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Public Investment Memorandum

**Exeter Industrial Value Fund V, L.P.**

Value-Add Real Estate Commitment

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**Melanie A. Cubias**  
Senior Investment Professional

**Melissa A. Quackenbush**  
Senior Portfolio Manager

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### **Recommendation:**

PSERS Investment Office Professionals (IOP), together with Hamilton Lane, recommend the Board commit up to \$100 million to Exeter Industrial Value Add Fund V, L.P. ("Fund").

Exeter Property Group ("Exeter" or the "Firm") will pursue a value-add strategy to acquire, develop, redevelop, lease, operate, and sell big box warehouse, last mile, light industrial, and flex/office-warehouse properties serving major markets throughout the United States and select markets in Canada and Mexico. Like previous Exeter value-add funds, the Fund will seek to invest at favorable cost by acquiring under-leased and under-managed properties at discounted pricing, as well as partially to fully leased assets with growth potential at value-oriented pricing. Exeter believes it is well-positioned to take advantage of the opportunities in the market and execute the Fund's investment strategy given the attributes of its experienced team of investment professionals.

Over the last 12 years, Exeter Property Group has established a proven investment track record that comprises \$13.5 billion in total property value comprising of approximately 1,000 buildings in Europe and the United States across core and value-add investment strategies. Exeter's U.S. industrial value-add investment track record spans 336 investments across the last 12 years, representing \$8.1 billion in total project cost. The U.S. industrial value-add series has generated since inception net returns of 20.1% leveraged IRR and 1.7x multiple as of March 31, 2019.

### **Firm Overview:**

Exeter is a privately held real estate investment manager based in Conshohocken, PA and employs 75 people in this office. The Firm also has 18 offices located throughout the United States as well as an office in Mexico and 11 offices in Europe. The Firm was founded in 2006 with the purpose of utilizing the team's property operator skills to serve institutional investors. As of 2019, the firm manages \$7 billion in AUM and has 165 employees, including 77 investment professionals.

Serving approximately 70 investors around the globe, Exeter manages four closed-end, value-add, industrial real estate funds in the U.S. (commenced 2007) and three in Europe (commenced 2014); three closed-end, core, industrial real estate funds in the U.S. (commenced 2012); four managed accounts in the U.S. and Europe (commenced 2015); and one closed-end, value-add, office real estate fund in the U.S. (commenced 2018).

### **Market Opportunity:**

E-commerce is driving demand for industrial space which in turn is driving changes in the patterns and growth of the shipping and distribution of goods. Greater consumer demand related to the population growth naturally resulted in a greater quantity of goods moving through the distribution network. Additionally, quicker delivery times have required distribution facilities to be closer to the populations they serve. Supply of industrial product is diminished by obsolescence as older buildings do not meet design specification required by most tenants. As such, demand has been strong for new construction. Redevelopment of older buildings can cater to last mile logistics in some cases. Despite absorption across the U.S. being mixed, due to lack of supply, the vacancy rate remains historically low at 5%.

