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The good and bad lessons learned by institutional investors in private real estate

Private real estate has been part of institutional portfolios long enough now to have generated three full boom-bust cycles worth of hard evidence about what the asset class actually delivers, as opposed to what it was sold to deliver. Pension funds, sovereign wealth funds, endowments and insurers built allocations to private real estate on a fairly simple thesis: stable income, a hedge against inflation, and a low correlation to stocks and bonds, in exchange for giving up daily tradability. Many individuals have this exposure, as well, through corporate or public pensions or insurance-backed annuities, which have supported the retirement needs of millions of individuals. Two decades and three crises later, that thesis has held up in some respects and been dented in others. The lessons are worth reviewing plainly, because the same mistakes tend to resurface in slightly different costumes every cycle.

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What has worked

1. Income durability
   The clearest lesson is that private real estate has, over long holding periods, done what it was intended to do within a diversified portfolio. Core, income-oriented real estate has historically produced returns with lower volatility than public equities and a return stream driven substantially by contractual rental income rather than daily price sentiment. For institutions with long liabilities – a pension fund paying benefits for decades, an endowment spending against a perpetual pool of capital – that income durability has been genuinely valuable, especially during periods when bond yields were pinned near zero and public equities were expensive.
2. A long-term strategic allocation
   Institutional investors learned that private real estate often rewards investors who treat it as a long-term portfolio management tool rather than an actively managed timing allocation. Investors that fared best were the ones that underwrote at the property and market level; invested in low leverage, core real estate; and rebalanced their overall portfolio based on asset allocation targets rather than simply trying to time the market by buying highly leveraged assets with the promise of outsized returns.
3. A benchmark for better understanding
   The maturation of indices such as the NCREIF Fund Index–Open End Diversified Core Equity (NFI-ODCE) gave institutional investors a common, quarterly appraisal-based yardstick for core real estate performance. That consistency has made it easier to compare managers, assess results across market cycles, and understand how an allocation performed relative to the broader institutional market. The benchmark provides greater context than relying only on manager-reported results in isolation – a genuine improvement in market discipline compared with earlier cycles.
4. Manager alignment matters
   Burned by fee arrangements in earlier cycles that paid managers well regardless of outcomes and, in fact, incentivized excessive risk-taking, many institutions pushed successfully for stronger risk parameters, better transparency, and fee structures more closely tied to realized performance. That evolution has not solved every alignment problem, but it represents meaningful progress in how institutional capital is negotiated and deployed today. The lesson learned is that investment results are influenced not only by the assets themselves, but also by the incentives guiding the managers who oversee them.
5. Not all real estate is created equal
   Perhaps the most important lesson learned has been that not all real estate carries the same risk and return profile. Property type, leverage, liquidity, investment structure and manager strategy can all materially influence outcomes. Institutional investors increasingly recognized these distinctions, leading many to differentiate between lower-risk core real estate and more volatile non-core strategies. Understanding those differences became critical to building portfolios designed to deliver specific outcomes. The lesson was not simply to own real estate, but to understand what type of real estate was owned, what risks it introduced, and what role it was intended to play.

What went wrong

1. Liquidity constraints
   The most expensive lesson, learned twice now, is that "private" and "illiquid" are not abstractions – they bind exactly when an investor most wants flexibility. In the 2008–2009 financial crisis, a number of open-end core funds that had marketed monthly or quarterly liquidity to institutional investors were forced to impose redemption queues, and investors waited to fully exit positions. The same dynamic reappeared in a different wrapper in 2022–2023. Blackstone's nontraded REIT, BREIT, drew roughly $69 billion in assets and offered monthly redemptions capped at 2 percent of net asset value and 5 percent quarterly. When redemption requests spiked as rates rose, BREIT honored only a small fraction of requests in some months – in December 2022, it met only about $151 million of roughly $3.8 billion requested, before the University of California's investment office stepped in with a $4.5 billion capital infusion that helped stabilize the vehicle. The redemption gate stayed in place for roughly 16 months before lifting in March 2024.



This is a reminder that semi-liquid structures offer conditional liquidity, not the real thing, and that the condition tends to bind exactly during the stress episode an investor is trying to exit. In hindsight, liquidity generally returns at the bottom of the market, the exact wrong time to sell.

2. The denominator effect

A closely related lesson is that institutional allocation mechanics can work against investors at precisely the wrong moment. The "denominator effect" – in which a decline in public stock and bond portfolios mechanically raises the percentage weight of illiquid private real estate holdings relative to target allocations – left many pension funds with far less room to commit new capital. The lesson is not that allocation targets are wrong, but that true diversification and non-correlation in a portfolio requires some of its investments to behave differently at different times. While the 60/40 portfolio has delivered strong performance over the past two years, the experience of 2022 remains a reminder of the risks that arise when stocks and bonds decline together.

3. Private markets reprice differently

Appraisal-based valuations, which are typically updated quarterly, tend to reflect market changes more slowly than publicly traded assets. As a result, private real estate values often appear more stable during periods of market volatility, even though the underlying economics may already be changing. Institutional investors were reminded of this reality during the 2022–2024 repricing cycle, as higher rates eventually worked their way into property valuations. The impact was particularly pronounced in more highly leveraged strategies, where leverage amplified the effect of declining values. The lesson is that delayed repricing does not eliminate risk, and that leverage magnifies both gains and losses when market conditions change.

4. Concentration risk dressed up as diversification

Institutions that built large exposures to office learned that a sector can go from core-defensive to structurally impaired within a few years as market forces change, such as remote and hybrid work. There is a live version of the same risk forming now on the other side of the ledger: Capital had rushed so quickly into life science and other adjacent real estate that investors ignored the concentration and pricing risk in a sector still short on long-run operating history – a reminder that today's obvious secular winner can become tomorrow's crowded trade.

Conclusion

Put together, the good and bad lessons point in the same direction: Private real estate has earned its place in institutional portfolios as a source of durable income and genuine diversification, but only when investors respect what the asset class actually is rather than what it is marketed as. That means treating semi-liquid vehicles as illiquid for planning purposes, building allocation policies flexible enough to avoid forced procyclical behavior, discounting appraisal-based marks during periods of rate volatility, watching leverage as closely as the property fundamentals underneath it, and resisting the temptation to mistake a popular sector for a permanently safe one. None of these lessons is new in the abstract; what each cycle adds is a fresh, expensive reminder of how easy they are to forget when returns are good and capital is abundant. Individuals are well served by the basic asset-allocation framework of building a long-term, diversified portfolio with the view that market timing often works to the detriment of returns. In fact, the pension portfolio builders of old are now building toward the same long-term goals for individuals, but simply in a different wrapper. The defined benefit plan of old is not the 401(k) or individual savings account today.

Sources:

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