Fresh Invest: Location, location… investment?
Season 2, Episode 7 Transcript

Alex Lieberman, Co-Founder and Chairman of Morning Brew Hey, everyone, I'm Alex Lieberman, co-founder and executive chairman of Morning Brew. This is season two of Fresh Invest, your favorite investing podcast sponsored by Fidelity Investments and powered by Morning Brew.

Alex Today's topic is where that brick colonial on the corner meets the Nasdaq. We're going to talk about real estate as an investment.

Alex Real estate has long been seen as a foundation of wealth building and one that rewards foresight. If you've ever met someone who bought a lower Manhattan loft in 1982 and now doesn't have to worry about retirement or their kid's his college tuition, you know what I'm talking about. That's the dream, right? You buy the place, then let time do its value appreciating thing. But just like any other asset class, real estate has its own unique features, its own personality, if you will. There are legitimate questions to ask before you buy property, including do I plan to live in this place, flip it or run it as a landlord, should I redecorate? If location is everything, does that mean the only properties worth buying are in Palm Beach, in Santa Monica? No, of course not. But there are lots of factors to consider before buying any kind of physical property, even if you don't plan on living there. That's what I'll discuss today with Fidelity professional Andy Rubin.

Alex Andy, welcome to the show. Pumped to have you here.

Andy Rubin, Portfolio Manager at Fidelity Investments Thanks, Alex. I'm excited to be here.

Alex So let's just start with a little bit about you. Can you introduce yourself and tell me what you do at Fidelity?

Andy Rubin I would be happy to. I am an institutional portfolio manager for real estate investment strategies within Fidelity's Asset Management Business. Fidelity's dedicated real estate investing pursuits span the globe, as well as all major real estate property types. And we invest actively in both real estate, equity, and real estate debt on behalf of our clients, and we have for decades. In my role, I'm tasked with maintaining deep knowledge of portfolio management, philosophy, process and construction, ensuring that the portfolios we run are managed in accordance with our clients expectations and guidelines. And I contribute to external investment thought leadership just like this podcast.

Alex I love it. So let's just start foundationally pun intended. What makes real estate an attractive investment as an asset class?

Andy Right. So I feel strongly, Alex, that real estate can be an essential building block within any investment portfolio. Generally, real estate is sought for its potential to diversify portfolios that are comprised of the traditional asset classes, stocks, and bonds, typically, as well as its income, generative qualities, and its potential to protect against inflation. Now, contrary to popular belief, real estate is not a homogenous sector, and there's a broad spectrum of different property types, each with unique demand drivers that exhibit varying levels of sensitivity to the economy. Now, depending on an investor's risk profile and return expectations, he or she may elect to focus their investments on one real estate asset, perhaps a collection of the same type of real estate assets. Think a portfolio of rental apartments as an example, and then other investors might pursue a diversified approach to real estate investing and seek exposure to a multitude of different property types in an effort to balance the potential risks. At the end of the day, what the typical real estate investor seeks, from my experience, is an attractive total return outcome that has the potential to be additive to their other investment pursuits.

Alex Another word you mention when you were talking about real estate as an asset class is the opportunity for diversification from other traditional assets like stocks and bonds. So does that mean that real estate generally has a negative correlation with these asset classes or what is the traditional or historical relationship?

Andy Yeah, so the first thing is that it depends on the form of real estate investment. But generally, yes, a key benefit of real estate is that it tends to be lowly correlated or, said differently, behave independently relative to these other major asset classes. Now publicly traded real estate stocks, as well as bonds, which are very popular choices among many investors, those naturally tend to be more correlated to the broad equity and bond markets, though those instruments can still be very effective. A direct investment in a piece of property or in a loan or a mortgage backed by property will inherently have a lower correlation to those broad equity and bond markets, particularly over shorter periods of time. And so therefore, there are many investors that that might prefer to go that route.

Alex Got it. And so, you know, that this is kind of the piece on relationship between real estate and stocks or bonds. What about the relationship between, let's call it the value of real estate or home values and the broader economy? And you can even just speak to kind of like the environment that we're in now in a low rate environment, bull market. How should we think about appreciation of real estate as an asset?

Andy Yeah, so let me split my response into two pieces. First, from a revenue or cash flow perspective, which which really applies to commercial or income producing forms of real estate. You know, investors in that case, they need to acknowledge that demand for these properties is is tied to economic growth. And so when the economy is adding jobs and the value of financial assets is gently rising, that typically results in demand for rental apartments, demand for industrial warehouse buildings, office and retail space, self-storage. The list goes on. This supports property occupancy and allows the owners of those properties to increase rent, both of which drive property cash flows or revenue, which in turn drives the value of the underlying properties.

Andy Now, the second piece to it I'll describe as sort of residential or homeownership. And that is different as there's no income or revenue generation when you own and live in your home. And in fact. The homeowners on a listening to the to the pod here can appreciate the fact that it tends to be the opposite, where you as the homeowner end up pouring income into the property to maintain it. Having said that, homeowners do have upside potential in the value of their home. And what ends up driving the the underlying value of the single family residential market tends to be more demographical in nature. So things like the overall homeownership rate in a given market, household formation, affordability of owning versus renting, you know, those tend to be really the main drivers. And recently, to your point, Alex, these trends have been quite favorable and we've seen very robust appreciation in the single family home market through really this pandemic period. So the favorable trends have supported values. That appreciation has been exceedingly high. We've seen some signs recently of a of a potential moderation in that price appreciation, which I think is very natural and healthy given the runway that we've been in here for for so many months.

Alex I love that. And so, you know, to me, the next obvious question here, once we understand the asset class is, like, should we get involved, how do we get involved? And before asking about, like tactically how we get involved, one question I first have is how do you decide if you say you buy into, you know, the inflation hedging properties of real estate, the negative correlation between stocks and bonds, traditionally, if you're just looking at kind of the two main buckets of real estate, commercial versus residential, how do you start thinking about what bucket makes sense for you to kind of play in as an investor?