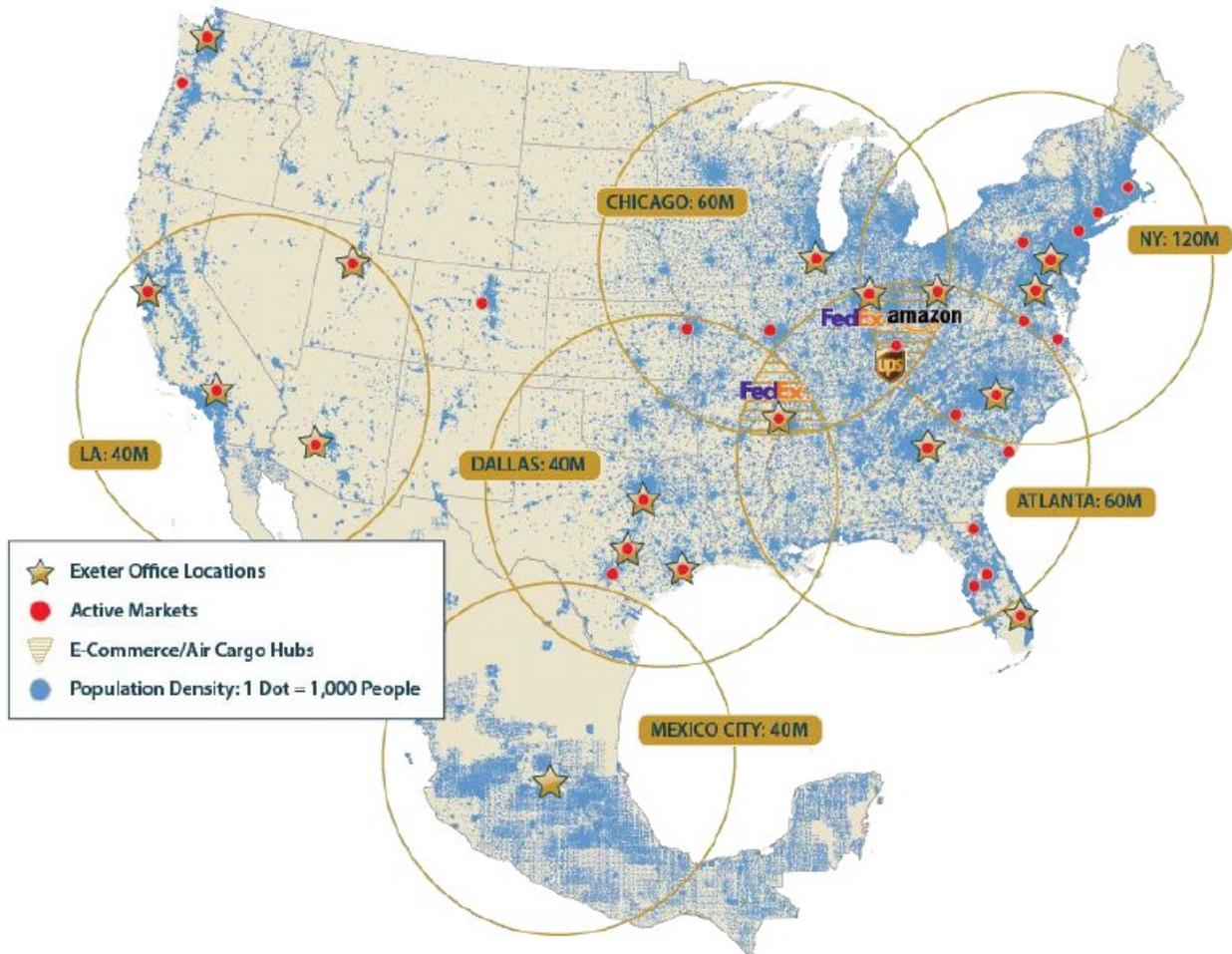
Exeter believes that the current industrial real estate market presents a period of opportunity. The industrial sector has shown strength as evidenced by 34 straight quarters of positive net absorption since emerging from the Global Financial Crisis in mid-2010. Yet, because of the steady but slow-growth economic recovery, rental rates did not start to recover until 2014 resulting in dormant development activity. Tenant demand, as measured by net absorption, has outpaced new supply every year for the last 9 years. As a result, overall occupancy in the U.S. industrial market has climbed to approximately 95%, leading to 5%-6% rental rate growth since 2016. This environment is expected to provide the Fund with abundant opportunity to increase Net Operating Income ("NOI") by leasing vacancy, resetting existing leases to market rental rates, which continue to climb given market fundamentals, and serving tenant demand for new development.



The industrial space has become more institutionalized as large portfolios have become attractive to institutional buyers. Over the longer term, Exeter believes that while tenant demand will be correlated to GDP, it will be additionally sustained by drivers that are specific to industrial real estate and result in this sector's unique profile. For example, warehouse demand is highly correlated to population growth due to baseline per capita consumption of goods. The U.S. population is forecast to grow significantly, by 2.3 million people per year through 2030, which corresponds to approximately 130 million square feet per year in new warehouse demand. This growing demand driver is augmented by the strong correlation between warehouse demand and e-commerce and international trade, both of which are substantially outpacing general growth of the economy. Fundamentals are stabilized by supply side dynamics, where obsolescence due to advances in warehousing technology causes a regular reduction in the inventory of functional industrial product.

Exeter has selected the top 30 U.S. distribution markets to pursue investments for the Fund. These 30 markets account for a great majority of warehouse demand driven by consumption and population growth. Exeter is targeting distribution markets that service the following:

- New York to Philadelphia to Washington, DC in the Northeast/Mid-Atlantic;
- The Chicago/Mid-South markets that service e-commerce supply chains and also have benefitted from the migration of population and commerce from mature Mid-Western metropolitan areas;
- The Atlanta and Central Florida markets;
- The Texas Triangle, particularly Dallas, Houston and Austin/San Antonio;
- Western markets along the coast from Southern California to Seattle and key inland markets including Phoenix.



*Represents population within a day's drive  
Source: Exeter Property Group*



**Portfolio Fit:**

A commitment to the Fund will be allocated to the value-add Real Estate portion of PSERS' Real Assets portfolio. Using the net market value from December 31, 2018 and adjusting the unfunded to include commitments from the prior and current Board meetings, the Real Estate portfolio would be 13.8% Core, 41.5% Opportunistic, and 44.8% Value-Add. With the proposed commitment the Firm would represent 5.7% of the Real Estate portfolio and is less than 1% of the Total Fund.

