



COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

Public Investment Memorandum

Blackstone Real Estate Debt Strategies III, L.P.

Real Estate Commitment

William P. Stalter
Senior Portfolio Manager

November 14, 2015



Recommendation:

Staff, together with Courtland Partners, Ltd., recommends to the Board a commitment of up to \$100 million to Blackstone Real Estate Debt Strategies III, L.P. ("Fund III" or the "Fund"). Blackstone ("Blackstone or the "Firm"), a New York, NY-based private investment firm, is sponsoring the Fund to make real estate debt investments primarily in North America and Europe.

Firm Overview:

The Blackstone Group is one of the world's leading investment firms. Blackstone is based in New York, with offices in Beijing, Dubai, Dublin, Dusseldorf, Hong Kong, Houston, London, Los Angeles, Madrid, Mexico City, Mumbai, San Francisco, Shanghai, Singapore, Sydney, Tokyo and Toronto. Blackstone's alternative asset management businesses include investment vehicles focused on private equity, real estate, hedge fund solutions, non-investment grade credit, secondary funds and multi asset class exposures falling outside of other funds' mandates. The firm was founded in 1985 and as of June 30, 2015, Blackstone had 138 Senior Managing Directors and employed approximately 954 other investment professionals.

Blackstone's Real Estate group was founded in 1991 and is one of the largest real estate investment managers in the world, with \$92 billion of investor capital under management. Blackstone Real Estate Debt Strategies ("BREDS") was launched in 2008 and has established itself as a preeminent real estate debt platform having originated and/or acquired over \$30 billion of loans since its inception. BREDS III will primarily focus on mezzanine and structured lending on institutional quality real estate in well-located, supply constrained markets globally. Blackstone will seek to generate attractive risk-adjusted returns with virtually all of the return generated on a current basis.

The closed-end BREDS funds have consistently delivered outstanding performance for investors, generating 12% net returns with no realized losses across the lending platform. BREDS' expansive role in providing debt capital continues to benefit from robust transaction activity and a shift away from traditional banks to specialty lenders such as BREDS for certain lending activities. BREDS' flexible mandate and scale of capital enable it to capitalize on these dynamics to identify and execute on innovative investment themes, resulting in attractive risk-adjusted returns. Importantly, BREDS' direct access to the resources, proprietary knowledge and relationships of the Blackstone Real Estate group provides a powerful advantage relative to other global real estate lenders.

Fund Size

Blackstone Real Estate Debt Strategies III, L.P. is seeking equity commitments of \$4 billion. There is not currently a cap on the size of the fund.



Investment Strategy:

The Fund will seek to originate/structure mezzanine debt associated with well-located institutional quality real estate properties located primarily in North America and Europe. The typical fund-level equity investment will be approximately \$100 million per transaction. The following characteristics are instrumental to the BREDS lending platform:

- Strong Sponsor Relationships
 - The overall Blackstone platform affords the BREDS management access to the most qualified and well-capitalized borrowers in the marketplace
- Focus on Preservation of Capital
 - Where last dollar of risk is below asset value and replacement cost. Last dollar of risk is typically in the mid-60% of estimated value
 - Further demonstrated by fact that the platform has experienced no realized losses since inception
- Significant Portion of Total Return
 - As with Fund II, BREDS III will make quarterly distributions to investors
 - BREDS II is currently yielding 9.1%

Investment Team:

The BREDS team has grown significantly since its inception and today totals 107 dedicated investment and asset management professionals. The platform's global footprint includes professionals located in New York, Los Angeles, Hong Kong, London, Mexico City, Sydney and Toronto. The BREDS team will continue to leverage the resources, relationships and proprietary information of the broader Blackstone Real Estate team to execute the BREDS III strategy.

The following senior professionals will focus on leading the Fund's investment efforts.

- Michael Nash is a Senior Managing Director and Global Head of BREDS. Mr. Nash has been with Blackstone Real Estate since 2007 and has over 28 years of real estate debt investment experience.
- Jonathan Pollack is a Senior Managing Director and Chief Investment Officer of BREDS. Mr. Pollack has 17 years of commercial real estate and structured finance experience.
- Robert Harper is a Senior Managing Director and Head of BREDS Europe. Mr. Harper has been involved in debt and equity transactions in the U.S. and Europe since joining Blackstone in 2002.
- Stephen Plavin is a Senior Managing Director and Chief Executive Officer of Blackstone Mortgage Trust. Mr. Plavin has over 30 years of debt investment experience.
- Ken Caplan is a Senior Managing Director and Chief Investment Officer of Blackstone Real Estate. Mr. Caplan has been with Blackstone Real Estate for over 18 years, most recently leading our BREP investment efforts across the U.S., Europe and Asia.
- Tim Johnson is a Managing Director and Head of U.S. Originations. Mr. Johnson has 13 years of experience sourcing, structuring and executing debt investments.
- Kathleen McCarthy is a Senior Managing Director and Global Chief Operating Officer of the Real Estate group and is based in New York. Ms. McCarthy oversees the Investor Relations and Business Development, Human Resources, Legal & Compliance and Finance teams supporting Real Estate. Ms. McCarthy joined Blackstone in 2010.
- Jonathan Gray is the Global Head of Real Estate and a member of the Board of Directors of Blackstone and is based in New York. He also sits on the firm's Management Committee. Since joining Blackstone in 1992, Mr. Gray has helped build the largest real estate platform in the world with \$92 billion in investor capital under management.



