



# Value-Added Real Estate Commitment

## LEM Multifamily Senior Equity Fund IV, L.P.

April 30, 2015

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William Stalter  
Senior Portfolio Manager

# LEM Multifamily Senior Equity Fund IV, L.P.– Value- Added Real Estate

## Overview

- Fund size: \$300 million (\$400 million cap)
- Fourth in a series of dedicated closed-end commingled real estate funds
- Sponsored by LEM Capital, a provider of senior equity and structured equity capital to commercial real estate owners, with over \$690 million AUM

## Fund Strategy

- To finance sponsor's equity primarily through senior equity investments, where the sponsor's cash is subordinate to that of the Fund
- Focus on current cash flow, with predictable distributions to Fund investors (target 60% of gross returns derived from current cash flow and 8% annual return paid quarterly)
- Target returns: 12-16% net
- Structure senior equity investments with upside participation, potentially enhancing Fund returns
- Invest exclusively in Class B multifamily properties, primarily in 1<sup>st</sup> and 2<sup>nd</sup> Tier markets in the U.S.
- Focus on small to midsize opportunities where transactions providing attractive risk-adjusted returns can be found "below the radar" of large investors

## Investment Team

- The Fund will be managed by Jay Eisner, Herb Miller and David Lazarus, who together oversee LEM's activities and are supported by 15 full-time employees, including 10 investment professionals
- LEM's team of professionals brings decades of experience in real estate investing, including lending, development, ownership, loan servicing, finance and operations
- LEM is an established midsize multifamily investor, with strong franchise value and institutional credibility in the marketplace
- Headquartered in Philadelphia, PA

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## GP “Value Add”

- Senior management actively involved in every deal
- Hands-on asset management, not reliant on 3<sup>rd</sup> party providers
- Deals structured so that LEM controls exit timing, along with major decision rights related to property sale/refinance, capital improvements, budgets and property management
- LEM’s experience and market presence provides the Fund with quality deal flow
- National network of operating partners provides consistent pipeline of potential transactions
- Focus on small to mid-size transactions provides meaningful diversity to the Fund

## Performance (in-place, as of December 31, 2014)

- LEM Real Estate Mezzanine Fund II, LP (2006): 1.20x MOC and 4.2% net IRR (net)
- LEM Real Estate Mezzanine Fund III, LP (2012): 1.34x MOC and 42.3% net IRR (net)

## Performance (projected, as of December 31, 2014)

- LEM Real Estate Mezzanine Fund II, LP (2006): 1.25-1.30x MOC and a 4.5-5.0% IRR (net)
- LEM Real Estate Mezzanine Fund III, LP (2012): 1.5-1.7x MOC and 12.5-15.5% IRR (net)

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## Market Opportunity

- Demand dynamics support the Class B multifamily market
  - Prime renter cohort of 20-34 year olds is projected to increase by 2 million people through 2020
  - High barriers to ownership cause renters to delay moving into single-family homes
  - Homeownership hit a near 20-year low of 64.4% in 3Q2014
- Virtually no new Class B being developed
  - Class B properties over 95% occupancy, effectively full
  - New multifamily supply is not expected to keep up with demand for new multifamily units, as cost of new construction continues to increase as material and labor costs are rising faster than inflation
- Stable real estate asset class
  - Multifamily has historically been the least volatile real estate asset class with solid fundamentals (predictable cash flow, limited new supply, favorable demographics)

## Potential Risks

- Leverage
  - LEM has historically employed property-level leverage in a conservative manner
  - Debt is readily available from lenders such as Fannie Mae, Freddie Mac, regional and national banks, insurance companies and specialty lenders
  - The Fund will not incur any Fund or portfolio-leverage except for a subscription facility
- Rising Interest Rates
  - Many economist and experts predict interest rates will increase as a result of the strengthening economy
  - Resulting downward pressure should be tempered by increasing rents and incomes as a result of wage growth, job growth and inflation
  - Home mortgage interest rates would likely rise, which would impact apartment renters ability to purchase homes, likely boosting demand for apartments

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## History with PSERS

- PSERS previously invested in LEM II (2006) and LEM III (2012)
- The LEM platform is part of the Independence Capital Partners umbrella organization, to which PSERS has made commitments to various funds sponsored by Lubert-Adler Partners, LLR Equity Partners, Quaker Bio-Ventures and LBC Credit Partners

## Board Issues

- Pennsylvania Presence –
  - Sherwood Apartments is a 428-unit multifamily portfolio in Bethlehem, Pennsylvania. Fund I has \$1,300,000 mezzanine loan on this portfolio
  - Oaks at McCandless is a 187-unit multifamily property located in McCandless Township, a suburb of Pittsburgh, Pennsylvania. Fund II has a \$1,015,000 mezzanine loan on this property
  - Falls Village is a 180-unit multifamily property located in East Falls, Pennsylvania. Fund III has a \$6,412,000 Senior Equity position in this property
- Placement agents –
  - LEM has not engaged the services of a placement agent
  - In the event a placement agent is utilized, none of the costs will 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.

# COURTLAND PARTNERS, LTD.

## INSTITUTIONAL REAL ESTATE SERVICES

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April 8, 2015

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

**Re: LEM Multifamily Senior Equity Fund IV, L.P.**

Dear Trustees:

Courtland Partners, Ltd. ("Courtland"), having been duly authorized by the Board of PSERS, has evaluated LEM Multifamily Senior Equity Fund IV, L.P. (the "Fund"). The Fund is sponsored by LEM Capital ("LEM"). LEM has maintained a strategy of originating and managing a diversified portfolio of commercial real estate structured debt and equity investments secured by multifamily, office, retail, industrial, and hospitality properties across the United States and Canada since its inception in 2002. LEM currently manages three funds with over \$530 million in total assets under management as of September 30, 2014.

LEM's strategy will be to continue to acquire high-quality, value-add Class B, middle-market properties and create value by improvement management and modernizing properties through capital upgrades. LEM focuses on infill locations in markets with diverse employment drivers and strong demographics, taking advantage of market fundamentals that support the Class B multifamily market. LEM invests with experienced local operating partners, targeting equity investments from \$5 million to \$10 million, and often employs a senior/sub structure that provides significant upside while protecting against downside risk.

All investments will be structured as equity which will generally take two forms:

- **Senior Equity:** LEM anticipates that the majority of investments will be structured in a senior/sub structure, where LEM's capital is senior to the operating partner's. In exchange, LEM relinquishes more of the upside to the operating partner for higher current cash flow and less downside risk.
- **Pari Passu Equity:** LEM anticipates that a minority of investments will be consummated using a *pari passu* structure, where the Fund's equity and that of the operating partner's are equal in priority. LEM anticipates that this latter structure will only be employed with operating partners with which LEM has previously invested or with those partners that are able to commit substantially greater capital to a transaction (in order to effectively align interests with those of the Fund).

All of the Fund's investments will be in the multifamily sector in the U.S. with at least 75% of the Fund's investments located in states along the east and west coasts, the northeast corridor and the greater metropolitan areas of Dallas, Houston, Austin, San Antonio, Nashville, Chicago, Minneapolis, and Denver. LEM will target 100 basis points of manufactured yield growth from value-add and 100

basis points of yield growth from the market over a five-year hold period.

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

- Detailed due diligence, including on-site interviews with key LEM management team members, and review of all relevant materials provided by LEM.
- Evaluation of the Fund's proposed investment strategy within the context of the current investment environment.
- Evaluation of LEM'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 the Fund. Courtland makes this recommendation considering LEM'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.**