



**PSERS OPPORTUNISTIC REAL ESTATE PROGRAM**

**Recommendation for Investment in  
MGP Europe Fund III, L.P.**

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# MGP Europe Fund III, L.P.

## EXECUTIVE SUMMARY

Macquarie Global Property Advisors (“MGPA”) is establishing MGP Europe, an English investment limited partnership, to invest in real estate opportunities in Europe. Building on the successful track record of its prior funds, MGPA will seek to provide Limited Partners with superior risk-adjusted returns through tactical and opportunistic investments in real estate and real estate related assets, including direct and indirect equity investments in completed projects via stand alone assets and portfolios, development and redevelopment projects, real estate operating companies, undeveloped land and mortgage loans and mezzanine finance for real estate.

MGP Europe expects to focus primarily on making real estate investments in the 27 states of the European Union, as well as Switzerland and Norway. The objective of the Partnership will be to create a portfolio of opportunistic investments, and in general the Fund will observe certain geographic limitations with regard to the investments as well as limitations on the size of individual investments. The Fund, along with MGP Asia, will target capital commitments aggregating approximately \$3.5 billion, including amounts invested by MGPA. The Fund is seeking to achieve an internal rate of return over time of 17% to 20% (after Base Fees, General Partner performance participation and other Partnership-level expenses).

## THE SPONSOR

MGPA is an established global real estate investment advisor headquartered in Bermuda and with offices and representatives in Frankfurt, London, Luxembourg, Paris, Munich, Beijing, Hong Kong, Kuala Lumpur, Shanghai, Seoul and Tokyo. It manages real estate assets throughout Europe and Asia, including development and re-development projects and joint-venture investments as well as investments in real estate operating companies, mortgage loans and listed real estate securities. MGPA employs over 115 staff across Europe and Asia including personnel experienced in real estate acquisitions, asset management, development and construction management, tax and legal structuring, finance and accounting and fund administration and compliance.

MGPA manages or advises four real estate investment funds and two co-investment vehicles (plus additional related parallel funds and alternative investment vehicles), with total assets under management of \$5.1 billion: (i) Lend Lease Global Properties, SICAF (“Global Fund”); (ii) MGP Europe Fund II, L.P. (“MGP Europe Fund II”); (iii) MGP Asia Fund II, L.P. (“MGP Asia Fund II” and, collectively with MGP Europe Fund II, “Global Fund II”); (iv) MGP Japan Core Plus Fund, L.P. (“MGP Japan Fund”); (v) MGP Millennium, L.P. (“MGP Millennium”) and (vi) MGP Vicwood Plaza, L.P. (“MGP Vicwood Plaza”). MGP Asia Fund II and MGP Europe Fund II are limited partnerships established to invest on an opportunistic basis in real estate assets across Europe and the Asia-Pacific region, respectively. MGP Japan Fund is a recently established partnership established to build a diversified portfolio of core plus real estate assets in Japan. MGP Millennium and MGP Vicwood Plaza were formed as two co-investment vehicles established to invest in two specific assets in joint venture with MGP Asia Fund II.

MGPA is currently majority owned (51%) by nine members of its Senior Management Team (the “Principals”), many of whom have been working together for over a decade. The remaining 49% of the business is currently owned by Macquarie, a pre-eminent

diversified global investment bank. MGPA's network is enhanced by its affiliation with Macquarie, which is listed on the Australian Stock Exchange (ASX), and has a global network of offices in 24 countries. MGPA has committed to invest up to the lesser of \$20 million (or its euro equivalent) and 10% of the aggregate Capital Commitments of MGP Europe and MGP Asia.

## **SPONSOR'S APPROACH TO INVESTING**

Building on the successful track record of Global Fund I, Global Fund II and MGP Japan Fund, the Fund's investment program will be driven by a focus on deriving returns from real estate investment fundamentals, in order to achieve its investment returns. Through a disciplined research process, MGPA seeks to identify mispriced risk opportunities and to target key sectors and markets that demonstrate counter-cyclical and early stage pro-cyclical performance criteria to generate consistently attractive risk-adjusted returns.

MGPA utilizes a "top-down" and "bottom-up" approach to analyze markets and to identify trends that may give rise to investment opportunities. The "top-down" approach focuses on regional macro-economic trends to identify capital misalignments, structural changes in economies and economic trends. MGPA then combines its macro-economic research with local market data sourced by MGPA's strong local network and its alliances. The "bottom-up" approach allows MGPA to identify local trends and opportunities and to apply its macro-economic analysis on a local level. MGPA has developed relationships with a series of key research providers for both macro-economic and real estate specific research and applies research tools that track the key cities within the Fund's target regions on both a macro- and micro-level. Once MGPA has identified key trends, it utilizes its extensive network of real estate professionals to source, underwrite and execute investments.

