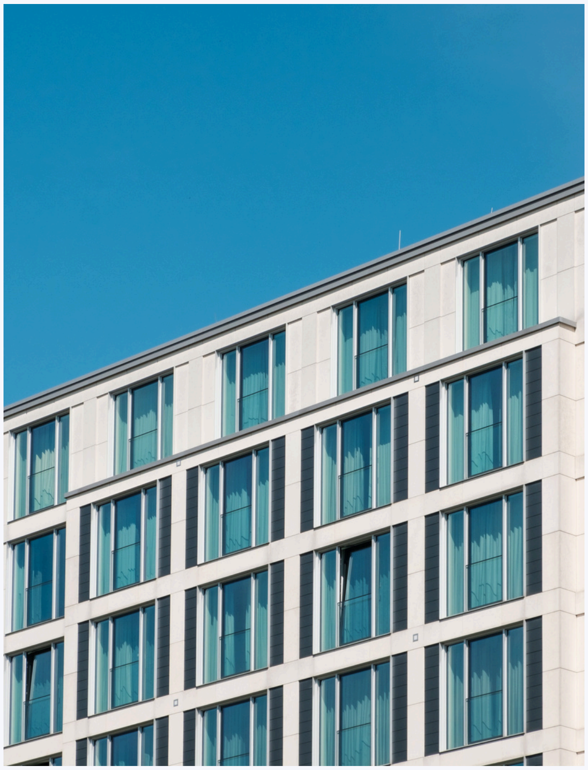
DCREC
DEFINED CONTRIBUTION
REAL ESTATE COUNCIL

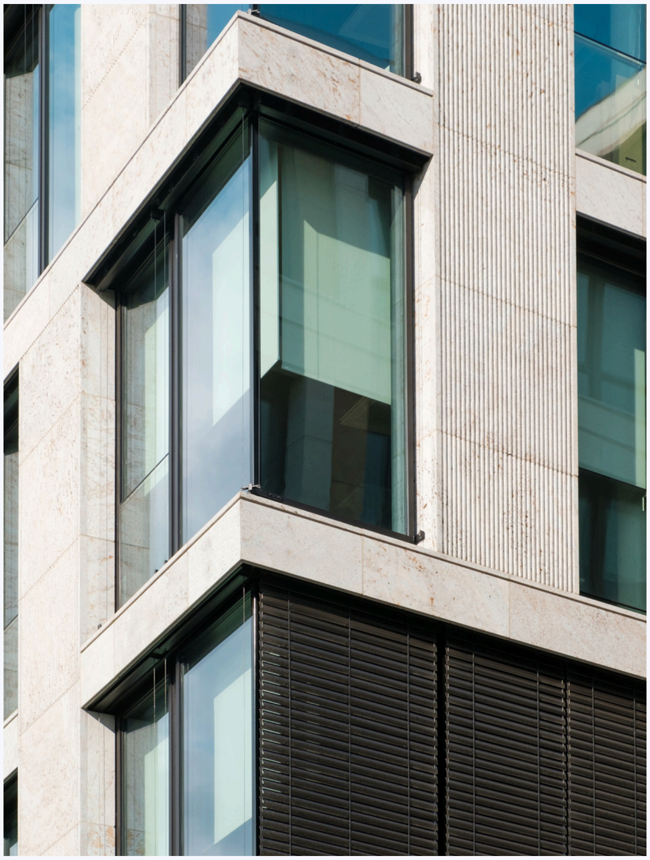
Private Real Estate Debt

Three reasons why the asset class is catching the attention of defined contribution plans

INTRODUCTION

Defined Contribution (DC) plan sponsors continue to look for innovative solutions to help enhance participant outcomes, and one area of emerging interest is in private real estate debt. Even after the broad increases in interest rates over the past few years, bond yields generally remain below historical, long-term averages, and the considerable volatility exhibited across many publicly traded fixed income markets as monetary policy tightened, further constrained returns. With this in mind, private real estate debt strategies can offer a compelling way to expand credit diversification, potentially increasing and stabilizing investment income generation and introducing a hedge against interest-rate and inflation risks, when included as part of a multi-asset portfolio or broader fixed income strategy.





