I. BACKGROUND

**Opportunistic** real estate investing is the financing, acquisition or investment in real estate assets, real estate companies, portfolios of real estate assets, private and public REIT’s that do not have access to traditional public equity or debt financing. Opportunistic real estate investing consists of strategies that seek to exploit market inefficiencies with an emphasis on total return. Opportunistic investments require specialized expertise and the flexibility to respond quickly to market imbalances or changing market conditions. Investments may include non-traditional property types and/or assets that involve development, re-development or leasing risks. Leverage is typically incorporated into this strategy to further enhance total returns.

**Value-added** real estate investing typically focuses on both income growth and appreciation potential, where opportunities created by dislocations and inefficiencies between and within segments of the real estate capital markets are capitalized upon to enhance returns. Investments can include high-yield equity and debt investments and undervalued or impaired properties in need of repositioning, re-development or leasing. Modest leverage is generally applied in value-added portfolios to facilitate the execution of a variety of value creation strategies.

II. OBJECTIVES

A. Portfolio Investment Performance Objective

The performance objective of opportunistic and value-added real estate fund investments is a total real return approximating 13%+ and 9-13%, respectively.

B. Risk Management

1. Standard Deviation - The standard deviation of returns, one measure of the risk or volatility of opportunistic and value-added real estate fund investments, is approximately 25% and 15%, respectively.
2. Lack of Liquidity - The time horizon for closed-end opportunistic and value-added real estate funds is typically eight to twelve years. These real estate investments should therefore be considered an illiquid investment. Because the nature of pension liabilities calls for a long-term investment horizon and positive cash flows can be expected to continue, PSERS is well structured for long-term investments. Such investments also match PSERS’ long-term liabilities for active employees.

C. Closed-end Real Estate Fund Portfolio Diversification

1. Asset Types – Closed-end opportunistic or value-added real estate funds retain discretion as to the diversification within real estate asset types. Many Value-added strategies focus solely on one property type or geographic region (i.e. west coast residential).

2. Size of Investments - Investments will be diversified among a range of partnerships of varying sizes. The minimum commitment to any single opportunistic or value-added real estate fund is $50 million.

3. Geography - PSERS will normally not consider geographical diversification in the selection of closed-end opportunistic and value-added real estate funds. The individual real estate funds are permitted to utilize foreign investments provided it is identified in the fund documents.

4. Time - PSERS will endeavor to invest in a consistent manner over time unless supply and demand influences cause the elimination of opportunities that are appropriate from a risk return perspective for this investment strategy.

5. Diversification – The maximum investment by PSERS will be limited to no more than 25% of the total amount of any commingled fund, and no more than 90.91% when PSERS is the only investor other than the investment manager.

D. Total Portfolio Diversification

Correlation with the returns of other asset classes is low; therefore, the inclusion of opportunistic and value-added real estate funds in the portfolio should provide an added means of diversification to the Fund.

E. Prudent Person Standard

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The selection of opportunistic and value-added real estate fund investments will be guided by Section 8521 (h) of the Public School Employees' Retirement Code ("Code"), 24 Pa.C.S.

III. CONSTRAINTS AND GUIDELINES

A. Minimum Requirements

1. Opportunistic and/or value-added real estate assets under management by the investment manager should be or have been substantial.

2. The investment manager must have displayed a track record of investments transacted under a similar investment strategy to the one being considered.

3. The investment manager must have demonstrated investor acceptance by retention of other institutional clients.

4. The returns realized or projected by the investment manager for previous investments must be or have been at a level consistent with an opportunistic and/or value-added real estate investment strategy for the period of time referenced.

5. The fund's investment manager must commit to a co-investment at a level not less than 5% of the fund’s total equity commitment or 10% of PSERS’ commitment in a parallel fund structure.

6. The financial structure must include a preferred return of at least 8% to PSERS.

7. The investment manager must be in a first loss position to PSERS’ position as an investor (limited partner or shareholder). This first loss position can be achieved through a distribution schedule where the full 5% investment manager contribution is subordinated to all other investor’s capital; or the investment manager may establish an escrow account that totals 10% of PSERS’ commitment for the benefit of PSERS; or the investment manager, if their resources are substantial, can issue a guarantee in an amount equal to 10% of PSERS’ contribution.

