I. GENERAL PROVISIONS

A. PRUDENT PERSON STANDARD

The selection of real estate investments will be guided by Section 8521 of the Public School Employees' Retirement Code (“Code”), 24 Pa.C.S.

B. MAXIMUM LIMITATION

The Pennsylvania Public School Employees' Retirement System (identified hereafter as “PSERS”, “Fund”, or “System”) Asset Allocation Policy limits the amount of the Fund's assets allocated to real estate investments.

C. IMPLEMENTATION

1. PSERS Staff Requirements

Appropriate staff will be assigned as the workload is determined. The timing and types of investments will be determined by the availability of staff.

2. Legal Counsel

PSERS will use internal legal counsel. In addition, due to the complex structure of real estate co-investments and secondary purchases, expert outside legal counsel may be retained.

3. Investment Process

The Managing Director of Private Markets & Real Estate and the Portfolio Manager of Real Estate will initially agree to bring the co-investment or secondary investment to an internal Review Committee for a vote to approve the investment. The Review Committee will consist of the Managing Directors in the Investment Office, the Deputy CIO, and the Chief Investment Officer (“CIO”). The CIO plus a majority of the other Review Committee must approve the co-investment.
4. **Action Plan**

Co-Investments are offered by fund sponsors on a case-by-case basis. PSERS’ Real Estate staff will continue to build strong relationships with General Partners and Fund Sponsors in the industry, which should enable strong co-investment deal flow.

Secondary purchases will be made on an opportunistic basis where the RE ("Real Estate") staff has particular insight into the fund valuation and outlook due to participation on the advisory board.

Co-Investments and Secondary Fund purchases will be sourced only from funds in which PSERS is already an investor.

5. **Procedures**

Any procedures in addition to those adopted by the Board will be developed by PSERS’ PM and RE staff.

D. **REVIEW AND MODIFICATION OF INVESTMENT POLICY STATEMENT**

In the Investment Policy Statement, the Chief Investment Officer has the authority to interpret the guidelines to meet individual portfolio needs and to determine the appropriateness of the 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.

II. **DIRECT PRIVATE PLACEMENTS**

Direct private placements will be referred to the Review Committee for evaluation and will be administered like any other real estate co-investment.
III. REAL ESTATE IN-HOUSE CO-INVESTMENT AND SECONDARY INVESTMENT POLICY

A. PHILOSOPHY

1. Fund Objectives

Real estate co-investments or secondary fund investments provide an appropriate addition to the System's portfolio. Although considered an illiquid investment, viewed from a total portfolio perspective, the risk/return tradeoff as well as the diversification potential makes this a suitable choice for the Fund.

Real estate co-investments or secondary fund investments are compatible with the general objectives of the Fund, which include:

a. Providing a means to pay benefits to the System's participants and to their beneficiaries.

b. Investing to produce a return on investment that is based on levels of liquidity and investment risk that are prudent and reasonable.

c. Attaining an adequate real return over the expected rate of inflation.

d. Earning a return over the assumed actuarial rate of interest.

e. Complying with all applicable laws and regulations concerning the investment of pension assets.

2. Conflicts of Interest

a. Corporate Governance

There does not appear to be any conflicts of interest between real estate partnership investments, co-investments or secondary investments and governance standards.

b. Current Holdings

As an investor in a co-investment in which PSERS has no discretion, a conflict would not appear to exist. As a sole investor or one in which PSERS exerts some influence, conflicts could be avoided at PSERS discretion.
3. Reasons to Invest in Co-Investments of Real Estate Partnerships

a. Higher Rate of Return

Total rates of return for real estate co-investments and secondary fund purchases are expected to be greater than primary partnership investments. The management fee and carried interest on co-investments will either not be charged, or will be reduced. Secondary fund purchases are typically purchased at a discount to net asset value, which improves the expected total return.

b. Diversification

Real estate co-investing and secondary fund investments have a low correlation to other investment classes and will therefore contribute to reduction of risks and the enhancement of returns on a portfolio basis.

B. OBJECTIVES

1. Portfolio Co-Investment or Secondary Fund purchase Performance Objective

The performance objective for real estate co-investment and secondary fund investments is a total return which represents a 2% premium above public market comparables over a 10 year period.

2. Risk Management

a. Business/Economic Related Risks include:

   (i) Buyers overpaying for assets.

   (ii) Investment has operational or physical difficulties, reducing capital available for debt service.,

   (iii) If interest rates rise, poorly structured, highly leveraged deals may be strained.