KEY TAKEAWAYS

- Private real estate debt presents a compelling risk/return profile, offering the potential to enhance retirement portfolio diversification, generate attractive income, and provide defensive benefits to help lower volatility and interest-rate and inflation risk exposures.
- Current higher interest rates and valuation adjustments have created attractive entry points for the asset class, with strong relative value, rising base rates, and declining loan-to-value ratios.
- An allocation to these strategies can integrate well within DC plans, either as part of a multi-asset portfolio or income-oriented solutions, thanks to liquidity and valuation advancements.

ASSET CLASS OVERVIEW

As the name suggests, private real estate debt strategies make or buy privately financed commercial real estate (CRE) mortgages, rather than acquiring the properties, as private real estate equity strategies do. These loans are backed by the real asset collateral of the properties, offering diverse underlying asset exposures, with digitization, demographic shifts and changing workplace, healthcare and housing trends all driving expanded lending opportunities. Loans tend to be made at conservative leverage levels and structured with floating rates set by changes based on an underlying benchmark, such as the Secured Overnight Financing Rate (SOFR), with typical maturities ranging from 3 to 5 years, though terms can vary.

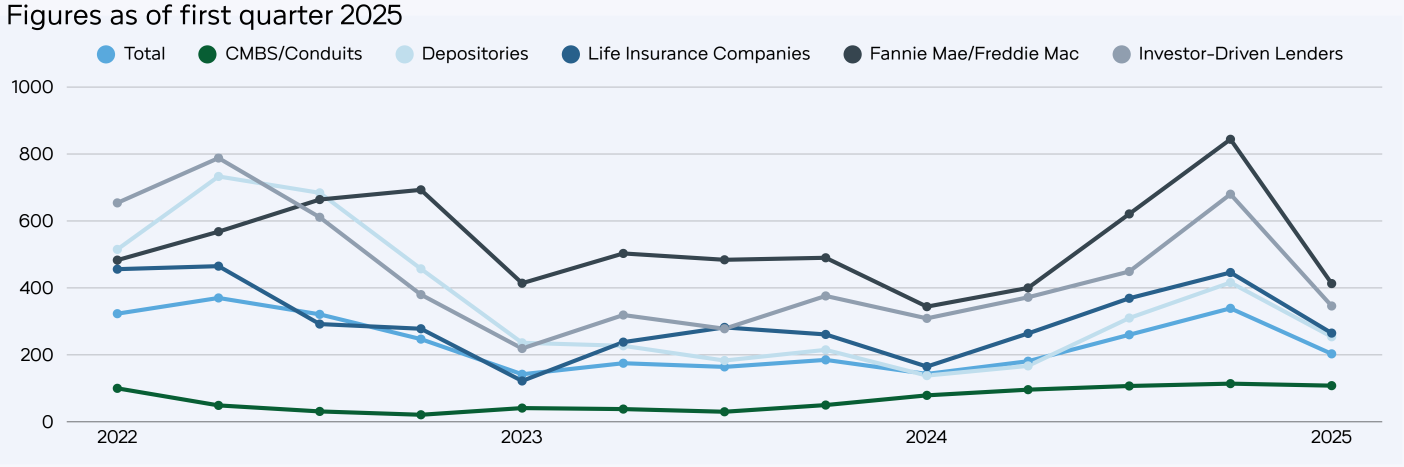
DIFFERENCES FROM PRIVATE CORPORATE CREDIT AND COMMERCIAL MORTGAGE-BACKED SECURITIES

Both private corporate credit and private real estate debt investments refer to loans made by non-bank lenders that are not publicly traded or issued. However, the former is backed by a company's balance sheet, while the latter is backed by a hard asset, which may make it easier to gain visibility around repayment risk and other investment factors. Similarly, it may be tempting to view private real estate debt as simply a less liquid version of commercial mortgage-backed securities (CMBS), since both represent investments in CRE loans, but there are several notable differences. Private loans usually offer more control around loan covenants and greater flexibility to navigate default risks as they arise.

LARGE OPPORTUNITY SET

U.S. CRE private lending represents a large market, with approximately $4.69 trillion in outstanding mortgage debt. Additionally, investor-driven solutions have increasingly stepped in as alternative lending demand has continued to accelerate as traditional funding sources have waned, driven by bank retrenchment and a steep decline in CMBS issuance (see Exhibit 1). Capital raising has been strong for these investment strategies, with steady growth in assets under management (from $84 billion in 2013 to over $260 billion by the end of 2024 and sizable amounts of "dry powder" cash reserves for new lending opportunities.

