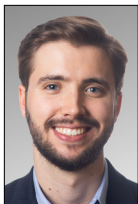


Finding the Optimal Approach: Real Estate Strategies and Portfolio Design



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In our previous article in the *PREA Quarterly*, we examined real asset fundraising trends and noted that fundraising has slowed over the past two years because of high interest rates, market uncertainty, and reduced transaction activity. Looking ahead to the remainder of 2025, we are cautiously optimistic that real asset fundraising activity will recover, supported by moderating interest rates, stabilizing asset valuations, and improving levels of transaction activity. However, risks remain around geopolitical tensions, policy uncertainties under the new Trump administration, and the potential for global supply chain disruptions.



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In times of market uncertainty, diversified real estate funds often perform well; however, a growing number of “diversified” funds have significant overweights to sectors such as industrial and multifamily. This raises the question of whether investors are better off investing with sector specialists targeting those property types instead. In this article, we address this question by analyzing the relative performance of sectors, strategies, and fund sizes, while also refreshing our analysis of business model structures, such as operators and allocators. Our goal is to provide greater clarity on how investors can optimally build their real estate portfolios and pursue manager selection.

What We’ve Observed

We recognize the limitations of relying on historical performance data to predict future outcomes. Still, Cambridge Associates’ (CA’s) database of performance data offers meaningful insights that can help inform foundational principles for portfolio construction. We started our review by analyzing the performance of more

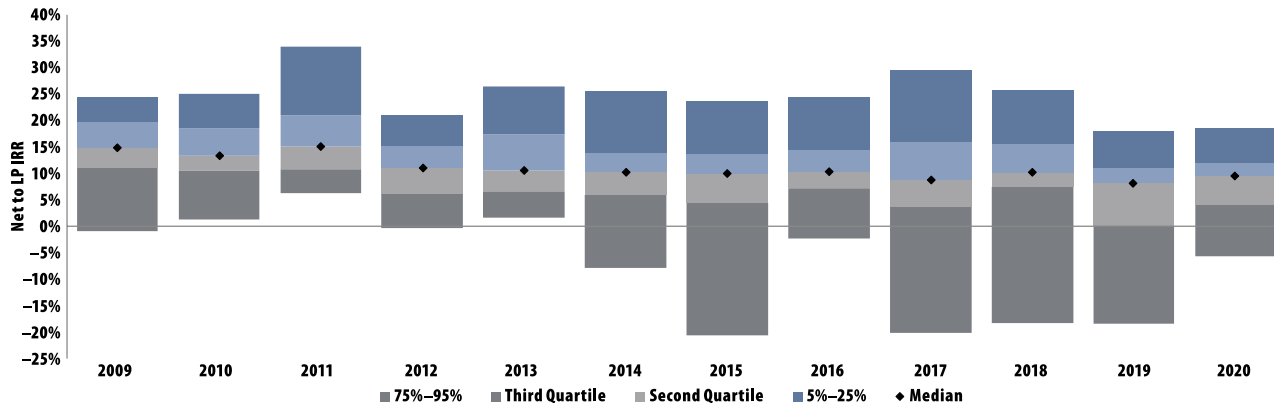
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than 500 North American private real estate funds with vintage years from 2009–2020 (as shown in Exhibit 1A). Over this period, the median net internal rate of return (IRR) was 10.6%; however, performance has been muted in recent years because fundamentals deteriorated in certain sectors. In the first five years following the global financial crisis, managers were able to capitalize on attractive valuations and widespread distress. Not surprisingly, vintage years 2009–2014 demonstrated the highest median IRRs, ranging from 10.2% to 15.1%, with a relatively low dispersion of returns.

In the subsequent vintages, 2015–2020, as more capital flowed into the space and valuations began to rise (partially as a result of the low interest rate environment), returns started to normalize. For these vintages, median returns trended downward, accompanied by greater performance dispersion. Nevertheless, upper-quartile managers consistently delivered strong results, on par with upper-quartile managers in the post-financial crisis period.

