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Investment Perspectives

Surveying the Potential Impact of Tariffs on Real Estate Investments

A look at the economic and investment implications of recent changes in U.S. trade policy for key sectors within the commercial and residential real estate markets.

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Real estate-linked investment vehicles such as commercial mortgage-backed securities (CMBS) and residential mortgage-backed securities (RMBS) are often significant holdings within core, core plus, and multi-sector fixed-income portfolios. As such, we are often asked how these asset classes will fare under various economic scenarios.

In our last update, which focused on the commercial real estate and CMBS markets, we noted that most property types and markets were balanced, suggesting a supply and demand equilibrium amid continued strong economic and labor market growth. Since then, the announcement of plans to implement higher tariffs on U.S. trading partners by the new U.S. administration on April 2 has spurred concerns about the impact of elevated trade friction on U.S. economic growth. (See our special report "Navigating Volatile Markets" for more on the economic and investment implications of the announced tariffs.)

We have received questions from investors regarding the potential impact of tariffs on commercial and residential real estate investments. Here, we offer a sector-by-sector view of the current landscape, along with some thoughts on investment positioning.

A Constructive Outlook on Select Property Types

The industrial property segment of commercial real estate (CRE) generally refers to spaces used for manufacturing, production, storage, and distribution of goods.

Our outlook for this sector is mixed given the potential effect of sustained tariffs. A decline in import volumes could be offset over time by the re-domestications of manufacturing activity. However, tenant demand is also tied to consumer spending, and we note that there could be headwinds for consumers due to higher prices.

Here are some observations on areas we favor within the industrial property space:

Logistics/Warehouses: We have remained focused on logistics/warehouse facilities used for storage and delivery of goods, and are favorable on facilities that are smaller, more flexible in terms of tenant configuration and use, and are located in dense infill locations (i.e., "last mile" sites).

Location is a key factor, in our view, as trade uncertainty continues. We believe West Coast ports and markets are more vulnerable as tenants may hesitate to sign new leases due to this uncertainty. Historically, a large segment of total demand in this region has been driven by companies in Asia and that concentration poses a potentially unique set of risks for markets such as Long Beach and Los Angeles, Calif. Within this sector, we favor other locations that are experiencing strong job growth, rising populations, and more favorable regulatory environments.

Data Centers: The demand for information technology should not be impacted by the tariffs. However, we would offer a caveat on that view as the buildout of data centers may face input cost pressures in a sector with one of the highest development pipelines. In addition, corporations could face pressure to reduce plans for large capital expenditures related to the construction or leasing of new data centers; however, recent management comments have affirmed or increased spending plans.

Here are some observations on other areas of real estate:

Housing Remains an Area of Relative Strength

The U.S. has a dearth of affordable single-family housing units, a situation which has been exacerbated by a historic increase in mortgage rates over the last few years and lackluster construction levels. While there are secular issues of higher operating expenses and rising insurance costs as well as potential cyclical pressures of unemployment and lower household formation, the sector should be a relative haven given the factors such as the lack of supply. As we've seen lately, the majority of consumers should continue to prioritize their mortgage payments over other more costly forms of consumer debt.

Office and Retail: Emphasizing Strong Capitalization and Essential Consumer Products

The rebound of office leasing activity seen in the second half of 2024 should wane as companies face economic pressures and continued uncertainty from tariffs. Much like during the COVID-19 crisis, the long-term leases common in the sector will buffer landlords' cash flows, provided the tenants remain solvent. We prefer well-capitalized sponsors that can afford the higher costs for tenant improvements and better-quality buildings in well-located areas.

Within the retail sector, our preference is for grocery-anchored shopping centers that benefit from necessity-based retailers. Marginal malls and power centers are most at risk from a strained consumer. We are keenly aware of possible tenant bankruptcies as retail margins and volumes are potentially squeezed due to tariffs.

