



Opportunistic Real Estate Fund Commitment

Ares European Real Estate Fund IV, L.P.

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Ares European Real Estate Fund IV, L.P. – Opportunistic Real Estate

Overview

- Fund size: \$1 billion target
- European Opportunistic real estate fund
- Founded in 1993 as Apollo Real Estate Advisors and now a wholly-owned subsidiary of Ares Capital, the global real estate team has invested more than \$14 billion of equity across Value-Add, Opportunistic, Debt and Institutional Joint Ventures strategies

Fund Strategy

- Target 16-20% gross/12-16% net IRR over a projected three to five-year holding period
- Focus on large and most liquid markets
 - Well-diversified economies with well-developed transportation networks
- Construct a portfolio of retail, office, residential and industrial assets that have the potential to produce substantial market liquidity at exit
- Capture value through acquisition and create value through intensive asset management, develop for-sale residential in the most supply-constrained markets
- Sell once business plan is successfully accomplished

Ares Organization

- Real Estate group based in New York, with 15 offices globally
- \$8.5 billion CCUM managed by 80 investment professionals
- Supported by a team of marketing, reporting and accounting, legal and compliance professionals
- Real Estate senior executives average 30 years experience

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GP “Value Add”

- European real estate team investing together since 1995, having committed \$3.3 billion of equity to 129 transactions across the European fund series
- Focus on off-market transactions sourced internally and in collaboration with their network of experienced JV partners
- “Bricks and Mortar” investment style focused on major property types and liquid markets
- Deep experience in all aspects of real estate investing, including acquisitions, structuring, operations, lending, legal, finance and accounting
- “Power of the Platform” – recent merger with Ares Capital provides the real estate team with additional research and other resources across the global platform

Performance

- AREA European Real Estate Fund III (2008):
 - MTM: 10.9% IRR and 1.4x EM (gross), 6.2% IRR and 1.2x EM (net)
 - Projected: 13.44% IRR and 1.7x (gross), 9.3% IRR and 1.5x (net)

Market Opportunity

- Distress, Deleveraging and Recapitalization
- High-quality assets with fractured ownership
- Limited capital available for assets in need of repositioning through active asset management
- Development opportunities in select markets such as London

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Risks and Considerations

European Investment Environment

- although trailing the US recovery, European recovery underway; banking systems beginning to deleverage
- economic, political and regulatory challenges exists; Fund's 3-year commitment period provides Ares management team ability to invest at a measured pace
- Ares track record in Europe established over several economic cycles, \$3 billion committed since 1995; 19.5% gross IRR and 1.7x gross equity multiple across its core markets
- focus on major European property markets, the most liquid property markets in the region
- limitations on non-EU countries; no investments in Russia or Ukraine

Leverage

- use of leverage may enhance returns or magnify losses
- track record demonstrates team has utilized leverage in a prudent manner over time
- leverage limit is 70% of acquisition costs
- limited use of recourse financing, will not cross-collateralize portfolio investments

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History with PSERS

- PSERS previously committed to AREA Real Estate Finance Corporation, AREFIN Co-Investment Corporation, AREA European Real Estate Fund III, AREA VEF VII and Ares US Real Estate Fund VIII

Board Issues

- Pennsylvania Presence
 - N/A, as this is a European strategy
- Placement Agents – No placement agent used in respect to PSERS' commitment; Park Hill Real Estate Group aiding marketing efforts in Europe; Bamberger-Rosenheim, an affiliate of Profimex, aiding marketing efforts in the Middle East
- PA Political Contributions – None
- Relationship with Consultant – No

Recommendation

- Staff, together with Courtland Partners Ltd., recommends that the Board invest an amount not to exceed \$100 million plus reasonable normal investment expenses

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February 20, 2014

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

Re: Ares European Real Estate Fund IV, L.P.

Dear Trustees:

Courtland Partners, Ltd. ("Courtland"), having been duly authorized by the Board of PSERS, has evaluated Ares European Real Estate Fund, L.P. (the "Fund"). Ares intends that the Fund will continue the European acquisition program of the prior funds by targeting real estate investments that offer the opportunity for attractive risk adjusted returns. Ares will seek to create a diversified portfolio of opportunistic assets, both in terms of asset class and geographical spread across Europe. The strategy of the Fund is to capitalize on ongoing distress in major European commercial real estate markets by: (i) fixing broken capital and ownership structures by injecting capital and providing active management into distressed property portfolios and funds; (ii) manufacturing "core" investments by applying intensive asset management and capital to under-managed and under-invested properties; and (iii) exploiting pockets of growth including selective development and refurbishments in prime areas with favorable supply/demand fundamentals.

Ares typically pursues special situations not widely available in the marketplace where quality assets are embedded in troubled ownership, or capital structures can be acquired at favorable prices. These assets are frequently shopping centers and office buildings located in the leading European investment markets of the U.K., Germany, and France. Ares often gains control of such assets by deleveraging over-indebted vehicles or purchasing them out of bankruptcy or administration. Ares also acquires properties which, because they do not meet the strict requirement of core buyers, are overly discounted. In all instances, Ares focuses on real estate fundamentals and seeks to add value through lease-up, re-tenanting, and capital improvements. Finally, Ares pursues selected development in market segments with favorable supply and demand characteristics.

Ares believes that the continued deleveraging in the European real estate market will offer attractive returns for experienced sponsors with access to capital and the ability to add value. Ares will continue to be most active in the U.K., Germany, and France, the most mature and liquid real estate markets in Europe. The Fund will focus approximately 75% of its strategy within the U.K., Germany, and France. Ares anticipates continuing to invest primarily in the major property types of retail, office, residential, and industrial with limited exposure to hospitality and special purpose assets.

Investable opportunities for the current Fund should arise from stressed borrowers with too much debt and insufficient fresh capital to fund property maintenance and/or improvements, banks, and other financial institutions looking to reduce their overall exposure to commercial property, the limited availability of capital for development finance, and limited new supply of commercial property.

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 Ares management team members, and review of all relevant materials provided by Ares.
- Evaluation of the Fund's proposed investment strategy within the context of the current investment environment.
- Evaluation of Ares' 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 \$100 million to the Fund. Courtland makes this recommendation considering the General Partner'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 the Fund. Courtland does not provide legal or other non-investment-related advice.

Sincerely,



Steven Novick
Principal-Chief Operating Officer

COURTLAND PARTNERS, LTD.