Exhibit 1: Investor-driven loans represent a significant portion of CRE origination
Figures as of first quarter 2025



Given this growth and continued strategy innovation, investing in private real estate debt has become a much more viable option for DC plans of all sizes. This paper highlights three reasons why to consider the asset class.

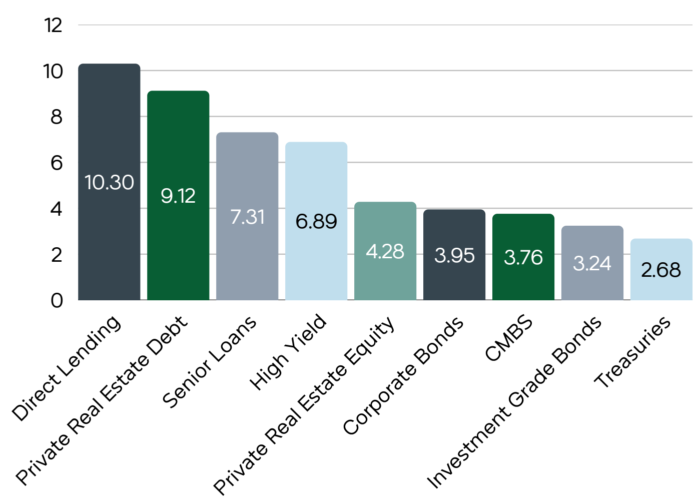
01 *Additive Investment Characteristics*

The big draw for private real estate debt for DC plans is the distinct risk/return profile that can help strengthen retirement portfolio diversification and long-term performance potential.

Attractive investment income and income growth potential: Private real estate debt has historically delivered enhanced income compared to many traditional fixed income segments—on average triple that provided by the broader investment grade bond segment and more than double by publicly traded corporate bonds and CMBS, on the whole, over the past five years (see Exhibit 2).

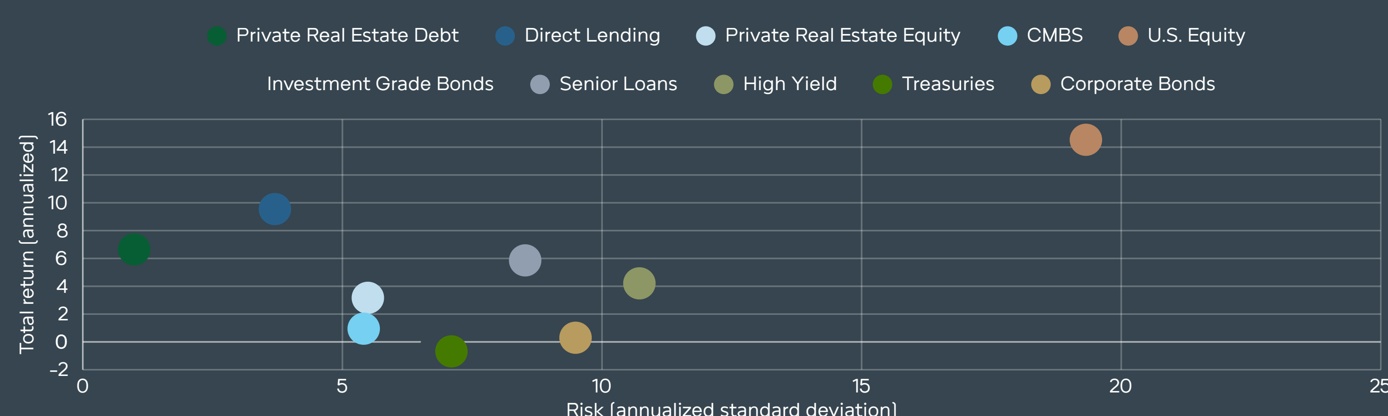
Lower volatility and other defensive attributes: Because these securities are not publicly traded, they have historically offered lower standard deviations with higher risk-adjusted performance than many traditional asset classes (see Exhibit 3). Due to their floating-rate and shorter-duration attributes, they have tended to exhibit lower drawdown exposures that can help to mitigate major interest-rate driven markdowns relative to traditional fixed income assets. They also generally provide higher equity cushions that can help absorb asset stress.

