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REAL ESTATECOMMERCIAL REAL ESTATE

Investors Yank Money From Commercial-Property Funds, Pressuring Real-Estate Values

Blackstone and Starwood funds limit withdrawals following surge of redemption requests

Some investors in Blackstone's flagship real-estate fund won't be able to cash out before next year.

PHOTO: ANDREW KELLY/REUTERS

By Konrad Putzier Follow *and Peter Grant* Follow

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Big and small investors are queuing up to pull money out of real-estate funds, the latest sign that the surge in interest rates is threatening to upend the commercial-property sector.

Blackstone Inc. last week said it would limit the amount of money investors could withdraw from its $69 billion flagship real-estate fund following a surge in redemption requests. Starwood Capital Group shortly after notified investors that it was also restricting withdrawals in a $14.6 billion fund, according to a person familiar with the matter.

The Blackstone and Starwood funds are the two largest nontraded real-estate investment trusts, a popular investment structure with wealthy individuals.

Other private real-estate funds in the U.K. targeting institutions managed by companies including BlackRock Inc. and CBRE Investment Management recently took similar steps to stem outflows, according to the companies. Some U.S. pensions are also starting to yank money out of real-estate funds, some advisers to these large investors say.

The rise in cash-out requests comes as more investors and financial firms turn their back on real estate. Rising interest rates are threatening to push down property values in this debt-laden industry. Meanwhile, concerns are growing about weak demand for office space and slowing rent growth in the apartment sector.

Commercial real-estate values "need to come down," said Joe Gorin, head of U.S. real estate acquisitions at the financial firm Barings, referring especially to office buildings. "The question is by how much."

The FTSE NAREIT All Equity REITs Index, which tracks publicly traded landlords, is down more than 20% this year, and office owners have seen far steeper declines. Banks are issuing fewer commercial mortgages than last year, brokers say, and the volume of building sales is down as buyers balk at prices no longer in line with a worsening outlook.

The rise in redemption requests is still relatively small, and it could prove to be short-lived. At the height of the pandemic in 2020, a number of pension funds asked to pull their money out of investment vehicles, but many changed their minds when the real-estate market's outlook brightened the following year.

Still, if the number of investors asking for their money back keeps growing, it would likely become a problem for the real-estate market. That is because funds that need to raise cash to pay back their investors often have no other choice but to sell buildings.

"That puts pressure on prices overall," said Nat Kellogg, president and director of manager search at investment adviser Marquette Associates.

Mr. Kellogg said a growing share of the pension funds and university endowments his firm advises are looking to pull money out of real-estate funds.

Unlike 2020, individual investors are also rushing for the exits. Nontraded REITs paid out $3.7 billion in redemptions in the third quarter. While they were still raising more new funds from investors than they were losing to withdrawals, that marked the highest withdrawal figure in years and a 12-fold increase from the third quarter of 2021, according to Robert A. Stanger & Co., an investment-banking firm that tracks the market.

These funds typically allow investors to withdraw money each month or quarter, but only up to a set limit. Blackstone's $69 billion fund, known as the Blackstone Real Estate Income Trust Inc., or BREIT, has a quarterly redemption limit of 5% of the fund's net assets. Last week, Blackstone said redemption requests exceeded the cap, meaning some investors won't be allowed to cash out before next year.

Blackstone's shares fell 7% the day it announced the redemption limitations. Starwood's nontraded REIT put on similar limitations as BREIT did, a person familiar with the matter said.

Individual investors are pulling their money out in part because they expect future losses, said Nori Lietz, a senior lecturer at Harvard Business School who has advised pension funds on real-estate investments. Real-estate funds typically base their valuations on appraisals that can be slow to adapt to changing markets. That has kept fund valuations high even as the real-estate market has deteriorated. But eventually, reality will catch up.

"Appraisals look backwards, and markets look forward, and people are trying to arbitrage and get their money out before the write-down occurs," Ms. Lietz said.

Pensions typically set a target for what percentage of their assets should be held in real estate. Because real-estate fund valuations have remained high while stocks and other markets are down, private real estate's share of pension-fund assets relative to stocks has gone up. That creates pressure to sell out of property funds to restore balance, Mr. Kellogg said.

That was the case for the Washington State Investment Board, said James Aber, the director of institutional relations for the board. The state pension fund reported that real estate made up 22.4% of its portfolio as of Sept. 30, but its target was 18%.

Big institutional investors are shifting instead to the lower-risk strategy of making loans or simply stockpiling cash for the bargains that inevitably crop up during a downturn.

In the U.K., property funds with over £15 billion, equivalent to $18.3 billion, in assets have blocked redemptions from institutions this fall, citing such needs as preserving cash and avoiding forced sales. Managers of these funds—including BlackRock, M&G Group, Schroders PLC, CBRE Investment Management and Legal & General—confirmed they had taken gating measures.

Real-estate funds are still raising money, but less than before. U.S.-focused property funds raised $15.6 billion in the third quarter, according to Preqin—the lowest quarterly figure since 2020.

High interest rates have also made nontraded REITs less appealing to new investors. When rates were low, nontraded REITs were appealing because they offered a much higher yield than bonds.

But now bonds are paying much higher returns and are more liquid and less risky than nontraded REITs, advisers say.

Kelly Nilsson, founder of Brava Financial LLC, a San Diego financial-planning firm, asked why investors would lock up their money in a real-estate fund that offers only a slightly higher return than some government bonds paying 4.5% or 5%.

"It's not a fair trade off," she said.

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