The relative performance of each real estate sector has diverged over the past decade, which helps explain why there is greater performance dispersion among

Exhibit 1A: Real Estate Return Dispersion



	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
N	20	30	49	43	45	56	49	49	43	49	41	43
5%	24.5%	25.1%	33.9%	21.1%	26.4%	25.6%	23.5%	24.5%	29.5%	25.7%	17.9%	18.4%
25%	19.8%	18.5%	21.0%	15.4%	17.4%	13.9%	13.7%	14.5%	16.1%	15.5%	11.0%	11.9%
Median	14.8%	13.4%	15.1%	11.1%	10.6%	10.2%	9.9%	10.3%	8.8%	10.2%	7.9%	9.5%
75%	11.1%	10.6%	10.8%	6.1%	6.7%	5.9%	4.4%	7.2%	3.7%	7.5%	-0.1%	4.1%
95%	-0.9%	1.3%	6.2%	-0.3%	1.7%	-7.8%	-20.5%	-2.3%	-20.1%	-18.3%	-18.4%	-5.7%

Source: Cambridge Associates LLC

Notes: Returns are horizon internal rates of return (IRRs) calculated since inception to Sept. 30, 2024. These returns are net of management fees, expenses, and performance fees that take the form of a carried interest. Vintage years are 2009–2020. Cambridge Associates (CA) is always working to grow its private investments performance database and ensure that its benchmarks are as representative as possible of investors’ institutional-quality opportunity set. As a result, CA continually adds funds to the database (both newly raised funds and backfill funds) and occasionally must remove funds that cease reporting. CA’s private investments performance database is dynamic and reflects both classification adjustments and changes to the underlying pool of contributing funds. As a result, there may be changes in the results of some historical benchmark return analyses. The percentile calculations, including top 5%, upper quartile, median, lower quartile, and bottom 5%, depict the distribution of the sample by describing what percentage of observations fall above and below a certain value. For example, the value of the upper quartile, also referred to as the 25th percentile, indicates that 25% of observations are above the given value, and 75% are equal to or below. All financial investments involve risk. Depending on the type of investment, losses can be unlimited. Past performance is not indicative of future returns.

funds with vintage years from 2015–2020. Sectors such as residential and industrial, which benefit from secular tailwinds such as e-commerce trends, housing affordability challenges, and an aging population, outperformed sectors such as office and retail, which are more dependent on cyclical demand drivers.

The COVID-19 pandemic brought significant disruption to the real estate industry and accelerated already ongoing trends. Changing consumer preferences, including a shift away from brick-and-mortar stores to e-commerce, have hurt the retail sector. Similarly, the abrupt move to a work-from-home environment during the pandemic, along with the evolution of the hybrid work model, negatively impacted the office sector. This sector was already struggling with high capital expenditure requirements and

a pronounced bifurcation in performance, where trophy assets outperformed properties of lower quality, prior to the pandemic, and has encountered even greater challenges in recent years. Not surprisingly, funds with significant exposure to office and retail or strategies focused solely on those sectors have been negatively impacted.

To isolate the effects of underperformance from funds that invested exclusively in those sectors, we excluded them from our analysis for all vintage years (2009–2020) and compared performance in Exhibit 1B. The impact on the returns is more pronounced in funds from the 2015–2020 vintage years because they were in the value-added phase during that period. As a result, they were particularly vulnerable to the trends described above, which delayed stabilization and, in some cases, severely