Exhibit 2: Private real estate debt has offered a meaningful yield advantage over traditional fixed income over the last five years
Five Year Average Distribution Yield (%) as of Q4 2024



Source: Invesco Real Estate, as of Q4 2024. Five-year annualized returns (2020Q1–2024Q4) based on data from Giliberto-Levy, Bloomberg, Morningstar, NCREIF, and Cliffwater indices. Past performance is not indicative of future results.

Exhibit 3: Private real estate debt has historically offered attractive total returns with less risk relative to many other asset classes
Five-year annualized performance as of Q4 2024



Data: 5-year annualized returns (2020Q1–2024Q4), updated semi-annually. An investment cannot be made into an index. Source: Invesco Real Estate, using data from Giliberto-Levy, Bloomberg, Morningstar, NCREIF, S&P, and Cliffwater indices. Past performance is not indicative of future results. Diversification does not guarantee a profit or eliminate the risk of loss.

Interest-rate and inflation hedge: As mentioned above, private real estate loans usually periodically adjust their interest rates in accordance with current market conditions, helping to protect against interest-rate risk volatility. Additionally, the commercial properties used as collateral for these loans have historically tended to exhibit positive correlations with inflation over time.

Expanded correlation diversification: Given its distinct risk/reward investment characteristics, private real estate debt has historically provided steady, low-/non-correlated returns relative to many asset classes and offered complementary exposure to private real estate equity (see Exhibit 4).

Exhibit 4: Private real estate debt has shown limited correlations with other asset classes over the past five years

Five-year period as of Q4 2024

	1	2	3	4	5	6	7	8	9	10
Private Real Estate Debt (1)	1									
High Yield (2)	0.03	1								
Senior Loans (3)	0.05	0.9	1							
Private Real Estate Equity (4)	0.45	-0.39	-0.29	1						
Corporate Bonds (5)	-0.11	0.82	0.52	-0.44	1					
CMBS (6)	-0.2	0.64	0.36	0.33	0.93	1				
Investment Grade Bonds (7)	-0.24	0.48	0.1	0.4	0.88	0.94	1			
Treasuries (8)	-0.3	-0.11	-0.28	0.29	0.62	0.78	0.92	1		
Direct Lending (9)	-0.19	0.79	0.9	-0.37	0.02	-0.21	-0.34	-0.37	1	
U.S. Equity (10)	0.07	0.93	0.85	0.57	0.43	0.77	0.77	0.1	0.77	1

-1.0 0 1.0

Data: 5-year annualized returns (2020Q1–2024Q4), updated semi-annually. An investment cannot be made into an index. Source: Invesco Real Estate, using data from Giliberto-Levy, Bloomberg, Morningstar, NCREIF, S&P, and Cliffwater indices. Past performance is not indicative of future results. Diversification does not guarantee a profit or eliminate the risk of loss.

