

COURTLAND PARTNERS, LTD.

INSTITUTIONAL REAL ESTATE SERVICES

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November 12, 2012

Board of Trustees
Pennsylvania Public School Employees' Retirement System
5 North 5th Street
Harrisburg, PA 17101

Re: Latitude Management Real Estate Capital III

Dear Trustees:

Courtland Partners, Ltd. ("Courtland"), having been duly authorized by the Board of PSERS, has evaluated Latitude Management Real Estate Capital III ("Fund III") sponsored by Latitude Management ("Latitude"). The Fund III investment strategy is to originate short term, floating rate, first mortgage bridge loans on transitional value-add commercial property. These loans typically have a term of three to four years; therefore they do not require long term market predictions. The assets must be fundamentally sound, but underperforming their peer group for reasons easily addressed by competent borrowers.

Latitude's niche is defined by its focus on smaller sized assets (\$5 to \$25 million) located in primary and secondary markets in the West, Southwest, and Southeast (Top 30 MSA). The underlying assets are cash-flowing or soon to be cash-flowing (no land, construction loans, or single tenant risks). The property types are limited to multi-family, multi-tenanted office, multi-tenanted industrial, limited service hospitality, and grocery anchored and urban in-fill multi-tenant retail.

Latitude believes that there will be demand for the type of first mortgage bridge loan it originates. Latitude generally originates these loans in conjunction with the acquisition of an underperforming asset by a new owner. Typically the new owner is attempting to "right the ship" via capital improvements, leasing, and improved management prior to locking in long term fixed rate financing. The current market has been and remains dominated by undercapitalized, or upside down borrowers and temporary bank ownership. The existing owners (including limited partnerships, special servicers, and out-of-state owners) frequently are unmotivated to, or simply incapable of, maximizing collateral value. Ultimately they are forced by the market to dispose of the collateral in an attempt to limit further losses. The disposition of these mismanaged assets provides acquisition opportunities for borrowers and loan investment opportunities for Latitude.

The following provides general characteristics of the targeted investments within the Fund:

- **Transaction Size**
 - Mid-market loans (\$5-\$25 million).

- **Geographic Diversification**
 - Focus on Southwest, Southeast, Pacific and Mountain states.
 - No international investment.

- **Property Type Diversification**

- 45%-50% multi-family (no more than 50% allowed pursuant to Fund limitations);
- 20%-25% primary and secondary market office (typically mid-rise office buildings);
- 15% hospitality (no more than 25% allowed pursuant to Fund limitations);
- 5%-10% multi-tenant warehouse/distribution/industrial;
- 10% retail (no more than 35% allowed pursuant to Fund limitations); and
- Focus on cash-flowing assets. No lending on land, construction projects, condos, single tenant properties, and limited use real estate (e.g., “telecom hotels,” golf courses, assisted living).

- **Capital Structure**

- Loans are typically first mortgages of up to 75%-85% of total project costs.

Latitude is a real estate fund manager of debt and equity funds. Its primary business is originating loans which it currently manages through Funds I, II, and III. In addition, Latitude also manages smaller equity funds focused on acquiring value-add multifamily properties. The original name of the firm from 2000 to March 2009 was Legg Mason Real Estate Investors, Inc. (“LMREI”). In April 2009, the stock of LMREI was acquired through a management buyout (non-leveraged) and was subsequently renamed Latitude Management Real Estate Investors.

Courtland’s recommendation is based upon the following factors and is made within the context of PSERS’ investment guidelines:

- Detailed due diligence, including interviews with key Latitude management team members, and review of all relevant materials provided by Latitude;
- Evaluation of Fund III’s proposed investment strategy within the context of the current investment environment;
- Evaluation of Latitude’s track record and organizational resources;
- Discussion and review of the market conditions in markets relative to the proposed investment strategy;
- The strategy proposed for the Fund is appropriate for the real estate component of the portfolio.

Based on the above, Courtland recommends that PSERS commit up to \$75 million to Fund III. Courtland makes this recommendation considering Latitude’s qualifications and PSERS’ overall investment guidelines.