Once investments have been acquired, MGPA will seek to maximize the value of those investments through intensive post-acquisition asset management. MGPA's management, together with the team members involved in the acquisition and underwriting of an investment, develop a detailed asset plan containing strategies to maximize the value of an investment and identify optimal exit strategies. During the life of an investment, MGPA reviews, at least quarterly, an investment's performance against the asset plan and makes appropriate adjustments to the asset plan. MGPA has successfully implemented this investment strategy in connection with its management of Global Fund I, Global Fund II and MGP Japan Fund.

## **INVESTMENT HIGHLIGHTS**

**Proven Track Record.** MGPA has total assets under management of \$5.1 billion and over the last eight years, MGPA's principals and team of professionals have acquired and managed approximately \$7.9 billion of real estate investments for Global Fund I, Global Fund II and MGP Japan Fund. These MGPA managed/advised funds have made 47 investments, including investments in approximately 182 properties in 17 countries throughout Europe and Asia.

**Experienced Management.** The members of MGPA's Senior Management Team have on average over 22 years of real estate experience and have participated in the execution of over \$49.4 billion in real estate transactions in Europe, Asia, North America and Australia. Many members of MGPA's Senior Management Team have been working together for over a decade, including in connection with the formation and management

of Global Fund I, Global Fund II and MGP Japan Fund. The team offers a range of skills from diverse backgrounds including property development, brokerage, banking, finance and accounting, corporate finance and asset management.

**Established Infrastructure.** MGPA has an extensive network of professionals and local business relationships dedicated to the Fund's target regions. In addition to its local business relationships, MGPA maintains offices or representatives in 11 countries within the Fund's target regions and employs over 115 staff including personnel experienced in real estate acquisitions, asset management, development and construction management, tax and legal structuring, finance and accounting, and fund administration and compliance.

**Disciplined Investment Methodology.** MGPA applies a rigorous, disciplined investment methodology which combines macro-economic research and a detailed "top-down" and "bottom-up" analysis of prospective markets and opportunities. MGPA's combination of local networks and broad experience in many real estate markets allows it to identify opportunities resulting from underlying trends and mispriced risk opportunities in its target markets. MGPA then uses its extensive local network of employees, business partners and alliances with other recognized real estate specialists to source, underwrite and execute investments based on those identified trends and opportunities. In particular, MGPA uses its networks to source private, off-market transactions as this type of transaction tends to reduce required acquisition consideration and thereby increase potential returns. In MGPA's view, the combination of this "top-down" and "bottom-up" approach uniquely positions MGPA to capitalize on impending real estate market cycles and structural changes in economies.

**Alignment of Interest.** As mentioned previously, MGPA has committed to invest the lesser of \$20 million (or its euro equivalent) and 10% of MGP Europe's and MGP Asia's aggregate Capital Commitments. This investment provides an alignment of interests between the Limited Partners, MGPA, and its Senior Management Team, nine of whom currently own 51% of MGPA. In addition, the General Partner's compensation will be heavily weighted towards incentive compensation. MGPA intends to grant direct rights to a significant portion of these potential incentive fees to the employees who will be involved and responsible for the achievement of the Fund's investment objective.

## **THE INVESTMENT OPPORTUNITY IN EUROPE**

The combination of the continued expansion of the investment universe in Europe, both in terms of asset class and geography, together with the structural differences that exist between countries, continues to offer a broad range of investment opportunities in Europe. Important factors that may drive investment opportunities in Europe include (i) the cyclical recovery of the office markets in Western Europe; (ii) the continued sale of real estate by owner-occupiers; (iii) the increasing maturity of the pan-European logistics sector; (iv) the expansion of the residential sector; (v) mispricing of real estate risks between different countries; (vi) the development of alternative asset classes; (vii) changes in regulatory environments; and (viii) the continued growth, increasing economic and political stability and improving business and investment environments of the economies and real estate markets of Central and Eastern Europe.

**Cyclical Recovery in Western Europe.** The main investment markets in Western Europe, including the U.K., France, Germany and the Nordic region are now well placed for a cyclical recovery in the office occupational markets and this trend is consistent with the gradual improvement in the macroeconomic environment for these countries.

MGPA expects Germany, the U.K. and France to remain important investment destinations as they are currently the most liquid investment markets in Europe. In particular, the London and Paris office markets are two of the largest in Europe with respect to total stock levels and both cities remain leading global financial and corporate centers. Central London contains nearly 14 million square meters of office stock and contains 30 million square meters if all the London boroughs are included. While London's office market is at a more advanced stage of the current cycle than most of continental Europe, the continued growth of the financial and business services sector suggests that there still remain investment opportunities in the Greater London area.

The French economy is highly centralized and dominated by the Paris region which accounts for a third of national GDP and over half of the total office stock in France. It is also well positioned in the current cycle, as occupier demand for office space in Paris is increasing and there is a fairly limited availability of supply due to the lack of speculative development in recent years.