8. PSERS should receive a prorata share of any co-investment opportunity offered to any investor.

9. The fund must agree to operate under a prudent expert standard of care and only receive indemnification if that standard is met.
10. If the fund’s general partner is a partnership, the general partner of that partnership must be committing an amount equal to at least one-half of the required 5% commitment.

11. PSERS requires a seat on any Advisory/Valuation Committee.

12. PSERS requires expense reimbursement for attending Advisory/Valuation Committee meetings and the fund’s Annual Meetings.

13. PSERS requires a Key Person provision, if it is deemed applicable, that may give investors the option to discontinue capital contributions.

14. PSERS requires a No Fault Divorce provision.

B. Maximum Limitation

1. PSERS’ Real Estate Asset Allocation Policy limits the amount of the Fund’s assets allocated to opportunistic and value-added real estate investments.

2. Individual opportunistic and value-added real estate funds should not be permitted to have an average portfolio level of leverage that exceeds 65%.

3. PSERS, as an investor, is limited to no more than 25% of the total amount of any commingled fund, and no more than 90% when PSERS is the only investor other than the general partner.

C. Evaluation Criteria

1. The primary emphasis will be on the quality, strategy and experience of the investment manager.

2. At a minimum, additional factors include:
   a) Ultimate size of the proposed fund
   b) Maximum leverage, individually and the average for the portfolio
   c) Size of the commitment by the investment manager
   d) Relationship with previous/current investors
   e) Nature of value-added involvement
   f) Continuity and depth of the organization
   g) Degree of discretion given the fund

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h) Percent of time allocated to the fund by key personnel
i) Past financial performance - risk and return
j) Deal flow

3. A due diligence review by the staff and/or the Real Estate Consultant comprising the following, when applicable:

   a) Review of whether the proposed investment falls within the Consultant’s Action Plan, constraints and guidelines, and if it complies with applicable investment policies.
   b) Background check of principals.
   c) Discussions with principals of the proposed investment.
   d) Review and analysis of all pertinent offering documents including: offering memoranda, subscription agreements, private placement memoranda and operative investment agreements.
   e) Consideration of potential conflicts of interest, if any, posed by the proposed investment and prior investments and activities of the principals.
   f) Review and analysis of investment:
      - Concept including entry and exit strategies
      - Terms including fees, principal participation, structure
   g) Review of news articles regarding principals, prior investments, and concepts.
   h) Discussions with other investors, peers and industry associates (reference checks).
   i) Review and analysis of performance for prior and current investments.
   j) Consideration of relative size of the proposed investment and other investors’ amounts.
   k) Investigation of special terms and side letter agreements with past or present investors.

4. A preliminary review by the staff and/or the Real Estate Consultant comprising, when appropriate, the following:

   a) Identification of key issues stemming from certain criteria or other concerns relating to particular proposed investments, including non-standard opportunities, prior to a full due diligence review.
   b) Highlighting such issues and concerns, along with suggestions as to how they may be addressed, resolved or mitigated (through negotiation or otherwise).
   c) Where a further review of such an opportunity is authorized and upon completion of a focused due diligence review,
identification of the attractive attributes as well as the concerns relating to the proposed opportunity and possible mitigation of such concerns.

d) For new investment manager relationships, PSERS staff will perform an on-site visit of the investment manager’s office as part of the due diligence process.

At each stage of such a preliminary review, the Chief Investment Officer will be furnished information regarding relevant issues early in the review process to permit flexibility in considering and deciding on such proposed opportunities.

D. Legal Constraints

1. UBTI (Unrelated Business Taxable Income) - Funds should be structured to minimize UBTI.

2. Plan Assets - Many partnership or fund documents contain language that addresses ERISA's rules concerning "Plan Assets." While these regulations do not apply to PSERS, it may be affected by such ERISA-related language.

E. Guidelines

1. Method of Participation - PSERS will generally participate as a limited partner in professionally managed funds or shareholder in private or public REIT’s. Although this policy is initially designed for participation through a partnership or shareholder structure, this policy does not preclude direct investments should the Board so elect.

2. Types of Allowable Investments:
   Opportunistic and value-added real estate fund investments include, but are not limited to:
   - U.S. and non-U.S. real estate operating companies
   - U.S. and non-U.S. real estate assets
   - Private and public REIT’s

3. Fees - Fees should be negotiated where prudent and without creating offsetting adverse effects.

IV. STRATEGY

A. Allocation - PSERS should endeavor to invest on a consistent basis. Annual commitments should not be budgeted, but rather meet and be
responsive to the opportunities and market dynamics of the real estate industry.

