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Gaal Surugeon On Real Assets

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Gaal Surugeon, Managing Director and Portfolio Manager at Brookfield Real Assets Income Fund talks about investing in real assets: infrastructure, natural resources, real estate and other tangible assets that play an essential role in the functioning of the global economy. “From an investment perspective, we don’t just look at these sectors through a single lens, we think about them being available throughout the entire capital structure, so both debt and equity, allowing us to really tailor our exposures based on where we see value and risk,” Surugeon said. AI and data centers, in particular, are a growing investment sector because of the ripple effects they create across the broader economy, he added. Surugeon also discussed the current state of real estate investing, citing select opportunities in certain commercial and residential mortgage-backed securities.

Learn more about Gaal Surugeon (https://www.brookfield.com/about-us/leadership/gaal-surugeon) and Brookfield Real Assets Income Fund (https://www.brookfieldoaktree.com/fund/brookfield-real-assets-income-fund-inc)

JANE KING: Gaal Surugeon is a managing director at Brookfield Asset Management, and is an experienced portfolio manager with expertise in real assets, asset allocation, and macro strategy. Welcome Gaal, very interested in talking to you about what you've got going on, so provide an overview of what it means to invest in real assets. What are we talking about here?

GAAL SURUGEON: Sure, and thanks for having me, Jane. So when we talk about real assets, we're referring to physical, tangible assets that play an essential role in functioning of the global economy, this includes infrastructure, real estate, and even natural resources, so effectively these are sectors that support everything from the flow of goods and energy to where people live and work. Now these assets are typically long-lived, high value, and backed by either regulated or contracted cash flows, so we think of these as subsectors of cell towers, utilities, pipelines, buildings, data centers, effectively assets that underpin daily life and have often strong barriers to entry. From an investment perspective, we don't just look at these sectors through a single lens though, we think about them being available throughout the entire capital structure, so both debt and equity, allowing us to really tailor our exposures based on where we see value and risk.

JANE KING: And you mentioned new areas of growth in this asset class, can you elaborate on that a bit?

GAAL SURUGEON: Yeah. One of the most exciting developments is the explosion, I would say, of investment around AI and data infrastructure. The scale of spending by hyperscaler, so think of Microsoft, Amazon, Google, on data centers is unprecedented. These are not just warehouses for computer servers, they're sophisticated power-intensive facilities that are becoming central to how AI and cloud-based computing operate, so this has ripple effects across multiple sectors in our space. From a real estate standpoint, of course data centers are now some of the most in-demand properties globally. In fact, McKinsey recently estimated that by 2030 data centers are projected to require $6.7 trillion worth of investment worldwide just to keep pace with the demand for compute power. And on the energy side, the intensity of AI workloads is drastically increasing requirements for power generation, so for context, an AI supercomputer today can consume over two and a half times the amount of power than a traditional cloud data center. The IEA just published a report projecting that electricity demand from data centers worldwide is set to more than double by 2030, to about 945 terawatt hours. So to put that into perspective, that's more than the entire electricity consumption of Japan, and mind you, Japan is the fourth largest consumer of electricity globally. So that is certainly driving demand for both regulated utilities and dispatchable generation, and we think renewables will fulfill much of that demand for power, but of course, even more traditional solutions such as natural gas and even nuclear will play an important and complimentary role. Now aside from AI and data, you mentioned growth, another growth driver of infrastructure is of course the energy transition. Onshore wind and utility scale solar have become the lowest cost sources of energy in many regions, and what's notable today is that it's corporations, not governments, that are driving a lot of that demand for new renewable power. They're signing long-term contracts for renewable energy to meet their own sustainability objectives, and this makes the sector inherently less reliant on subsidies and government policy than it has in the past, and really helps create that long-term contracted revenue stream that as I mentioned earlier underpins real assets. So while the underlying assets are familiar, the growth drivers are certainly evolving fast.

JANE KING: Yeah, and interesting how renewable is becoming more market-oriented too. Let's transition to real estate and what we think of traditionally in real estate. What are your views on that sector today?

GAAL SURUGEON: Sure. Look, it's no secret that real estate has gone through significant change over the last few years, certainly post-pandemic. Of course the office sector in particular is still finding its footing after COVID with the work-from-home dynamics reshaping demand in many markets, and of course the rise in interest rates has been a headwind. It's made both development and refinancing more expensive, and has put pressure on asset values, but that said, there are green shoots to focus on within real estate. I would say the debt markets remain relatively well functioning, fixed-rate financing remains expensive, but floating rate debt and alternative capital sources, primarily from insurance and private credit, are filling the gaps, and the that's been enabling refinancing and opportunistic acquisitions. Albeit the amount of transaction volumes is still depressed prior to COVID levels, but we have seen that slowly increasing, and it's more about uncertainty from transactions, either the buyers or the sellers coming to market, but it's not for lack of available financing. We've been the beneficiary of this call on private credit origination, which has really stepped in since the pullback of banks and traditional lenders in commercial real estate, and that's really provided access to high-quality loans backed by cash generating hard assets such as real estate. With respect to the asset values in in real estate, we do see them stabilizing with modest upward bias, we think cap rate expansion has largely run its course in most property types and regions. Price discovery is slowly improving and distressed selling is moderating as peak policy fears, we believe, have shown some easing.

