advantage of preferreds relative to investment-grade fixed income categories, assuming the higher tax rate on interest income, based on current yields. We believe preferred securities should continue to see strong demand in the coming years based on the combination of tax-advantaged distributions and attractive relative yields.

$1M+ earners may see higher taxes on qualified dividends. Biden's proposal seeks to increase taxes on households earning more than $1 million (representing the top 0.3% of the U.S. population) by taxing dividends and capital gains at the same rate as ordinary income. This would be a clear negative for high-income families, as tax rates on dividend-paying securities, including equities and many preferreds, would rise from 20% to 39.6%. However, based on current yields taxed at the highest marginal rate for ordinary income, the after-tax income from preferreds would still be higher than other investment-grade bonds, on average (Exhibit 1).

Exhibit 1: Preferred securities' income advantage under Biden U.S. tax proposal



At September 30, 2020. Source: ICE, BofA, Cohen & Steers.

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Corporate investors' effective tax rate likely to remain at 10.5%. U.S. corporations may obtain tax benefits from preferred securities investments, as dividends issued directly from U.S. corporate entities are generally eligible for the dividends received deduction (DRD). The 2017 tax reforms reduced the DRD for most corporations to offset the lower corporate tax rate, maintaining an effective tax rate on preferred dividends at 10.5%. We expect an increase in the corporate tax rate would be accompanied by an upward adjustment to the DRD rate, again preserving the long-running 10.5% effective tax rate that has been in place for decades.

Higher corporate taxes and stricter regulations modestly negative for banks. Just as lower taxes enacted in 2017 benefited net profitability for many preferred issuers, we believe higher taxes would be a modest negative for both creditors and equity holders. Banks would likely be most impacted, as they tend to have high effective tax rates. Furthermore, tighter regulation of consumer lending practices under a Biden administration could impact bank profit margins and lead to slower earnings growth. We believe that under a Democratic sweep, financial institutions should be able to absorb higher tax rates due to the potential benefits from larger fiscal stimulus and reduced loan defaults

Trump

Sustained demand for tax-advantaged income. Under the post-2017 tax code, many high-income earners have seen their tax bills rise due to the $10,000 cap on state and local tax deductions, which have particularly impacted residents of high-tax states. As a result, we have continued to see strong demand for preferred securities due to their high income rates and the significant proportion of distributions taxed at the 20% QDI rate. We expect this demand would continue under a second Trump term.

Either scenario

Preferreds trading at attractive relative values. Preferred securities underperformed many other segments of fixed income through the first three quarters of 2020, and the risk premiums offered by preferreds for subordination to senior debt have increased amid economic uncertainty associated with COVID-19. We believe a gradual improvement in the global economy over the next several quarters could potentially drive material outperformance by preferreds (relative to corporate bonds) due to a combination of higher income and narrowing subordination spreads.

Infrastructure

Biden

Not quite a Green New Deal, but close. We believe a Democratic sweep could bring massive investment in clean energy infrastructure, ushering in one of the largest changes in U.S. energy policy in history. Within infrastructure, we believe the most notable impacts would be within the utilities and midstream sectors.

Utilities shifting to green energy sources. Policies that support renewables, such as ambitious carbon reduction targets and extensions of tax credits, should benefit utilities that own and develop solar and wind generation. Most U.S. utilities have been transitioning away from carbon-based fuel sources, and this would solidify their growth runway as they build more renewable assets. Power grids should also benefit from greater capex needs as new power plants are connected.

Pipeline development could face increasing pressure. Although the executive branch can impact pipeline development, key decisions on interstate midstream projects often rest in the hands of federal court judges, agencies and the U.S. appeals court system. Ultimately, changes to U.S. energy policy pursued by a new administration will depend on geographic location and regulatory oversight. We think a Biden win will continue to exacerbate uncertainty around the appropriate terminal value that pipeline assets warrant. Importantly, as it relates to fossil fuel use, while Biden opposes new drilling on public lands and waters, he has not supported a nationwide ban on fracking or crude exports.

Relative winners and losers from higher corporate taxes. Freight rail operators would be among those most impacted by higher corporate taxes, as they pay some of the highest effective tax rates among infrastructure businesses. However, tax changes would not likely roll back full expensing of capital investment, allowing rail companies to continue to fully write off spending, reducing their up-front tax burden. Relative winners would include cell towers and utilities, as they had the least to gain from the 2017 tax cuts. MLPs remain a wildcard: rising corporate taxes would increase the benefits gained by the partnership structure, but the tax advantages of the MLP structure could be phased out, which would potentially be negative for those entities

Trump

Efforts to accelerate permitting would remain limited by local regulatory bodies. A continuation of the Trump administration would be business as usual, keeping "energy-friendly" policies in place. However, we expect state and local regulation and opposition to continue to challenge the pursuit of new oil and gas pipeline projects in the midstream sector.