   (iv) A severe recession may cause a property or portfolio to fail under its debt load.
b. Political/Tax

Legislative bodies and/or regulators may change laws or regulations that impact the risk profile of the investment.

c. Lack of Liquidity

The time horizon for real estate co-investments is 3 to 7 years and a secondary purchase is typically 5 to 10 years. Real estate investments should therefore be considered an illiquid investment.

d. Blind Pool

In respect to secondary partnership investments, control is vested with the fund sponsor. Investments already made are known, while future investments are generally unknown at the time the purchase is made.

3. Co-Investments and Secondary Purchases Portfolio Diversification

In order to reduce the risks associated with real estate co-investments or secondary partnership investments, a well-diversified portfolio is highly desirable. Each investment should be evaluated relative to the characteristics within the existing portfolio.

The following types of diversification should be considered:

a. Property Sectors – Real estate investments will be diversified by property type, with a focus on major property types. Non-traditional property investments will be considered on a case-by-case basis.

b. Geography – Real estate investments will be diversified by market and sub-market, with a primary focus of North and South America, Europe and Asia

c. Maximum Investment - The initial investment by PSERS will be limited to no more than $15 million. The total investment, including follow-on investments, is limited to no more than $25 million.

d. Time - PSERS will endeavor to invest in a consistent manner over time, unless markets are extremely over-valued.
e. Investment per year – The initial allocation to the program will be $100 million, and investment pacing will depend on the level of desirable opportunities. All allocations must be approved by the Board.
4. **Total Portfolio Diversification**

Correlation of private real estate with the returns of other asset classes is low, due in part to the infrequency of valuation compared to the daily valuation of public markets.

C. **CONSTRAINTS AND GUIDELINES**

1. **Evaluation Criteria**

   a. A due diligence review by the staff comprising the following, as deemed appropriate:

      (i) Review of whether the proposed investment falls within PSERS’ investment plan, constraints and guidelines, and if it complies with applicable investment policies.

      (ii) Discussions with principals of the proposed investment.

      (iii) Review and analysis of all pertinent offering documents including: (1) offering memoranda, (2) subscription agreements, (3) private placement memoranda, and (4) operative investment agreements.

      (iv) Consideration of potential conflicts of interest, if any, posed by the proposed investment and prior investments and activities of the principals.

      (v) Review and analysis of investment:

         - Concept - including entry and exit strategies
         - Terms - including fees, principal participation, structure

      (vi) Review of news articles regarding principals, prior investments, and concepts.

      (vii) Discussions with other investors, peers, and industry associates (reference checks).

      (viii) Review and analysis of performance for prior and current investments.
(ix) Consideration of the percentage of capital commitment available to PSERS.

(x) Investigation of special terms and side letter agreements with past, present, or future investors.

(xi) On-site due diligence as needed

b. Additional critical diligence items to be examined include:

(i) A summary of the investment opportunity which includes: property/portfolio information, property/portfolio research, market research that includes competitive analysis, and internal due diligence materials generated by the fund sponsor

(ii) Expected process timeline

(iii) Current valuation with details

(iv) Deal structure which includes all debt and equity investors, including co-investors

(v) Debt covenant schedule and maturity profile

(vi) Project capital requirements for the term of the investment

(vii) A copy of any third party due diligence reports

(viii) Expected value creation

(ix) Expected return multiple and IRR

2. **Guidelines**

a. **Method of Participation**

   PSERS will generally participate as a limited partner in co-investments of professionally managed funds in which PSERS is already an investor.

b. **Types of Authorized Investments**

   Domestic and foreign real estate funds

c. **Fees**

   Real Estate co-investments should, at a minimum, be offered with a reduced management fee and reduced carried interest.
D. STRATEGY

1. **Allocation** - PSERS should endeavor to invest on a consistent basis. Initial allocation for investments will be capped at $100 million. All allocations must be approved by the Board.

2. **Method of Participation** - PSERS should secure a core holding in this asset class attained through investment in well-established real estate funds.

E. MONITORING

1. **Performance**

   Performance will be assessed relative to:

   a. Objectives established by the general partners or the principals managing the investment.

   b. Risks undertaken.

   c. General real estate markets.

   d. An internal rate of return (“IRR”) and compared to vintage year peer groups.

2. **Adherence to Strategy**

   The actual strategy employed by the partnership or the investment will be judged relative to the stated objectives and strategies.

3. **Frequency and Types of Monitoring Reports**

   Reports required from real estate co-investments and secondaries will be negotiated by staff.

4. **Board Reports**

   Reports on the co-investments and secondaries will be provided to the Board quarterly.