Germany, the largest economy in the Eurozone, is demonstrating signs of a cyclical recovery and important initiatives, such as labor reforms, are being implemented, which could lead to improvements in productivity. More importantly, sentiment across Germany has been improving which has led to increased business investment and consumer spending levels. Following the recent growth in employment in Germany, there are signs of a recovery in the key office markets, most notably in Munich and Hamburg.

The Nordic area is currently witnessing a period of strong economic growth particularly across Sweden, Norway, Denmark and Finland and the growth in employment, particularly in office-centric business sectors such as business services, finance and IT, is leading to a general recovery in the office markets. Much of the strength of the region also comes from the Nordic technology sector.

**Investment Horizon moves further East.** The countries of Central and Eastern Europe, including those that acceded to the E.U. in 2004, such as Poland, Hungary and the Czech Republic, have seen considerable convergence of their economies and real estate markets with those of Western Europe, which MGPA believes has led to increased transparency and liquidity levels in these markets (although both the Eastern and Southern European markets are still smaller and less transparent than the more liquid Western European markets). There is also a considerable wealth gap between the Central and Eastern European Markets as compared with the more mature European economies such as the U.K. and France. As a result, MGPA believes that there may be attractive investment opportunities in these countries driven by this continued convergence.

The E.U. has continued to expand with the addition of Romania and Bulgaria in 2007, bringing the total number of member states to 27. Romania has already attracted attention from investors due to its size and Bucharest is thought to have the potential to achieve a transformation similar to that seen in Warsaw, Budapest and Prague. In addition, MGPA also believes that other attractive emerging Central and Eastern European markets include the main cities in Croatia and the Czech Republic, and the secondary cities in Poland.

**Changes in the Regulatory Environment.** The outlook for listed investment vehicles in Europe remains positive and market capitalization has increased by over 50% since the introduction of the SIIC (French REIT) in France in 2003, with the expansion of the SIIC sector itself and further developments regarding REIT structures, most notably in Germany, Italy and the U.K. where the REIT-style regulations came into force on

January 1, 2007. In the U.K., MGPA expects to see a number of opportunities to arise as a result of companies converting to REIT-style structures, rebalancing their portfolios and splitting them into stabilized, income-producing “REIT-able” assets and development assets not suitable for the REIT-style structure. MGPA also expects REIT-style structures to promote liquidity and transparency across the E.U. markets and that such structures present opportunities by enhancing liquidity for exit as the REIT sector can be expected to acquire core assets from opportunistic investors who have extracted the higher-risk value from development and management initiatives and have stabilized the asset.

**Mispricing of Real Estate Risks.** There have been record levels of investment in real estate across the E.U. in recent years with the majority of investment directed at core, well-leased assets by institutions seeking secure income yielding investments. The increased investment volumes have led to significantly lower yields across asset classes and, in particular, a substantial degree of yield convergence across the E.U. Despite this convergence in pricing, significant differences still remain between countries, particularly with respect to tax regimes, property law and lease structures and customs. Such differences become magnified when considering investment in countries beyond Western Europe.

Notably, currency risk also remains within the E.U. as nine of the ten countries that were admitted to the E.U. in May 2004 and both countries admitted on January 1, 2007 have not yet adopted the euro. In addition, some of the older member states such as the U.K., Sweden and Denmark still choose not to adopt the euro at this stage. Some property owners and purchasers do not properly take into account these structural differences in their assessment of property valuation, which can lead to mispricing and thereby continued investment opportunities across Europe.

**Liquid Markets.** Europe has seen a significant increase in real estate liquidity over the last few years, with overall transaction volume more than doubling from €79 billion in 2000 to €164 billion in 2005. The U.K. and Germany together account for over two thirds of 2005 volume (€111 billion), underpinning their position as the leading European real estate markets. Transaction volume in CEE markets, including Russia, Turkey and the Ukraine, has also increased dramatically; transaction volume has grown over fifteen times from €460 million in 2000 to €7.1 billion in 2005. Despite the large increase of transactions in CEE, however, these markets still only represent 4% of European overall transaction volume. Newly integrated Eastern European countries will continue to mature and provide markets where high demand will create value on exit from an investment. As evidenced by the increased flows of capital into CEE, these markets appear to be now attracting institutional investors.