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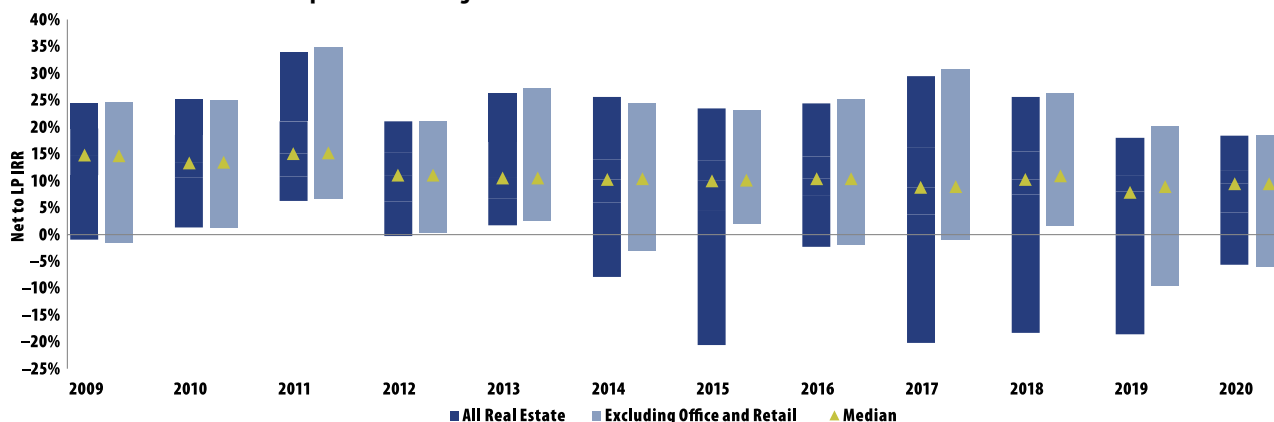
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Exhibit 1B: Real Estate Return Dispersion Excluding Office and Retail

Source: Cambridge Associates LLC

Notes: Returns are horizon internal rates of return (IRR) calculated since inception to Sept. 30, 2024. These returns are net of management fees, expenses, and performance fees that take the form of a carried interest. Vintage years include 2009–2020. Cambridge Associates (CA) is always working to grow its private investments performance database and ensure that its benchmarks are as representative as possible of investors’ institutional-quality opportunity set. As a result, CA continually adds funds to the database (both newly raised funds and backfill funds) and occasionally must remove funds that cease reporting. CA’s private investments performance database is dynamic and reflects both classification adjustments and changes to the underlying pool of contributing funds. As a result, there may be changes in the results of some historical benchmark return analyses. All financial investments involve risk. Depending on the type of investment, losses can be unlimited. Past performance is not indicative of future returns.

limited their ability to generate returns. In addition, while returns for the 2015–2020 vintages are not fully realized and may improve, downward pressure on valuations and ongoing liquidity challenges (especially for office assets) may continue to hurt performance for those cohorts.

Without sector-specialist office and retail funds, bottom-quartile performance improved dramatically. While the mean return for each vintage year improved, the median returned remained relatively similar. As we discuss later in this article, sector specialists can deliver strong risk-adjusted returns. However, when market sentiment and secular changes emerge, especially as they did during the pandemic, sector-focused strategies may struggle as a result. Managers with more flexible mandates can be better positioned to capitalize on those secular shifts. Later in the article, we discuss why one investor may prefer a single diversified strategy while another may benefit more from multiple sector specialists. For now, here is a review of the impact of sectors on returns.

The Impact of Sector Exposure on Returns

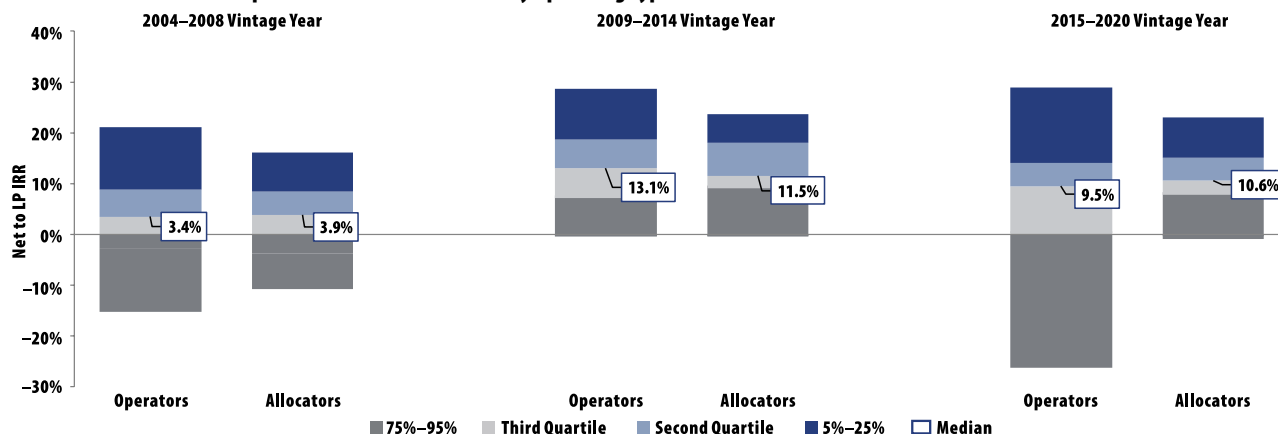
As discussed, real estate sector performance has diverged over the past decade. The NCREIF Property Apartments