Investment Instruments:

BREDS will primarily invest in mezzanine real estate debt originations and other structured real estate loans. Subject to market conditions, the Fund may invest in legacy real estate loans.

Market Opportunity:

Transitional Lending

- Underwriting complex real estate where traditional capital is scarce

Whole Loan Syndications

- Creating outsized mezzanine returns through syndications

Non-U.S. Lending

- Flexible global mandate to take advantage of pockets of dislocation

Construction Loans

- Lending at attractive bases to well-capitalized sponsors

Investment Highlights:

Experienced & Cohesive Senior Management Team
The BREDS platform is led by Michael Nash, who has led Blackstone's real estate debt business since its inception in 2007. The 23 partners in the real estate group average 12 years at Blackstone.
Strong Track Record
The BREDS platform manages \$10 billion of investor commitments and has achieved net returns of 12% since 2008. There have been no lending losses across the BREDS platform.
Deal Execution
The BREDS team leverages off of the overall Blackstone real estate investing platform, which is the largest in the industry. BREDS' success is attributable to its innovative approach, its ability to execute with speed and certainty and its history of transacting with repeat borrowers.

Investment Considerations:

Investment Terms/Interest Rate Environment
Given the current low interest rate environment, the fund promote waterfall is subject to a preferred return of 6%, which is lower than the predecessor BREDS fund. There is a clawback mechanism to ensure LPs are made whole should any excess returns be paid to the general partner over the life of the Fund.
Public Market Benchmark Returns
BREDS Fund I and II have exceeded the public benchmark (FTSE NAREIT TR Index, mortgage component) by 3.2% and 3.1%, respectively. There have been no realized losses across the BREDS platform.
Foreign Country/Currency Risks
The Fund may invest outside the US (up to 50% outside the US and Canada, including up to 15% in non-OECD countries). Investing outside the US can subject investors to currency, political, economic and tax instability. Blackstone is a large global firm and has significant experience investing capital across many markets. As it has demonstrated in the past, Blackstone will utilize firm resources to determine how best to hedge currency risk.



PSERS History & Performance:

Since 2006, PSERS has committed approximately \$1.6 billion to seven Blackstone-managed partnerships. As of June 30, 2015, Blackstone generated a 14.18% net IRR and a 1.65x net MOIC for PSERS across their real estate private equity and real estate debt funds. The table below summarizes PSERS' historical performance with Blackstone by partnership:

Investment	Vintage	Commitment	Paid-In	Distributions	Valuation	IRR	Multiple
Blackstone Real Estate Partners V, L.P.	2006	200,000,000	214,491,119	240,637,927	168,727,133	11.70	1.91
Blackstone Real Estate Partners VI, L.P.	2007	400,000,000	431,244,547	527,346,404	320,892,030	14.06	1.97
Blackstone Real Estate Partners Europe III, L.P.	2009	223,060,000	263,411,198	149,735,076	223,620,146	14.82	1.42
Blackstone Real Estate Partners VII, L.P.	2011	300,000,000	333,262,820	171,423,736	311,782,688	25.48	1.45
Blackstone Real Estate Debt Strategies II, L.P.	2013	100,000,000	54,827,948	21,109,142	40,060,521	9.31	1.12
Blackstone Real Estate Partners Europe IV, L.P.	2013	100,000,000	52,880,030	4,438,080	50,242,600	4.68	1.03
Blackstone Real Estate Partners VIII, L.P.	2015	300,000,000	-	-	N/A	N/A	N/A
Totals		1,623,060,000	1,350,117,662	1,114,690,365	1,115,325,118	14.18	1.65

Portfolio Fit:

A commitment to BREDS Fund III will provide PSERS' real estate portfolio exposure to a lending platform that is unique in size and scale, a platform that will focus on making larger loans across geographies and structures, all of which will be complementary to other real estate debt strategies within PSERS' Real Estate portfolio. Blackstone's real estate debt funds have historically delivered compelling risk-adjusted returns and provided a significant portion of total return through current income. Additionally, this fund investment will help PSERS' achieve its long-term strategic allocation target to Value-Add strategies.