We do see select opportunities in certain subsets of real estate debt, we see opportunities in commercial mortgage-backed securities, primarily floating-rate single assets, single borrower CMBS and even CRE CLOs, We also allocate meaningfully to residential mortgage-backed securities, especially in deals backed by high-quality collateral. Now that could either be legacy, residential securities which were issued pre-Financial Crisis, so think of those as time and stress-tested collateral pull. The borrowers have been through it all, and that really supports the quality of that collateral, but also even new capital investing in primarily non-qualified or non-QM mortgage loans. Multi-family housing really underpins that opportunity set. Multi-family housing continues to benefit from affordability pressures and demographic demand as the cost to own remains elevated in the face of both home price appreciation and higher mortgage rights. So ultimately real estate's not a monolith, some areas are certainly challenged, but other areas like healthcare, data centers, and even specialized residential, not necessarily just traditional multi-family but we think of senior housing or student housing as subsets of the residential market, are seeing secular growth, and we believe those will continue to attract capital.

JANE KING: Interesting. And of course this has been a year full of a lot of global uncertainties, we've had tariff proposals and some tariffs, and pullbacks on tariffs and things like that. How does that factor into your decision making? Do you think we've seen the worst of that? Looking ahead to the second half of the year, what's on your radar screen in terms of global uncertainty in geopolitics?

GAAL SURUGEON: Yeah, there's definitely been a tremendous amount of uncertainty this year. It's on the back of four years of uncertainty post-pandemic, so we're definitely watching closely for macro signals, but a lot of that uncertainty that you're citing comes from, effectively year to date, a lot of the new tariff policies. Fortunately, we believe our sectors, infrastructure and real estate particularly, tend to exhibit relatively low direct sensitivity to tariffs and global trade uncertainty. That's particularly compared to the more cyclical sectors, of course, such as manufacturing or technology hardware. Most infrastructure assets are domestically oriented, and oftentimes regulated, so that makes them less exposed to these cross-border trade flows or tariff policies, right? The revenue streams are typically contracted and often inflation linked, so what that does is it provides somewhat of a resilience during periods of macro uncertainty. Now of course indirectly there still could certainly be exposure to tariffs, but those are linked to construction or equipment costs for new projects, so think of the imported materials such as steel or solar panels or transformer, if those are subject to tariffs, then inherently they will increase the cost of new construction. And of course we can't forget about the risk that supply chain gets delayed due to these trade tensions, and that may impact the timeliness of new development. Now for real estate, I would say core sectors within real estate, multi-family, logistics, strip centers, those tend to serve local economies, and they're again relatively insulated, from our perspective, from international trade. Revenue is typically derived in those property types from long-term leases, and operating expenses are largely domestic. But of course, in sectors such as industrial real estate, especially ports near major transport hubs, those can be impacted if trade volumes decline due to tariffs or global uncertainty, and that may just affect tenant demand and rent growth in those property types. And of course, just like infrastructure, input costs are most at risk, so construction costs can rise from tariffs just due to the cost of building materials. But theoretically, that also puts a cap on new supply, and as we know from Econ 101, if we cap supply, inherently we also raise the value of our existing properties. So generally I would say on the macro side, we are in an environment of mixed signals, we know the Fed has been data dependent, remains to be very data dependent, we've seen softening in consumer data and labor markets but inflation, particularly in core services, remain sticky. Commodity sensitive components, so energy and food, also have stayed fairly elevated, and that could complicate the timing of rate cuts. Because remember, the Fed has a dual mandate, they have to balance slowing growth and higher inflation, and so our base scenario is for moderate deceleration of global growth for the rest of this year. But there are upside risks that that keep us optimistic, and that's really from US fiscal spending, easing financial conditions, or even any signs of stabilization in Europe and China.

JANE KING: Okay.

GAAL SURUGEON: In this type of environment, we do think real assets are well positioned. We think they tend to offer that inflation linkage, steady income, resilience through volatility, so despite the macro outlook, we think we're well positioned within our asset class.

JANE KING: As always, a lot of moving parts and things to consider when you're making these decisions. Gaal, thank you so much for your insight. Very interesting.

GAAL SURUGEON: My pleasure. Thanks Jane.

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