## **MANAGEMENT OF THE FUND**

**James Quille, Chairman and Chief Executive Officer.** Mr. Quille has over 30 years of experience in the real estate sector spanning the U.S., Europe, Asia, South America and Australia. Mr. Quille, as CEO of MGPA and a member of the MGPA Investment Committee, will serve in an oversight capacity for the Fund. He has been directly involved in real estate funds management for the last 15 years working in both the listed and private equity sectors. Mr. Quille founded MGPA in 2004 following a Management buy out of Lend Lease Corporation’s Global Property fund unit, which he led and he subsequently led the formation of a joint venture between MGPA and Macquarie Bank. Mr. Quille was largely responsible for the establishment in 1992 of The Asia Pacific Investment Company, one of the first pan-Asian real estate funds and has been involved in the structuring, capital raising, investment program and performance of Global Fund I as well

as the establishment of MGPA's other products including Global Fund II, MGP Japan Fund and investment partnerships in both Asia and Europe.

**Andrew Wood, Director, Chief Operating Officer, Global Fund I.** Mr. Wood's responsibilities include the day-to-day operations of MGPA and its advisory functions and he is a member of the MGPA Investment Committee. He also retains responsibilities for the day-to-day operations of Global Fund I, which he assisted in establishing in 1999. Mr. Wood has over 30 years of experience in the real estate sector in the U.K., Continental Europe, Asia and the U.S. Mr. Wood is a founding shareholder of MGPA and prior to establishing MGPA he was a Principal of Lend Lease Real Estate Investments, Inc in the United States where his responsibilities included funds management, investor relations and product development. Mr. Wood is a Counselor of Real Estate in the U.S. and Fellow of the Royal Institution of Chartered Surveyors in the U.K.

**Alex Jeffrey, Director, Managing Director, MGP Europe Fund II & III.** Mr. Jeffrey's responsibilities include the day-to-day operations of MGP Europe Fund II including the pan-European investment program for the fund. He will perform a similar role for MGP Europe III. Mr. Jeffrey is a member of the MGPA Investment Committee and is a founding shareholder of MGPA. He was previously the Chief Financial Officer of MGPA in which role he oversaw all financial accounting and compliance functions of MGPA and Global Fund I and was closely involved in a number of Global Fund I's major investments in Europe and Asia. Prior to joining MGPA, Mr. Jeffrey was responsible for Lend Lease's corporate finance activities. Mr. Jeffrey has 19 years of experience in finance and banking, of which the past ten have been exclusively dedicated to real estate. Mr. Jeffrey has an MA (Hons) in Law from the University of Cambridge in the U.K. and an MBA from INSEAD in France.

**Digby Okell, Principal, Managing Director and Head of Investment Management — Europe.** Mr. Okell is a founding shareholder of MGPA and his responsibilities include the day-to-day investment management operations in Europe for Global Fund I, MGP Europe II and investment partnerships. He is also a member of the MGPA Investment Committee. Mr. Okell has over 27 years of experience in the real estate sector and, prior to establishing MGPA, he worked in the investment management, asset management development and project management disciplines across the Lend Lease Group. He has experience in managing investments in Asia, the U.K., the E.U., Australia and South Africa. Mr. Okell has a Bachelor of Science degree in Quantity Surveying from Natal University in South Africa.

**Neil Jones, Principal, Managing Director and Chief Financial Officer.** Mr. Jones is a founding shareholder of MGPA and his responsibilities include the management of all financial, accounting and compliance functions of managed funds, including statutory and management reporting, foreign exchange, hedging policy and risk management. He is also a member of the MGPA Investment Committee and has over 20 years of finance, accounting and risk management experience working in the U.K., the U.S., Hong Kong and Australia, of which the last nine years were in the real estate sector. Mr. Jones has a Bachelor of Economics degree from Macquarie University, Sydney in Australia, a post-graduate Investment Diploma with the Securities Institute of Australia and is a member of the Institute of Chartered Accountants of Australia.

**Anthony Butler, Head of Asset Management — Europe.** Mr. Butler's responsibilities include the asset management of all European investments in the MGPA managed funds. He has 15 years of experience in the real estate industry working across all property sectors in the U.K. He is a qualified chartered surveyor and member of the Investment

Property Forum. Prior to joining MGPA, he trained and worked for major real estate consultancies, Donaldsons and CBRE, and he worked for nine years for RREEF, Deutsche Bank's global real estate investment arm, where he was Head of Asset Management for the U.K. business. At RREEF Mr. Butler was responsible for the management of real estate in Core/Core Plus and Value Add/Opportunity Funds across all real estate sectors and has been involved in a major city center regeneration scheme. Mr. Butler has a BSc (Hons) in Construction Management from University of Manchester and a Diploma in Management from Henley Management College.

## **CONCLUSION/RECOMMENDATION**

Based upon the successful track record and experience of the principals and the recommendation of PSERS' consultant, Courtland Partners, Ltd., staff recommends that the Board invest an amount equal to 25 percent of the committed capital, but not to exceed €100 million plus reasonable normal investment expenses, in MGP Europe Real Estate Fund III, L.P. The final terms and conditions of the investment must be satisfactory to the Investment Office, the Office of Chief Counsel, and the Executive Director.