Either scenario

The energy value chain is embracing the transition to clean energy. Governments around the world and at the local level continue to push for more renewable and carbon-efficient alternatives to fossil fuels. State regulators at public utility commissions often support renewables, especially with declining costs making clean energy economically competitive with traditional resources in many areas of the country. Many traditional oil and gas producers—including BP, ExxonMobil, Shell, Total and others—have begun to redirect capex toward renewable platforms. Even within midstream energy, companies are beginning to expand their asset base to include renewables—such as Enbridge's wind assets and Energy Transfer Partners' solar-dedicated power purchase agreement.

Natural Resources and Commodities

Biden

Shifting supply dynamics could impact oil prices. Reentry into the Iran nuclear deal would allow Iran to freely export oil again, likely bringing an additional 1 million barrels per day of supply online by the end of 2021. This could act as a temporary headwind for oil prices in the near term, although we believe OPEC (Organization of the Petroleum Exporting Countries) would likely adjust its policy to accommodate the additional barrels. In the medium term, drilling impediments, such as a ban on new permits on federal lands, could curtail supply and drive oil prices higher. Over time, we believe a unified Democratic government could put enough regulatory and tax pressure on U.S. energy producers to knock out weaker companies, raising the marginal cost of production, reducing supply and putting upward pressure on oil prices.

Biden's fossil fuel ("green energy") recommendations have focused on

- Reducing conventional greenhouse gas pollution in all regulated sectors, including oil and gas
- Applying climate tests to all major projects that require federal approval and use federal funds/financing
- Ending financing of coal projects overseas
- Repealing fossil fuel subsidies and tax breaks, such as the ability to expense intangible drilling costs
- Reducing methane pollution through federal standards and targeted infrastructure improvements
- Banning new oil and gas permitting on public lands and waters and instituting a moratorium on new lease sales

Increased biofuel demand. Improved prospects for renewable fuels subsidies and mandates could boost market sentiment for corn, sugarcane and biodiesel (derived from vegetable oils and animal fats). The Environmental Protection Agency is charged with setting biofuel blending requirements, and would likely be more favorable to biofuels than refiners in its implementation of the Renewable Fuel Standard.

Trump

Positive for agriculture and livestock commodities, meat processors and agriculture machinery. Farmer government receipts would likely continue to allow farmers to plant more acres to corn, soybeans and wheat than they would otherwise, increasing supply of those crops and pressuring prices. However, a Trump victory would increase the chances that China adheres to the phase 1 trade deal signed with Trump in early 2020, increasing its purchases of U.S. agricultural commodities and (potentially) agricultural machinery. We also believe Trump would support biofuels adoption, as it would be seen favorably among farmers as soybean oil is a key input.

Either scenario

Bullish on gold. Under a Biden administration, we anticipate dollar weakness due to increased stimulus, low interest rates and rising inflation concerns as a vaccine is approved, along with higher taxes, increased spending on social safety nets and less-business-friendly policies, supporting a continued bull market in precious metals. Under a Trump administration, we believe a slower economic recovery, extended trade uncertainty and protectionist policies would benefit precious metals as a store of value.

Infrastructure spending positive for metals and bulk commodities. Both candidates are in favor of passing an infrastructure bill (see page 3), which would be demand-positive for certain metals and bulk commodities. A Blue Wave outcome would be the easiest path for a bill to become a reality, although we believe an infrastructure bill could eventually make it through the legislative process even under a split Congress.

Key Takeaways

1. Though fiscal relief may impact the recovery in the near term, infrastructure spending and secular trends—such as accelerated adoption of e-commerce and the shift to renewables—will likely have a much greater impact on real asset performance.
2. The combination of low interest rates and tax concerns should continue to drive strong demand for asset classes offering attractive, tax-advantaged income.
3. In our view, real estate, infrastructure, preferred securities and diversified real asset strategies are well positioned to deliver attractive total returns, income, and potential inflation-hedging and diversification benefits.

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Preferred securities: ICE BofA Fixed Rate Preferred Securities Index (Credit quality: BBB) tracks the performance of fixed-rate U.S. dollar-denominated preferred securities issued in the U.S. domestic market. **Municipal bonds:** ICE BofA Municipal Master Index (Credit quality: AA-) tracks the performance of U.S. dollar-denominated investment-grade tax-exempt debt publicly issued by U.S. states and territories, and their political subdivisions, in the U.S. domestic market. **Corporate bonds:** ICE BofA Corporate Master Index (Credit quality: A-) tracks the performance of U.S. dollar-denominated investment-grade corporate debt publicly issued in the U.S. domestic market. **High yield bonds:** ICE BofA High Yield Master Index (Credit quality: B+) tracks the performance of U.S. dollar-denominated below-investment-grade corporate debt publicly issued in the U.S. domestic market.

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Risks of Investing in Global Infrastructure Securities. Investments in global infrastructure securities will likely be more susceptible to adverse economic or regulatory occurrences affecting global infrastructure companies than an investment that is not primarily invested in global infrastructure companies. Infrastructure issuers may be subject to regulation by various governmental authorities and may also be affected by governmental regulation of rates charged to customers, operational or other mishaps, tariffs, and changes in tax laws, regulatory policies, and accounting standards.

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