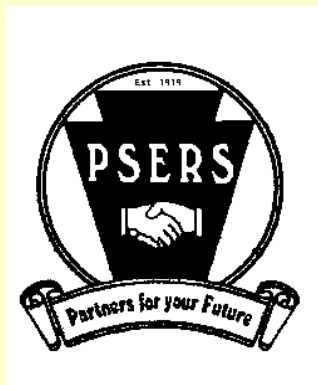
This recommendation is given solely for the benefit of PSERS and cannot be relied upon by other investors considering an investment in the Fund, since their needs, objectives and circumstances may not be identical to those of PSERS. The scope of this recommendation is limited to the investment merits of Fund III. Courtland does not provide legal or other non-investment-related advice.

Sincerely,



Steven Novick
Principal-Chief Operating Officer

COURTLAND PARTNERS, LTD.



Value-Added Real Estate Commitment

Latitude Management Real Estate Capital III, Inc.

December 5, 2012

See Last Page for Disclaimer

Laurann H. Stepp
Portfolio Manager, Real Estate

Latitude Management Real Estate Capital III, Inc. – Value-Added Real Estate

Overview

- Fund size is anticipated to be \$550 million
- Origination of floating rate first mortgages via a short term bridge loan strategy. Utilize conservative leverage to generate a net return to investors of 11% per annum
- Latitude Management Real Estate Capital was formally known as Legg Mason Real Estate Investors. They became Latitude in April 2009 when Legg Mason exited the business

Fund Strategy

- Approximately 95% of fund will be 3-4 year first mortgages of \$5-\$25 Million, on cash flowing real estate assets (not land, condos, construction and single purpose real estate) that are acquired with a value-add component. Investments are made with a loan to value of no more than 70-75%
- Match floating rate portfolio leverage to the loans to borrowers; requiring borrowers to purchase floating interest rate caps

Investment Team

- The fund will be led by two founders, Glenn Sonnenberg and Chip Sellers who have worked together for over 15 years and two other Managing Directors, who each have over 17 years of real estate experience
- The team consists of 21 professionals with real estate, capital markets and management skills; all located at the Los Angeles headquarters

Latitude Management Real Estate Capital III, Inc. – Value-Added Real Estate

GP “Value Add”

- Experience in all real estate cycles. Understand importance of cash controls, restructuring, workouts and asset management. Sixth debt fund created and managed by the Latitude team
- Loans are primarily privately negotiated, proprietary transactions sourced from their network of contacts
- Reputation with borrowers under time constraints is that LMREC offers certainty of closing and flexibility. For such borrowers, loan pricing is not the controlling factor
- Mid-size asset strategy, with an inefficient market that is not covered by mega funds
- Bottoms up underwriting with in-house ability to manage a foreclosed asset

Performance (as of March 31, 2012)

- LMREC Fund I (2002-2004) has a net 1.00x MOC and a 1% net IRR
- LMREC Fund II (2005-2007) has a net 1.34x MOC and a 7% net IRR

Market Opportunity

- Vast inventory of commercial real estate assets that need to be recapitalized as part of the industry’s reduction of outstanding debt. Market inventory will take multiple years to process and the traditional lenders are still reducing their real estate lending practices
- Many properties that are being sold have been neglected in the past few years and new owners will need short term bridge debt to fund renovations and improvements to management and marketing

Latitude Management Real Estate Capital III, Inc. – Value-Added Real Estate

History with PSERS

- This will be PSERS third fund investment with LMREC. PSERS invested \$57.6 million in Legg Mason Real Estate Capital I, Inc. in 2002, and \$100 million in Legg Mason Real Estate Capital II, Inc. in 2005

Board Issues

- Pennsylvania Presence – There are no Pennsylvania loans but one borrower pledged a Horsham, PA building as additional collateral for a loan on a Baltimore, MD property
- Placement agents – No placement agent has been used in connection with PSERS' commitment. Wren Capital, Mary Paeng and Anne Oh, has been retained to identify new investors. Any fee payable will be paid by the Manager and will not be paid by the Fund
- PA political contributions – none
- Relationship with consultant – none

Recommendation

- Staff, together with Courtland Partners, Ltd, recommend that the Board invest an amount not to exceed \$75 million plus reasonable normal investment expenses

Notice: This document was presented to the Public School Employees' Retirement Board at the public meeting at which the Board acted on the resolution to which the information relates. The sole purpose for posting the presentation information on this website is to enable the public to have access to documents that were utilized at a public meeting of the Public School Employees' Retirement Board, and no other purpose or use is intended.