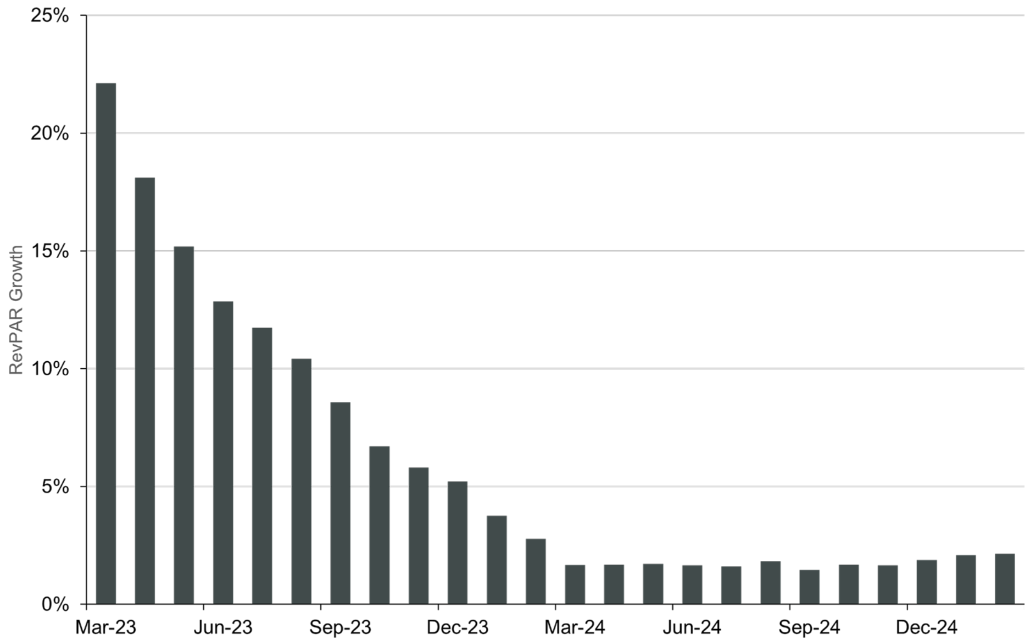
Hotels and Hospitality: Cyclical and Geopolitical Concerns

The hospitality sector is cyclical in nature and highly correlated to the overall health of the economy. A strained U.S. consumer is likely to reduce travel plans, while foreign travelers may also cut back on U.S. travel due to the recent boycott announcement in Canada and a potential extension of this dynamic to other countries. We believe this may reduce discretionary spending by both consumers and businesses and new group bookings.

Hotel fundamentals have already been slowing over the last twelve months, and we have been generally less constructive on the sector over the past year, with the recent tariff announcement adding to our concern. Revenue per available room (RevPAR) is a key performance metric and has registered approximately 2% growth over the trailing 12-month period through February 2025, down from approximately 3% growth over the same period through February 2024 (see Figure 1). These national figures are also being pulled higher from an increase in demand from natural disasters attributable to hurricanes in the Southeast and wildfires in Los Angeles, according to CoStar.

Figure 1. Hotel Fundamentals May Signal Challenges Ahead

Trailing 12-month growth in revenue per available room (RevPAR), March 2023-February 2025



Source: CoStar and Smith Travel Research (STR). Data as of February 2025. RevPAR is a metric used in the hospitality industry to assess a property's ability to fill its available rooms at an average rate. **The historical data are for illustrative purposes only, do not represent any specific portfolio managed by Lord Abbett or any particular investment, and are not intended to predict or depict future results.**

We remain focused on quality in this sector, such as AAA-rated single asset single borrower (SASB) issues that are high in the capital structure and have attractive loan-to-value (LTV) ratios.

Investment Positioning

Overall, we believe real estate will likely be less affected by the direct impact of the tariffs relative to other asset classes or industries. Nonetheless, real estate is inherently sensitive to macroeconomic conditions, and different sectors will likely be affected in different ways.

Regarding portfolio positioning, our year-to-date (through May 1) efforts to move higher in quality—emphasizing the highest-rated capital structures in securitized investments and emphasizing conduit, super-senior AAA-rated securities--have left us in an advantageous position to capitalize on opportunities resulting from increased market volatility, in our view.