Investment Type	Active Commitments ⁽¹⁾		Market Value		Unfunded ⁽¹⁾		Total Exposure ⁽¹⁾	
	\$	%	\$	%	\$	%	\$	%
Opportunistic	\$9,661.4	58.6%	\$3,314.0	62.4%	\$1,117.7	43.5%	\$4,431.7	56.3%
Value-Add	\$5,225.6	31.7%	\$1,474.4	27.8%	\$1,099.5	42.8%	\$2,573.9	32.7%
Core	\$1,592.8	9.7%	\$522.7	9.8%	\$350.0	13.6%	\$872.7	11.1%
Total	\$16,479.8	100.0%	\$5,311.1	100.0%	\$2,567.2	100.0%	\$7,878.3	100.0%

(1) Includes post Q2'2015 pending/closed commitments.

Liquidity & Leverage Profile:

The Fund is expected to be invested within five years of its final closing. Capital contributions returned from Investments disposed of may be recalled (subject to certain limitations) prior to the second anniversary of the end of the Investment Period. The Fund leverage cap is 50%.



Finance Committee Disclosure:

Relationship with Courtland Partners, Ltd.:	None
Placement Agent:	Blackstone Advisory Partners, however this group receives no compensation for such services in respect to the Fund capital raise
PA Political Contributions:	None Disclosed
PA Presence:	BREDS I: 12 PA-related loans within two separate loan pools BREDS II: 9 PA-related loans within one loan pool
Conflicts:	None Disclosed
History with PSERS:	Yes
PSERS Internal Alpha Committee Approval:	Yes

Oversight Responsibility:

Investment Office:	Charles J. Spiller Managing Director William P. Stalter Senior Portfolio Manager
External Consultant:	Courtland Partners, Ltd.

COURTLAND PARTNERS, LTD.

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November 11, 2015

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

Re: Blackstone Real Estate Debt Strategies III, L.P.

Dear Trustees:

Courtland Partners, Ltd. ("Courtland"), having been duly authorized by the Board of PSERS, has evaluated Blackstone Real Estate Debt Strategies III, L.P. ("BREDS III" or the "Fund"). BREDS III will primarily focus on mezzanine and structured lending on institutional quality real estate in well-located, supply constrained markets globally. BREDS III will seek target net returns of 9-11%, with virtually all of its return generated through current income. Blackstone Real Estate Debt Strategies ("BREDS") seeks to generate attractive risk-adjusted returns while seeking to minimize risk of principal loss. BREDS focuses on investing in junior positions in the capital structure with a loan to value ratio of approximately 60%-80%, primarily in floating rate structures.

BREDS' role in providing debt capital continues to benefit from robust transaction activity and a shift away from traditional banks to specialty lenders such as BREDS for certain lending activities. BREDS' flexible mandate and scale of capital enable it to capitalize on these dynamics to identify and execute on innovative investment themes, resulting in attractive risk-adjusted returns. Importantly, BREDS' direct access to the resources, proprietary knowledge and relationships of the Blackstone Real Estate Group provides a powerful advantage relative to other global real estate lenders. BREDS will continue to employ the same strategy that has proven successful over the past seven years by targeting investments with:

- **Current Cash Flow.** One of the Fund's primary investment objectives is generating significant current income, which will be distributed on a quarterly basis.
- **Capital Protection.** A disciplined focus on safety of principal is central to the BREDS strategy. BREDS III will focus on investments with a last dollar of risk that is well below estimated asset value and current replacement cost.
- **High Quality Borrowers.** BREDS and Blackstone Real Estate have extensive relationships with best-in-class real estate borrowers around the world. BREDS has a reputation as a lender that offers speed and certainty of execution, and has established itself as a preferred lender for strong sponsors.

BREDS focuses on lending on institutional quality assets by originating and structuring mezzanine debt. Investment themes are expected to include: bridge/transitional lending, whole loan syndications, global lending, construction loans, and legacy loans.

As one of the largest real estate investors in the world, Blackstone developed a strong network of international relationships with leading owners of real estate, financial institutions, operating partners, senior business executives, and government officials. These relationships form the backbone of the firm's investment-sourcing network. This network has allowed the firm to access key information and investment-execution resources at critical points in the investment process. Blackstone has, and expects to continue to have, a significant volume of deal flow.

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 Blackstone management team members, and review of all relevant materials provided by Blackstone.
- Evaluation of the Fund's proposed investment strategy within the context of the current investment environment.
- Evaluation of Blackstone's track record and organizational resources.
- Discussion and review of the market conditions in markets relative to the proposed investment strategy.

Based on the above, Courtland recommends that PSERS commit up to \$100 million to the Fund. Courtland makes this recommendation considering Blackstone'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.