and Industrial subindexes outperformed the aggregate NCREIF Property Index from 2009–2024, 2014–2024, and 2020–2024. Conversely, the NCREIF Property Office and Retail subindexes underperformed the aggregate index over the same time periods.

Given that sector exposure shaped overall real estate performance, we analyzed how underlying sector exposure impacted relative outperformance. To do this, we reviewed the top-performing real estate funds in each vintage year from 2009–2020 within the CA real estate benchmark universe to determine if these trends were reflected in fund performance. Indeed they were—the top-ten funds for each vintage year were dominated by residential- and industrial-focused funds, as well as diversified funds that were overweight to these sectors. Specifically, while residential- and industrial-sector-specialist funds accounted for 25% of funds raised between 2009 and 2020, they represented 38% of the top-performing funds for those vintage years. Additionally, 60% of diversified funds in the top-ten-performing funds of each vintage year demonstrated a preference for these sectors, with more than 50% of fund capital invested in residential or industrial assets.

Conversely, retail- and office-sector-specialist funds accounted for 9% of funds raised from 2009–2020 but

Exhibit 2: Performance Dispersion of Real Estate Funds by Operating Type



Source: Cambridge Associates LLC

Notes: Returns are horizon internal rates of return (IRRs) calculated since inception to Sept. 30, 2024. These returns are net of management fees, expenses, and performance fees that take the form of carried interest. Vintage years are 2004–2020. Cambridge Associates (CA) is always working to grow its private investments performance database and ensure that its benchmarks are as representative as possible of investors’ institutional-quality opportunity set. As a result, CA continually adds funds to the database (both newly raised funds and backfill funds) and occasionally must remove funds that cease reporting. CA’s private investments performance database is dynamic and reflects both classification adjustments and changes to the underlying pool of contributing funds. As a result, there may be changes in the results of some historical benchmark return analyses. Changes to CA’s allocator-operator analysis, including updated classifications (e.g., classifying hybrid funds as allocators), revised time periods, and a focus on median rather than mean returns, have resulted in reduced performance dispersion for allocators compared with prior years. The percentile calculations, including top 5%, upper quartile, median, lower quartile, and bottom 5%, depict the distribution of the sample by describing what percentage of observations fall above and below a certain value. For example, the value of the upper quartile, also referred to as the 25th percentile, indicates that 25% of observations are above the given value, and 75% are equal to or below. The sample includes 111 operators and 80 allocators in 2004–2008, 111 operators and 103 allocators in 2009–2014, and 136 operators and 100 allocators in 2015–2020. All financial investments involve risk. Depending on the type of investment, losses can be unlimited. Past performance is not indicative of future returns.

represented 23% of the bottom-ten-performing funds in these vintages. Of the diversified funds, where data is available, 44% were overweight to office and retail.