The table below summarizes PSERS' projected exposure inclusive of a recommended \$100 million commitment to the Fund, as of December 31, 2018:

Investment Type (\$M)	Market Value	%	Unfunded	%	Total Exposure	%	Long Term Target (%)
Core	741.1	15.6%	346.9	11.0%	1,088.0	13.8%	20%
Opportunistic	2,232.4	47.1%	1,041.6	33.0%	3,274.0	41.5%	30%
Value-Add	1,769.9	37.3%	1,766.0	56.0%	3,535.9	44.8%	50%
<b>Total</b>	<b>\$ 4,743.4</b>	<b>100%</b>	<b>\$ 3,154.5</b>	<b>100%</b>	<b>\$ 7,897.9</b>	<b>100%</b>	<b>100%</b>

**Investment Strategy:**

The Fund will invest in major markets throughout the U.S. and may invest up to 7% in Canada and Mexico. The investment strategy entails the acquisition of (1) under-leased and under-managed industrial properties (or their related whole loan, first mortgage notes) at distressed pricing; and (2) partially- to fully-leased, short term leased assets with existing cash flow and NOI growth potential, which are available at value pricing due to institutional portfolio rebalancing and/or sellers' needs to recapitalize over-leveraged properties. The Fund will also pursue development and redevelopment opportunities which serve the current pent-up demand for modern warehouses while ensuring the Fund pays no more than replacement cost for best-in-submarket assets. Exeter intends to generate strong income returns by actively managing the properties to increase occupancy and reset rental rates to market levels, thereby increasing NOI. Consequently, Exeter's ability to grow NOI, coupled with its strategy of negotiating long term leases, is expected to generate significant appreciation in asset values. Exeter intends to utilize its technical expertise to execute renovation, redevelopment, and development opportunities.

The Fund's investment strategy entails consummating predominately single asset transactions and aggregating the assets into portfolios to obtain diversification benefits and maximize disposition proceeds given the domestic and international capital market demand for large core industrial portfolios.

The Fund will be invested based on the following investment themes:

Theme	Description
Acquire Under Performing Properties	Acquire assets at a discount to current market values by identifying assets that are distressed due to vacancy, lease expirations, and over-leverage or refinance defaults.
Aggregate Single Assets for Portfolio Diversity	Exeter mitigates the single asset/tenant risks and inefficiencies by aggregating investments to create a portfolio with product, credit, tenant, and geographic diversification. Diversity is expected to provide more stable cash flows, enhanced yields, and maximum disposition attractiveness by positioning the Fund for either one-off or portfolio sales.
Focus on Primary Industrial Real Estate Markets	Over the span of their careers, the management team members have actively examined, traveled to and performed studies on the ground in over 80 markets throughout the United States, Canada, Mexico, China, the United Kingdom, Western Europe and Central Europe. Accordingly, they have extensive experience in analyzing and selecting markets and property characteristics with the best investment value based on the dynamics of demographics, real estate fundamentals (such as occupancy, space absorption, and rental rate growth potential), industrial space demand drivers, and competitive characteristics in each market.



Focus on Modern Single Tenant Bulk Industrial Properties	Modern building design is critical to attracting and retaining industrial tenants who demand ever-greater efficiency and product throughput in their facilities. The Fund will emphasize acquiring or developing single tenant, modern bulk industrial assets, which include big box warehouses for regional distribution and last mile warehouses for local distribution.
Build Portfolio with in Place Cash Flow to Drive NOI Growth	Exeter also pursues assets that are partially to fully occupied at acquisition and thus have existing cash flow. This strategy is expected to reduce exposure to vacancy and lease-up risk. Exeter will seek to enhance the value of these investments by raising occupancy, increasing rents upon renewal (rental rates have been growing at 4-6% annually since 2014, well above 2% historic growth rate), and signing long-term leases.
Build to Suit and Speculative Development	Low vacancy, high tenant absorption, and rapidly rising rental rates have led to acquisition pricing that is often above replacement cost creating an opportunity for new development. Exeter's in-house team has expertise required to address complicated Leadership in Energy and Environmental Design ("LEED") construction, environmental, municipal, and engineering challenges. These challenges are the predominate reason why supply has not yet caught up with demand. Build-to-suit and speculative development are likely to comprise 25%-30% of the Fund's investments. Exeter's existing relationships with national corporate tenants are expected to be a significant source of such build-to-suit opportunities.
Renovating, Redeveloping, Repositioning	Exeter's technical property expertise and market knowledge are expected to enable the Fund to undertake renovation and redevelopment projects that are often too complex for less experienced or less capitalized developers. Exeter implements renovations at essentially all of its assets as part of the lease up and re-tenanting process in order to enhance a property's competitiveness in the leasing market. More extensive physical improvements, entailing the redevelopment of a vacant facility, can allow for higher returns than ground-up development due to the distressed pricing of vacant properties, the quick turnaround of space solutions for tenants, and lower completion risk. An understanding of the cost trade-offs between new construction and redevelopment is critical to achieving successful returns in redevelopment.

