The Journal of Portfolio Management

Real Estate Matters

Peter L. Bernstein

As assets go, real estate is both a youngster and the most aged. Individuals have owned real estate since the beginning of time, but institutional interest in real estate in the United States reaches back only some 30 years. The reasons for this lag are curious, especially as real estate has been a major investment asset for European pension funds for a much longer time.

First, a few facts. I have been in the investment area for over 50 years, and recall no serious institutional attention paid to real estate before the inflationary 1970s. Then, in the second half of the 1970s, as inflation warmed up and the crash of 1974 shocked the world of equity investment, a small number of insurance companies like Prudential and Hancock began marketing real estate products to institutions, along with a few adventuresome investment management innovators in the area such as Peter Aldrich in Boston and Claude Rosenberg in San Francisco.

This journal is 29 years old as of this writing. We carried only four articles on real estate in the 1970s, despite the increasing power of the inflationary forces during that decade. Then a wave of real estate articles flowed in to us, a total of sixteen in the 1980s, six of them in 1987 alone. Interest then tailed off once again during the 1990s, as disinflation plus the high tech mania and other attractions distracted investment managers from history's greatest asset. We have published only six articles on real estate since the end of the 1980s.*

In the early days of our country, George Washington, the Van Rensselaers, Gouverneur Morris and Robert Morris (no relation, but they did do business together), the Livingstons, the Schuylers, and all the other families of great wealth built their fortunes from land. As the capital markets developed, and investors learned to have fun with stocks and bonds, real estate became less important. In fact, it has always had to compete with paper for investor attention.

When I started in the investment business about 50 years ago, real estate was considered not altogether respectable as an asset for institutions or for stuffy investment managers like my firm, which specialized in what is today called high net worth individuals. We had clients who had made fortunes in real estate but were eager to enter the mainstream by owning shares in General Motors and DuPont and AT&T. William Zeckendorf, one of the most creative real estate investors of all time, was a kind of curiosity to those of us in the stock and bond markets.

Looking back, I can only wish I had become a real estate investment manager instead of focusing on tradable assets. Real estate is fascinating. To a far greater degree than stocks and bonds, real estate combines sociology, geography, demography, architecture, and political forces, with the dynamics of fundamental economic trends, complex financing problems, the perils of illiquidity, and subtle valuation considerations. The capital markets may have invented interesting instruments to make real estate more liquid and more divisible—to say nothing of the games people play in the mortgage area today—but the underlying asset remains as important, as challenging, and as mesmerizing as ever. Compared to paper, specific risk in real estate carries a much greater weight than systematic risk (Zeckendorf always emphasized that every piece of real estate is unique), which makes for greater opportunities for alpha and for much more interesting challenges.

For all these reasons, we should join in thanking Frank Fabozzi, Jacques Gordon, and Susan Hudson-Wilson, the coeditors for this Special Issue, for their efforts in putting together this impressive array of research in the real estate field. We need to know more about real estate in today's world, which differs so much from the 1970s and 1980s when real estate first became an important asset in U.S. institutional portfolios. It is perhaps more important that delving into real estate's many complexities can deepen our understanding of the typically conventional assets that constitute the largest share of most portfolios.

*Three real estate experts in this issue are making a repeat appearance in our pages—Patrick Corcoran (1987), Michael Giliberto (1993), and Susan Hudson-Wilson (1995, 1999, and 2001).