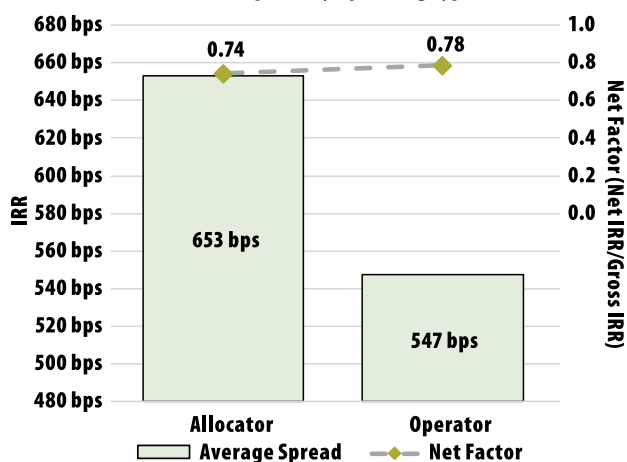
Top Performance Comes in Different Forms

Real estate funds also vary in their operational structure, which can provide guidance on risk-return potential. We categorize private equity real estate firms as either “operators” or “allocators.” Operators are firms that are nearly or fully vertically integrated, managing in-house most of day-to-day asset management, including construction, leasing, and property management. Allocators are managers that act as a majority equity sponsor, relying on a network of local partners and operators for most day-to-day asset management and, occasionally, deal sourcing. We recognize that some allocators operate assets by building out portfolio companies, offering economies of scale, or by holding ownership stakes in operators that provide greater control and potentially reduce leakage associated with

the traditional allocator model. This type of allocator utilizes a more hybrid operating model. However, for the purposes of this analysis, we have included hybrids in our allocator group.

Allocators tend to execute larger, diversified strategies, and operators tend to be sector specialists and are often smaller in size. Because investors often face the decision of whether to pursue a single, multisector diversified allocator or to allocate capital to several sector-specialist operators, we reviewed the performance of managers in each group over multiple periods to see what insights we could learn. As shown in Exhibit 2, we compared performance of each operating type across vintage years in three time periods. Operator funds exhibited wider performance dispersion in all periods and outperformed allocator funds from a median return perspective only during the 2009–2014 post-financial crisis recovery. However, top-quartile operator funds generated meaningful outperformance, delivering between 440 basis points (bps) and 680 bps of alpha compared with

Exhibit 3: Gross to Net IRR Spread by Operating Type



Source: Cambridge Associates LLC

Notes: Data are as of Sept. 30, 2024. Sample size includes 37 allocator funds and 27 operator funds from the 2009–2013 vintage years that achieved net IRRs of 11% or greater. Net internal rates of return are net of fees, expenses, and carried interest.

top-quartile allocators in each period of comparison. Still, bottom-quartile operators (many of which were dedicated office funds) lagged bottom-quartile allocators by as much as 1,000 bps. Operators offer greater alpha opportunities but with significantly more volatility, particularly in challenging market periods.

Operators rely on their in-house management capabilities and act as market or sector specialists, primarily pursuing sector-focused or regional-focused strategies. Their outperformance can be due to their ability to leverage local relationships and generate deal flow in less institutional markets, manage portfolios closely to drive excess value, and avoid excess fee drag. However, operators’ inability to pivot across markets or sectors combined with smaller fund sizes might have led to wider performance dispersion.

Although allocators spend less time on day-to-day management, they control and approve key business decisions in the value creation process. They offer access to capital markets and provide institutional oversight to operating partners, leveraging their expertise in deal structuring. Allocators are more likely to have a diversified strategy with more robust and institutional processes, which could explain their narrower performance dispersion. For limited partners

(LPs), however, paying double promotes (fees to an allocator and its operating partners) has a drag on returns. Digging into the difference between gross and net returns for top-performing allocator and operator funds can help uncover the extent of “leakage,” or spread—the difference between a fund’s gross IRR and ultimate net IRR paid to fund LPs—across both groups.

Allocators Tend to Have Greater Return Leakage

While fund net returns serve as one of the primary evaluation metrics for fund and manager performance, also important is considering how “efficient” managers are in achieving these returns when factoring in operating expenses, fund management fees, carried interest, and promote payout to operating partners. To measure the relationship between gross and net returns, we calculated the ratio of the net IRR to gross IRR, referred to here as a “net factor” (similar to a payout ratio). A higher net factor indicates that LPs receive a higher percentage of gross returns. For our analysis, we focused on top-performing operators and allocators from older funds (vintage years 2009–2013), which are more mature and contain a higher percentage of realized investments.

