Rick Romano, Head of Global Real Estate Securities

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Julie Hyman: Well as trade uncertainty continues to spark fluctuation in the markets, our next guest says investors might want to turn to real estate and more specifically REITs, commercial REITs. Joining us now to discuss is Rick Romano. He's the head of global real estate securities at PGIM Real Estate. Welcome Rick. We've had a lot of people come on recently and say, "The world is crazy right now. Here's how you should handle it. Diversify or try to get yields somehow." So this is another method to try to gain stability in this crazy world.

Rick Romano: It is. So when you think about commercial real estate, it's a very local business. It's driven by a local supply and demand. So local consumption. When you think about the underlying properties that a lot of these REITs hold, there's such diversification and lack of correlation. An office building in Sweden for example, doesn't trade the same way that a grocery store in Des Moines, Iowa does. So it gives you that diversification, that hard asset. But more importantly in a lot of ways, you have long lease duration. So if you think about this building as an example, this is owned by a REIT. You have Yahoo Finance in here, you've got Facebook. And they're going to pay their rent if there's a trade war or not. Right? So the landlord's getting a check and it's got a long lease duration.

What's going to more effect the value of this building is if somebody puts up another building across the street. That might affect rents of this building or occupancy of this building. So when you think about defensiveness, dividend yield, long lease duration, good credit tenants, that's a good place to hide out or bunker up in a trade war.

Speaker 3: If you go back a couple years ago, here in New York city, one of the things that was really bullying, both primarily residential but also commercial real estate prices was an inflow of Chinese money and investment.

Rick Romano: Yes.

Speaker 3: And that has really fallen off significantly. How big of a factor is that looking beyond Manhattan, rest of the country? Is that factor to consider?

Rick Romano: We track capital flows a lot. So we're attached to a large private real estate group, which invests in commercial assets across the world. You're right, China and some other sovereign wealth funds, particularly China though, have pulled back a bit in terms of acquiring big trophy properties. If you remember, they bought the Waldorf Astoria a few years back. One of the companies there bought it. With that capital stepping out, we have seen a little bit of softness in the high end of commercial real estate, so the real trophy buildings, particularly in New York City.

Now in New York city also is in sort of, for commercial real estate at least, a little bit cyclically challenged because there's been so much supply added, right? So the city is moving west and south. Hudson Yards has a lot of square footage. Downtown has a lot of square footage. So the combination of that supply, demand is still strong, but the combination of that supply plus maybe some big capital providers pulling out leaves us, as we positioned. We're less bullish on New York City. We like west coast office better.

Julie Hyman: Also as you look at this sort of maybe slowing down of the global economy, maybe slowing down of the economy here in the US, if you're looking to real estate, should you maybe shift your expectations to stability versus appreciation? We're not going to see that same kind of price increases that we've seen in the past.

Rick Romano: Yeah. It is interesting. We've got rates that are 1.5% here and negative globally. So the spread between the 10 year bond and sort of what I would call the real estate cashflow yield is quite wide. Wider than it's been historically on average. I think that is attractive. And in terms of stability versus growth, the interesting part is that we're pretty far into this cycle, 10 years. And supply is not at levels that it has been at historically. In many areas, we haven't even reached average supply levels. Typically it takes three to four years of supply above average to start to really tip the real estate cycle.

What that means is that we're getting good cashflow growth in a lot of property types across the world. So we're seeing rent growth of 9% in Tokyo. West coast office, we're seeing rent growth of nine or 10%. so I think that there is still an opportunity for growth here, of cashflow growth within real estate that we're finding.

Speaker 4: Real quick, if you're a main street type of retail investor, how do you get in on this?

Rick Romano: That's a great question. REITs were designed for mom and pop and the mainstream investor to get involved in commercial real estate the way that institutions have for years. Now the legislation's been sitting out there for decades and decades, and it doesn't seem that mom and pop are really taking advantage of this. Right? So they're under invested in real estate. A lot of people, I think, think if they own a home, that's their exposure. But again, going back to what I said before, the correlation of a home is really driven by jobs, access, local jobs, growth regulation in that local market to a certain extent.

The way to access a diversified thousands and thousands of properties in commercial real estate is through REITs. You don't get the phone calls to wake up and fix the leaky faucet. It's a great advantage for individual investors that they're not necessarily taking advantage of. The footprint is 17% globally. And in the US the S&P 500 footprint of REITs is only two and a half percent.

Julie Hyman: Interesting. Rick, thanks for coming in. Rick Romano at PGIM. I appreciate it.

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