Exeter has demonstrated that some of its best investments are made on a single asset basis and are then aggregated into diversified portfolios to maximize disposition value. Once Exeter has optimized property income and lease duration, it is expected that most Fund investments will be sold in portfolios of complementary assets as this format typically commands a pricing premium. Such portfolios are targeted to core investors who seek to deploy large-scale investments, typically in the range of \$1 billion to \$10 billion in transaction value, which are characterized by long term occupancy, staggered lease expirations (to provide smooth occupancy and income), and diversity in tenant base and geography.

**Investment Structure:**

The Fund is a Delaware Limited Partnership, sponsored by Exeter Property Group LLC. The General Partner, Exeter Property Group V, L.P. ("GP"), is a Delaware Limited Partnership.

The Fund will be managed by Exeter Property Group, LLC., which is controlled by the Firm's Senior Principals through their ownership of the GP.

**Investment Instruments:**

Investments are expected to be real estate industrial properties held through fee simple or whole loan, first mortgage notes in special purpose entities.

**Investment Team:**

Exeter's cohesive and long-time management team has worked together for over 17 years on average. Even prior to the formation of Exeter 13 years ago, most of the Firm's senior professionals, including those heading the European platform, worked together either at Liberty Property Trust (NYSE: LPT) and its predecessor company Rouse & Associates, or at Terramics Property Company, both of which were based in Malvern, Pennsylvania. As such, the majority of senior personnel have common business experiences and philosophies, and a shared culture of entrepreneurship, integrity, hard work, and transparency.



**Investment Highlights:**

- Tenant Relationships Provide Competitive Advantage
- Off Market Sourcing
- Ability to Add Value Through In-house Leasing and Asset Management
- Design Skills Enhance Returns
- Competition

**Investment / Risk Considerations:**

- Leasing Risk
- Economic Slowdown
- Development Activities
- Leverage

**PSERS History & Performance:**

PSERS relationship with Exeter began in 2011. The following table summarizes PSERS' historical performance with Exeter as of December 31, 2018:

Fund. (\$M)	Vintage	Fund Size	Commitment	Contributions	Distributions	NAV	Net IRR	MoC
Exeter Core Industrial Club Fund II, L.P.	2016	575.8	100.0	58.9	7.2	65.2	14.3	1.2
Exeter Industrial Core Fund III, L.P. <sup>(1)</sup>	2019	n/a	100.0	n/a	n/a	n/a	n/a	n/a
<b>Total Exeter Core</b>			<b>100.0</b>	<b>58.9</b>	<b>7.2</b>	<b>65.2</b>	<b>14.3</b>	<b>1.2x</b>
Exeter Industrial Value Fund II, L.P.	2011	615.0	75.0	73.5	148.7	2.2	30.6	2.1
Exeter Industrial Value Fund III, L.P.	2014	832.8	75.0	72.7	100.8	37.0	30.4	1.9
Exeter Industrial Value Fund IV, L.P.	2017	1,275.0	100.0	55.0	-	59.3	12.3	1.1
<b>Total Exeter Value-Add</b>			<b>250.0</b>	<b>201.3</b>	<b>249.5</b>	<b>98.6</b>	<b>29.9</b>	<b>1.7</b>
<b>Total</b>			<b>\$ 350.0</b>	<b>\$ 260.1</b>	<b>\$ 256.7</b>	<b>\$ 163.7</b>	<b>28.4%</b>	<b>1.6x</b>

<sup>(1)</sup> Fund has not yet held its final close or called any capital

**Investment Committee Disclosure:**

<b>Relationship with Hamilton Lane:</b>	None
<b>Introduction Source:</b>	Fund Sponsor
<b>Placement Agent:</b>	None
<b>PA Political Contributions:</b>	None
<b>PA Presence:</b>	14 properties worth \$469 million
<b>Potential Conflicts:</b>	None Disclosed
<b>First Time Fund With PSERS:</b>	No
<b>PSERS Allocation Implementation Committee Approval:</b>	September 9, 2019

**Oversight Responsibility:**

<b>Investment Office:</b>	Charles J. Spiller Melanie A. Cubias Melissa A. Quackenbush	Deputy CIO, Non-Traditional Investments Senior Investment Professional Senior Portfolio Manager
<b>External Consultant:</b>	Hamilton Lane	