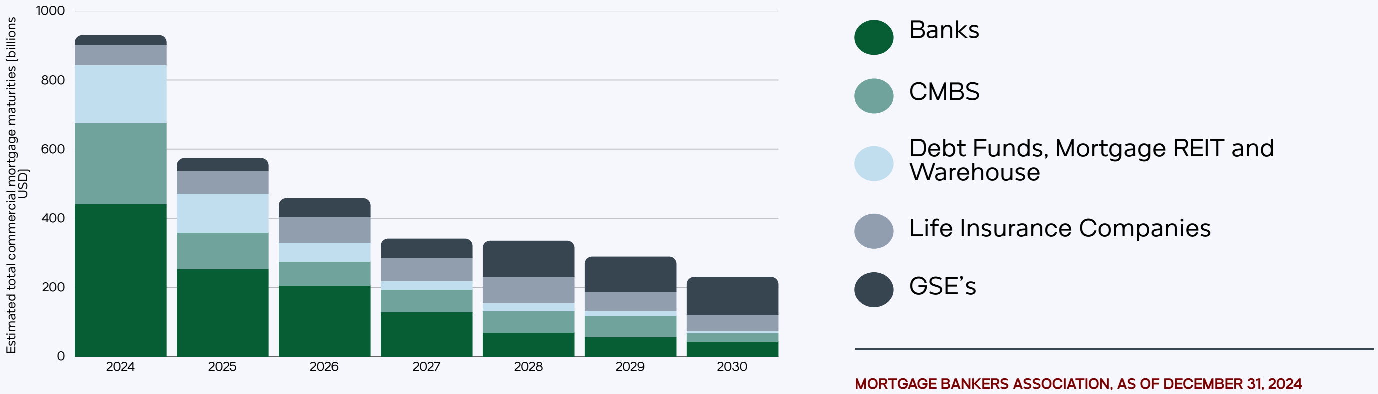
02 *Favorable Investment Tailwinds*

The current investment environment also appears to be favorable for private real estate debt. Higher interest rates and valuation resets have created potentially highly attractive entry points into the asset class. Recent pricing levels appear to offer strong relative value with high levels of current income, and exposure levels have notably lowered. This has resulted in largely positive shifts in base rates and spreads, while underlying credit metrics have remained solid.

Demand also remains highly supportive, with over $1.5 trillion of CRE debt expected to mature across 2026, 2027 and 2028, much of which will be financed by private lenders (see Exhibit 5). As borrowers refinance these assets against diminishing supply sources, it should result in a continued favorable lender’s market.

Exhibit 5: $2 trillion in CRE mortgages will mature over the next three years

Figures as of December 31, 2024



MORTGAGE BANKERS ASSOCIATION, AS OF DECEMBER 31, 2024

03 *Flexible Portfolio Applications*

Within DC plans, most interest in private real estate debt strategies tends to revolve around two main applications:

- As a custom sleeve to expand alternative exposures in a multi-asset portfolio, such as a target date fund (TDF) or managed account portfolio.

- As part of a multi-asset core plus strategy or income-oriented portfolio.

Both approaches appear to help strengthen retirement outcomes, in terms of enhancing and smoothing out long-term return potential. Advancements in liquidity and daily valuations have also resolved the major challenges that may have previously placed the asset class out of reach for DC investors.

Liquidity: While there is not a way to make an illiquid asset, such as private mortgage debt, liquid, there are options at the CIT (or top vehicle) level that can create an acceptable amount of periodic liquidity for a variety of client implementations. The inclusion of a liquidity sleeve within the CIT may be desirable to allow operational ease, similar to existing real estate equity funds. In the case of a target date implementation, a manager may prefer access without a liquidity sleeve, instead using other assets in the TDF allocations to satisfy shorter-term liquidity needs. However, most client use cases will likely require a 15%-25% liquidity sleeve, the makeup of which may consist of assets such as fixed income index funds and CMBS ETFs, as two examples.

Valuation: The basis for daily valuation of private real estate debt begins with the periodic value of each holding established in accordance with accounting and legal requirements through both a yield method (estimating asset cashflows using discount rates appropriate for the instruments, their credit risk, liquidity and marketability) and analysis of the underlying property collateral. Daily valuation of a private real estate debt fund can be anchored to those periodic valuations and updated with interim cashflows and relative transactions and public market movements.

These innovations are similar to the approaches applied to other private-market and alternative strategies with additive risk/return profiles that are increasingly being embraced by plan sponsors that may not be as accessible or suitable for participants as standalone investment options but fit easily into more broadly diversified investment vehicles.

CONCLUSION

As DC plan sponsors continue to explore new ways to help strengthen participant outcomes, private real estate debt is emerging as an increasingly viable solution. With its potential to boost income generation, mitigate market volatility and capitalize on current economic and market cycles, the asset class appears to offer a useful avenue to help further optimize retirement portfolio diversification. Additionally, the evolving private lending landscape—driven by strong demand and supportive structural dynamics—underscores its growing relevance both in the marketplace and to investors. With this in mind, and as access to private real estate debt continues to expand, plan sponsors may want to consider how this innovative opportunity may help better support the long-term financial security of participants.

ABOUT DCREC

Founded in 2012, the Defined Contribution Real Estate Council (DCREC) is an organization of investment managers, consultants, and others dedicated to improving outcomes for defined contribution plan participants through the investment of retirement assets in direct or securitized real estate.

We are the only organization looking at this in a rigorous, systematic way. Our research has helped address the fundamental questions around the use of direct private real estate, in particular liquidity and daily valuation.

For more information or to get involved, contact us at info@dcrec.org or visit dcrec.org.