We currently favor high-quality AAA CMBS that are at the top of the capital structure (i.e., have the priority for repayment), including conduit and select industrial, multifamily, retail, and office SASB transactions. Additionally, we favor CRE securities backed by a portfolio of properties that are cross collateralized and benefit from geographic and portfolio diversity. These securities offer attractive LTV ratios—the amount of the loan relative to the value of the asset or property is low—and can potentially benefit from property releases due to positive loan performance factors.

We expect housing will be a more attractive opportunity in the foreseeable future. Within the sector, we remain primarily focused on prime jumbo, select non-qualifying mortgage, single-family rentals, and select types of agency CMBS, such as Fannie Mae designated underwriter servicing (DUS) and Freddie Mac multifamily participation certificates (PCs).

In the nine-decade-plus history of Lord Abbett, a defining aspect of our success in active portfolio management has been our rigorous approach to fundamental credit research and security valuation. We will continue to monitor economic and market conditions as part of our efforts to deliver attractive returns with appropriate volatility in all our portfolios.

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Asset allocation or diversification does not guarantee a profit or protect against loss in declining markets.

No investing strategy can overcome all market volatility or guarantee future results.

The value of investments and any income from them is not guaranteed and may fall as well as rise, and an investor may not get back the amount originally invested. Investment decisions should always be made based on an investor's specific financial needs, objectives, goals, time horizon, and risk tolerance.

Market forecasts and projections are based on current market conditions and are subject to change without notice. Projections should not be considered a guarantee.

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The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of companies and/or sectors in the economy. While growth stocks are subject to the daily ups and downs of the stock market, their long-term potential as well as their volatility can be substantial. Value investing involves the risk that the market may not recognize that securities are undervalued, and they may not appreciate as anticipated. Smaller companies tend to be more volatile and less liquid than larger companies. Small cap companies may also have more limited product lines, markets, or financial resources and typically experience a higher risk of failure than large cap companies.

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The value of investments in fixed-income securities will change as interest rates fluctuate and in response to market movements. Generally, when interest rates rise, the prices of debt securities fall, and when interest rates fall, prices generally rise. High yield securities, sometimes called junk bonds, carry increased risks of price volatility, illiquidity, and the possibility of default in the timely payment of interest and principal. Bonds may also be subject to other types of risk, such as call, credit, liquidity, and general market risks. Longer-term debt securities are usually more sensitive to interest-rate changes; the longer the maturity of a security, the greater the effect a change in interest rates is likely to have on its price.

The credit quality of fixed-income securities in a portfolio is assigned by a nationally recognized statistical rating organization (NRSRO), such as Standard & Poor's, Moody's, or Fitch, as an indication of an issuer's creditworthiness. Ratings range from 'AAA' (highest) to 'D' (lowest). Bonds rated 'BBB' or above are considered investment grade. Credit ratings 'BB' and below are lower-rated securities (junk bonds). High-yielding, non-investment-grade bonds (junk bonds) involve higher risks than investment-grade bonds. Adverse conditions may affect the issuer's ability to pay interest and principal on these securities.

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Glossary & Index Definitions

An **asset-backed security (ABS)** is a financial instrument that is collateralized by a pool of assets that may generate cash flow from the debt.

In securitized lending, **capital structure** refers to the mix of debt and equity used to finance a pool of assets that are then securitized and sold to investors. This often involves creating different classes of securities (tranches) with varying levels of risk and return, and the capital structure determines how losses and gains are distributed among these tranches.

Commercial mortgage-backed security (CMBS) is a type of mortgage-backed security backed by commercial and multifamily mortgages rather than residential real estate.

Mortgage-backed security (MBS) is a type of asset-backed security which is secured by a mortgage or collection of mortgages. The mortgages are aggregated and sold to a group of individuals that securitizes, or packages, the loans together into a security that investors can buy.

The **Federal National Mortgage Association**, commonly known as Fannie Mae, is a United States government-sponsored enterprise that provides mortgage financing in the U.S.

The **Federal Home Loan Mortgage Corporation**, commonly known as Freddie Mac, is a government-sponsored enterprise in the U.S. that provides mortgage financing in the U.S. by purchasing and selling conventional loans from smaller banks and credit unions.

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