Andy Yeah, so I think as a as a general proposition, I tend to be very sort of long term oriented in terms of my investment philosophy and approach. And there is a bias certainly given my role at Fidelity and how we tend to invest. And so I often get questions about, you know, can you make a quick buck flipping real estate, either single family homes or even pieces of commercial property. And, you know, again, my personal reaction to that is that a shorter term oriented approach is very difficult to execute both consistently and profitably over time. So that's that's the first thing I'll say.

Andy What I do believe and feel strongly about is that for the average individual investor, it's very prudent to maintain static strategic exposure to some form of real estate investment over time. And I think that a diverse approach where you're not picking a specific property type, whether that's within the commercial realm or in the in the single family sort of home ownership world, but to have that diverse exposure and benefit from the sort of yin and yang and the zig zag that occurs, given the different drivers, depending on that underlying property type. And to put that exposure on by way of a professionally managed vehicle like a mutual fund or an exchange traded fund, an ETF—or one of the many different private fund or partnership structures that are available today, many of which in recent years have have brought investment minimums down pretty meaningfully. So they bring the access to a very wide swath of the individual investing public. And as I said, it's all about that strategic sort of through-cycle allocation where you're not trying to time the market, but you're sort of setting that appropriate allocation. You're rebalancing over time, just as you're guided to do with your stock and bond allocations. But you sort of set it and forget it with a periodic rebalancing. And that helps to counter sort of the ebb and flow of the market and the potential for that allocation to get out of whack. And you turn around years down the line and that allocation should really be should be highly additive to to your overall diversified approach.

Alex That's super helpful, and I'm not sure if you know this number on hand, so if not, no big deal, but obviously past performance, not a predictor of future performance. But how historically has real estate as an asset class from a return perspective performed relative to, let's just say, the benchmark that everyone like looks at, like the S&P, which I believe is, you know, generally compounding seven percent year over year for the last 40 years?

Andy Yeah, it's difficult to generalize because there's all these different flavors of real estate and it's hard to identify what's the best proxy. That said, I'll approach it this way. So I think a reasonable apples to apples-ish way to compare it is to look at the listed U.S. real estate equity group. So the publicly traded companies that own own real estate and operate real estate. There's, you know, 150-200 some odd of these listed real estate entities in the U.S. If you look at their history that, you know, which goes back, I would say, you know, the last 30 years is sort of the the most relevant time period to look at. If you go further back than that the universe is very small and there's some other issues. But if you compare the annualized return over very long periods, you know, 15, 20, 25 years, it's exceedingly compelling. That depending on the index of that listed U.S. real estate group, what you would find is average annualized returns that are in the very high single digits, even low double digits per annum over those long stretches. So I would say it's very competitive. Over certain periods, you would find that it has outpaced broad equity headline indexes. So, yeah, I think in of itself it is it is exceedingly compelling in that regard.

Alex Worth taking a look at. One last question before we finish up the conversation. This season Fresh Investor, we've taken questions from the audience and one audience member asked what criteria or indicators are important when assessing or investing in real estate?

Andy Sure. As I mentioned earlier in our discussion, I view real estate as an essential building block within any investment portfolio. Having said that, you know, investors, many investors may be looking to dial their real estate exposure up or down at certain points in time, depending on the environment or based on a view they may have at a point in time. And oftentimes that is impacted by certain metrics or indicators. So along those lines, because, and I'm going to focus on the commercial side, because fundamentally speaking, commercial real estate is really about supply and demand, I would encourage investors to look at the gauge, some gauge of the demand for commercial property, whether that's in a specific property type or a specific geographic market. There's a multitude of metrics out there that are at investors disposal, things like occupancy rates, rental rate growth. Those are probably the two biggest keys to get a gauge of how strong demand is in a given subset.

Andy And then on the supply side of that of that supply and demand equation, you need to be mindful there, too. If there's an abundance of property being built and delivered, well, then that can be problematic and that can oversaturate a market with too much supply that might exceed demand. And so there's indicators of new supply that are closely followed. And I would again also encourage investors to be mindful of those.

Andy The only other thing I'd mentioned, Alex, is I like to describe real estate as a capital intensive industry and pursuit, and, therefore, the availability of capital and the cost of that capital—said differently the prevailing interest rates in the market, right—what type of rate environment are we in? And as a property owner, what is the going rate for to borrow against a piece of property? In recent years, it's been very competitive. We've been in a low rate environment on a historical basis, and so that's been very supportive. But you need to pay a close eye to that and you need to have a view, I think, on the direction of rates as well.

Alex Andy, this has been super insightful from just how to think about real estate as an asset class relative to, you know, some of the more traditional assets we look like look at like stocks or bonds. But also taking it a step further as investors, as retail investors, how we can think about getting involved in the space, both like theoretically but also tactically. So really appreciate your time. Thanks for joining Fresh Invest.

Andy It was my pleasure. I really enjoyed it. Thanks, Alex.

Alex Thanks for listening in today, everyone. I personally found it super helpful to pass out the received wisdom on real estate from how property actually works as a potential wealth builder. What may have worked in 1992 may not be the right path today. And the right move for someone living in Brooklyn may not be the wisest choice for someone in Akron. I thought Andy's comments on flipping houses was particularly interesting. I think the key terms he used were consistency and profitability. You may be successful slapping a new coat of paint on one property, but doing it over and over may not work.

Alex That's why next week we're going to explore real estate investment vehicles that are somewhat removed from physical properties. We'll introduce you to some nifty tools you can use to invest in real estate without buying property. So we'll see you then.

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