In this select sample, both groups achieved similar gross IRRs, but operators had higher net IRRs with lower leakage and a higher payout ratio (as shown in Exhibit 3). While the spread between gross and net returns is not insignificant for both groups (as a reminder, our analysis focused on top-quartile managers, whose spreads, if measured in basis points, tend to widen as returns grow), the greater focus should be on the payout ratio, which is higher for operators. Because operators are vertically integrated, it makes sense that these managers would have less leakage because they often have no other partners to share the promote with. This analysis also suggests that, compared with allocators, operators may take on slightly lower risk-return deals (measured by lower gross IRRs) and still achieve similar net returns.

For investors with limited resources or smaller real estate allocations, diversified allocator funds can offer multi-sector exposure in a single commitment, providing a more predictable return profile. Achieving similar diversification through sector- and market-focused

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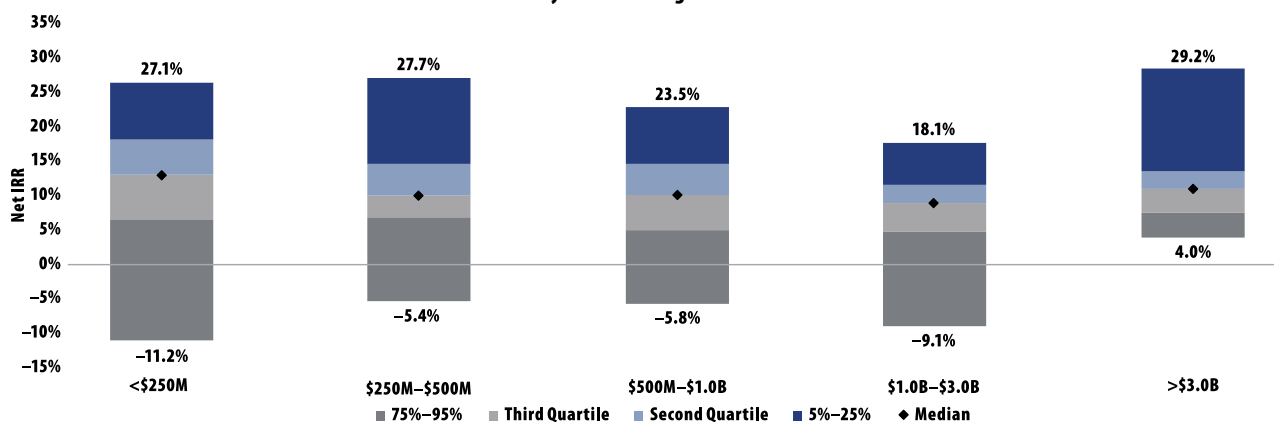
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Exhibit 4: Performance of North America Real Estate Funds by Size—Vintages 2009–2020



Fund Size	<\$250M	\$250M–\$500M	\$500M–\$1.0B	\$1.0B–\$3.0B	>\$3.0B
N	153	122	125	96	22
5%	27.1%	27.7%	23.5%	18.1%	29.2%
25%	18.6%	15.0%	15.0%	11.9%	13.9%
Median	13.4%	10.3%	10.4%	9.1%	11.3%
75%	6.7%	7.0%	5.2%	4.9%	7.7%
95%	-11.2%	-5.4%	-5.8%	-9.1%	4.0%

Source: Cambridge Associates LLC

Notes: Returns are horizon internal rates of return (IRRs) calculated since inception to Sept. 30, 2024. These returns are net of management fees, expenses, and performance fees that take the form of carried interest. Vintage years are 2009–2020. Each vintage year includes at least 22 real estate funds. Managers with fewer than four years of data do not have meaningful performance and are thus excluded. Cambridge Associates (CA) is always working to grow its private investments performance database and ensure that its benchmarks are as representative as possible of investors’ institutional-quality opportunity set. As a result, CA continually adds funds to the database (both newly raised funds and backfill funds) and occasionally must remove funds that cease reporting. CA’s private investments performance database is dynamic and reflects both classification adjustments and changes to the underlying pool of contributing funds. As a result, there may be changes in the results of some historical benchmark return analyses. The percentile calculations, including top 5%, upper quartile, median, lower quartile, and bottom 5%, depict the distribution of the sample by describing what percentage of observations fall above and below a certain value. For example, the value of the upper quartile, also referred to as the 25th percentile, indicates that 25% of observations are above the given value, and 75% are equal to or below. All financial investments involve risk. Depending on the type of investment, losses can be unlimited. Past performance is not indicative of future returns.

operators requires significantly more capital to justify separate fund commitments, a well-staffed investment office to manage relationships, access to a broad funnel of opportunities, and a robust due diligence process to identify the best managers.