B. Size of Partnerships - All types of opportunistic and value-added real estate funds should be considered, including smaller partnerships of at least $200 million, though diversity in size is recommended overall.

V. IMPLEMENTATION

A. PSERS Staff Requirements - Appropriate staff will be assigned as the workload is determined. The timing and types of investments shall be determined by the availability of staff.

B. Legal Counsel - PSERS’ internal legal counsel will review partnership or fund documents. Due to the complex structure of these opportunistic and value-added real estate vehicles, expert outside legal counsel may be retained.

C. Investment Process - If the investment meets the above criteria for investment recommendation, it will be scheduled as an agenda item at the next possible Finance Committee meeting for its recommendation for Board approval at the next Board meeting. Documents relating to an investment approved under this process will be executed in accordance with PSERS' standard policy; i.e., by any two of the individuals holding the positions of Executive Director, Chief Investment Officer, Deputy Executive Director, Assistant Executive Director, Chief Financial Officer, or Managing Director of External Public Markets, Risk & Compliance.

D. Action Plan - On or before January 31 of each year, the Real Estate Consultant will provide the Chief Investment Officer with an Action Plan for the following calendar year. The purpose of the Action Plan is to provide PSERS with the Real Estate Consultant's outlook for the general real estate markets as well as an overview of the Real Estate Consultant's specific investment objectives and goals for PSERS for the upcoming year. The Action Plan should address the following:

1. An overview of the Real Estate Consultant's outlook for the overall real estate market for the succeeding calendar year and for the following two years.

2. The Real Estate Consultant's recommended investment strategy for PSERS for the following calendar year. The investment strategy should specify opportunistic and value-added real estate strategies and other relevant investment characteristics.
3. An estimate of the number of partnerships the Real Estate Consultant expects to recommend to PSERS for the following year and the amount of capital connected therewith.

E. Procedures - Any procedures in addition to those adopted by the Board will be developed by staff and the Real Estate Consultant according to the manner of involvement the Board directs.

VI. MONITORING

A. Performance - Performance will be assessed relative to:

1. Objectives established by the partnership or the principals managing the investment.

2. Risks undertaken.

3. Other similar partnership performance.

4. The general real estate market.

5. Performance will be measured by an internal rate of return ("IRR") and compared to cohort year peer groups.

B. Adherence to Strategy - The actual strategy employed by the investment manager will be judged relative to the stated objectives and strategies.

C. Frequency and Types of Monitoring Reports - Reports required from opportunistic and value-added real estate investments will be negotiated by staff.

D. Board Reports - Annual reports on the partnership investments will be provided to the Board.

VII. REVIEW AND MODIFICATION OF INVESTMENT POLICY STATEMENT

In the application and implementation of the Investment Objectives and Guidelines, the Chief Investment Officer has the authority to interpret the guidelines to meet individual portfolio needs and to determine the appropriateness of the investment. On material policy issues and amounts, the Chief Investment Officer and/or the Executive Director, in conjunction with the Chair of the Finance Committee and/or the Chair of the Board, will evaluate and determine the appropriateness of any investment. All interpretations of material policy issues and dollar amounts will be reported to the Finance Committee at the next regularly scheduled meeting.
The Board will review the policy statement from time to time to determine if modifications are necessary or desirable.

VIII. AMENDMENTS AND ACCEPTANCE

It is the Board’s intention that the investment staff, with the support of the Consultant, reviews manager compliance with this document on a quarterly basis. Should these guidelines change in any way, the foregoing will be modified.

If at any time the Managing Director or Consultants believe that the objectives of this program cannot be met, or that these guidelines constrict performance, the Chief Investment Officer should be notified in writing. The Managing Director and Consultants are encouraged to suggest changes to these guidelines at any time. By signature, the Managing Director agrees to these Investment Objectives and Guidelines and shall perform in accordance herewith.

_____________________________  Pennsylvania Public School Employees’ Retirement System
Company Name

_____________________________  Chief Investment Officer
Managing Director Signature

Managing Director Name

_____________________________  ___________________________
Date Accepted  Date Proposed

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