Top Performance Comes in Different Sizes

In addition to a strategy type, LPs have to consider fund size, which is often one of the central considerations in evaluating a manager. Many investors generally consider larger fund sizes as a concern, given large assets under management, and the associated management fee streams often minimize the importance of carried interest, thus weakening alignment.

To examine the relationship between fund size and performance, we grouped funds by their total capitalization and reviewed the performance of funds with vintage years from 2009–2020. Indeed, fund size did have an impact on performance, as shown in Exhibit 4. The smallest funds—with total capitalization less than \$250 million—generated the highest median performance (13.4% net IRR). That said, these smaller funds had a much larger dispersion of outcomes. For this size cohort, the range of performance outcomes spanned 38.3% (i.e., the difference between the top and bottom quartiles).

At the other end of the size spectrum, the largest funds, with total capitalization in excess of \$3 billion, were

the second-highest performing size cohort, delivering a median return of 11.3% net IRR while exhibiting lower return dispersion. For this size cohort, the range of performance outcomes spanned 25.2%, significantly lower than that of their smaller counterparts. Notably, bottom-performing funds in this size cohort did not generate negative returns. Note that the number of funds, and sponsor firms, within the largest size cohort is relatively small, and the observed performance might have differed with a larger sample size.

Multiple factors contribute to these dynamics. Larger firms, which typically follow an allocator model, can leverage their deep, longstanding industry relationships and scale to secure preferential financing terms, attract top talent, access capital to transact in top-tier liquid markets that appeal to core buyers, and build operating platforms that provide data insights and economies of scale. Said otherwise, their investment process is repeatable and can offer stability regardless of market cycle.

Conversely, smaller funds are generally raised by emerging managers that face greater execution risk; these managers with “hungrier” teams and a sustainable edge can deliver outperformance and access to niche sectors and less competitive markets. However, building the right organization to execute on those opportunities can be challenging, and many emerging franchises do not survive. Manager selection for this cohort remains especially critical; a capital commitment reflects conviction not just to a team’s investment acumen but also to its ability to build out a strong organization.

Staying Disciplined During Market Uncertainty And Inflation

Recent market uncertainty, intensified by shifting US trade and tariff policies, increases the risks of inflation and global market volatility, requiring careful risk management. Although some real assets can serve as an inflation hedge, the relationship between inflation and real asset performance is complex and comes with opportunity costs. Real estate performance is often driven by supply-demand dynamics rather than by embedded rent growth alone. While private real estate

can provide inflation protection through annual rent increases, it can be less effective during periods of unexpected inflation and market volatility, which can reduce fund distributions when investors need liquidity the most.

It is important to remember that building an optimal portfolio is not as simple as lining up the matrices across size, structure, and strategy and picking the perceived Goldilocks fund. Performance outcomes will vary across strategies and managers, and the role of real estate within a portfolio will depend on the investor’s risk-return appetite and liquidity needs. In 2025, as some risks subside and others emerge, investors must balance portfolio protection with return generation.

We favor a portfolio construction model that includes a mix of managers across operating models and strategies because diversification enhances portfolio resilience. An anchor commitment to a large, diversified fund managed by an established firm can provide market beta and—with savvy manager selection—opportunity for upside; smaller, adjoining commitments to specialized operators with smaller funds can help clients better dictate their sector and market weightings in search of alpha. Manager selection remains critical, especially in volatile markets, and we believe the performance data over the past cycle can offer guidance on how investors should evaluate managers and position their portfolios. ■

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